

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Investor Advisory Group meeting on March 28, 2012 that relates to the Board's Concept Release on Auditor Independence and Audit Firm Rotation. The other topics discussed during the March 28, 2012 meeting are not included in this transcript excerpt.

The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: http://pcaobus.org/News/Webcasts/Pages/03282012_IAGMeeting.aspx

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

+ + + + +

INVESTOR ADVISORY GROUP

+ + + + +

MEETING

+ + + + +

WEDNESDAY

MARCH 28, 2012

+ + + + +

The Investor Advisory Group met in the
Mount Vernon Room in the Madison Hotel, 1117
15th Street, N.W., Washington, D.C., at 9:00
a.m., Steve Harris, PCAOB Board Member,
presiding.

PCAOB BOARD OF DIRECTORS
JAMES R. DOTY, Chairman

LEWIS H. FERGUSON, Board Member

JEANETTE M. FRANZEL, Board Member

JAY D. HANSON, Board Member

STEVEN B. HARRIS, Board Member

SECURITIES AND EXCHANGE COMMISSION
ELISSE WALTERS, Commissioner
BRIAN CROTEAU, Deputy Chief Accountant

MIKE STARR, Deputy Chief Accountant

INVESTOR ADVISORY GROUP

BRANDON BECKER, Executive Vice President
and Chief Legal Officer, TIAA-CREF

KELVIN M. BLAKE, Investment
Advisor/Broker-Dealer Unit Chief and Assistant
Attorney General, Division of Securities of
the State of Maryland

JOSEPH V. CARCELLO, Ernst & Young
Professor, Department of Accounting and
Information Management, and Co-Founder and
Director of Research, Corporate Governance
Center, University of Tennessee

NORMAN J. HARRISON, Senior Managing Director,
FTI Consulting

MICHAEL J. HEAD, Managing Director of
Corporate Audit, TD Ameritrade Holding
Corporation

BONNIE HILL, President, B. Hill Enterprises
LLC, Co-Founder, Icon Blue, Inc.

BARBARA L. ROPER, Director of Investor
Protection, Consumer Federation of America
DAMON A. SILVERS, Director of Policy and
Special Counsel, AFL-CIO

ANNE SIMPSON, Senior Portfolio Manager, Global
Equity, California Public Employees'
Retirement System (CalPERS)

TONY SONDHI, President, A.C. Sondhi &
Associates, LLC

JUDGE STANLEY SPORKIN, Retired

ROBERT M. TAROLA, President, Right Advisory
LLC

LYNN E. TURNER, Managing Director, LitiNomics
and former SEC Chief Accountant

ANN YERGER, Executive Director, Council of
Institutional Investors

1 much appreciate the effort that has gone into
2 each of the panel presentations. I know how
3 much work it has been throughout, and we are
4 three for four, and I know that we are going
5 to be four for four in 15 minutes.

6 So I would like to take a 15-
7 minute break and convene back here promptly at
8 3:30.

9 Thank you.

10 (Whereupon, the above-entitled
11 matter went off the record at 3:14 p.m., and
12 resumed at 3:31 p.m.)

13 MR. HARRIS: Saving the least
14 controversial until last, our final
15 presentation is by the Working Group that has
16 been examining auditor independence,
17 objectivity, and professional skepticism.
18 Barbara Roper led this Working Group and
19 members included Kelvin Blake, Judge Sporkin,
20 Eric Vincent, and Meredith Williams. Barbara,
21 thank you very much and take it away.

22 MS. ROPER: Sure. So, obviously,

1 this is a natural segue from our last panel,
2 which dealt with a number of issues that
3 relate to independence. And just in preparing
4 this presentation we took sort of -- we did
5 not come here with specific recommendations on
6 the policy proposals that are before the
7 Board. Instead, we thought we'd take a
8 historic look at the issues as they've
9 developed over the years and how that informs
10 a discussion about the proposals that the
11 Board is considering, so open that up to get
12 a broader set of viewpoints in the second
13 half.

14 So, I thought it was useful to
15 start with a reminder. We throw around this
16 word about auditor independence. What's the
17 basis for that? And the Supreme Court decision
18 in United States v. Arthur Young says, "This
19 public watchdog function demands that the
20 accountant maintain total independence from
21 the client at all times and requires complete
22 fidelity to the public trust."

1 And one of the things that struck
2 me as we talk about these issues about
3 independence is how far we are from that
4 ideal. I mean, even in the strongest, sort of
5 most extreme proposals in this area, no one is
6 really talking in any meaningful way about
7 getting to total independence from the audit
8 client at all times. So, I think that's worth
9 keeping in mind as we consider these issues.

10 Second, when the SEC was updating
11 its auditor independence standards in 2000,
12 one of the things -- it talked about why
13 independence matters. Why do we care? And
14 they talk about two goals; one is to foster
15 high-quality audits by minimizing the
16 possibility that any external factors will
17 influence an auditor's judgment. And it seems
18 to me that when we talk about this issue we
19 spend a lot of time, I think appropriately,
20 focused on this issue of: will the reforms
21 we're discussing lead to higher quality
22 audits?

1 But the other related goal that
2 the Commission talked about is to promote
3 investor confidence in the financial
4 statements of public companies. Investors are
5 more likely to invest and pricing is more
6 likely to be efficient the greater the
7 assurance that the financial
8 information disclosed by issuers is reliable.
9 And I think, again, it's worthwhile as we're
10 thinking about that to ponder how confident do
11 we think investors are today in the
12 reliability of the financial statements in the
13 independence of the audit, because that
14 matters, independent of the issue of audit
15 quality.

16 And then just more generally,
17 taking this issue one step forward, why
18 independence matters. In sort of a fundamental
19 way, the audit has no value if it's not
20 independent. You know, if it's just another
21 set of eyes confirming management's view, they
22 have -- we have sort of an internal financial

1 reporting function at companies to provide
2 that. We look to the auditor to provide an
3 outside objective, skeptical view of that
4 information. And that has become more
5 important, not less, as we move to more
6 principles-based standards, greater reliance
7 on judgment.

8 And, yet, we have this basic
9 conflict in the business model, the client
10 pays business model, that says, in essence,
11 we've decided we're not going to have a truly
12 independent audit, so the auditor independence
13 rules are really designed simply to minimize
14 the conflict, mitigate its effects and promote
15 objectivity and professional skepticism in the
16 conduct of the audit. And so really,
17 independence, in my view, at least, is sort of
18 a means towards an end. It is the role of
19 independence in promoting that professional
20 skepticism that's what we're really talking
21 about here.

22 In looking back over this issue,

1 one of the things that struck me is just how
2 long we have been having various different
3 versions of this debate. So, 1977, in the wake
4 of the scandals at Penn Central, you have
5 Senator Lee Metcalf and his Subcommittee
6 publishing a report in which they express
7 grave concern over the alarming lack of
8 independence shown by the large accounting
9 firms. And in that, they discuss both the
10 issue of non-audit services and the long
11 tenure of audit engagements.

12 There was at about that same time,
13 I don't have a slide on this, but at about
14 that same time, so Congressman Dingell was
15 having hearings in the House Financial -- I
16 mean, the House Energy and Commerce Committee
17 about auditor conflicts.

18 There was an up-and-coming young
19 man who gave a speech at the American
20 Accounting Association at that time in which
21 he talked about the need for realism in
22 financial statements. Stanley Sporkin talked

1 about how the accounting literature is now
2 replete with cases where the independent
3 auditor simply ignored facts which they knew
4 or were readily available to them, and one of
5 his ultimate recommendations was that in all
6 instances, an accountant should maintain a
7 healthy skepticism. So, that was 1982.

8 So, when this came up at the SEC
9 in response, in part, to the hearings that
10 Congressman Dingell had been holding, the SEC
11 actually issued a report in 1994 indicating
12 that they didn't think any fundamental changes
13 were needed at that time. But what you see
14 soon after that is, you know, a real change in
15 attitude at the SEC, and evidence of growing
16 concern at the Agency, so that in 1998, I
17 think Lynn referred to this earlier, you have
18 the numbers game speech that Arthur Levitt
19 gave. And what he was talking about there --
20 it's actually not primarily on accounting.
21 He's talking about the pressure that companies
22 were feeling to make the numbers in terms of

1 earnings estimates, in a market where missing
2 the numbers by a penny or two could have
3 dramatic consequences for companies.

4 He talked about a game of nods and
5 winks between corporate managers, auditors,
6 and analysts in which the zeal to satisfy
7 consensus earnings estimates and project a
8 smooth earnings path, wishful thinking may be
9 winning the day over faithful representation.

10 And then there's another change
11 directly related to what we were talking about
12 earlier that started to occur over the 1990s,
13 and that was the growing importance of
14 consulting services within the audit firms.
15 The consulting services were both becoming
16 more important to the bottom lines of the
17 audit firms during that period, and to
18 individual auditors' compensation and
19 advancement within the firm.

20 So, you saw a progression from
21 where 1991 you had consulting revenues just 13
22 percent of total revenues. By 1999, for the

1 Big Five firms, consulting services accounted
2 for roughly half the revenues. And you would
3 see this play out in some fairly dramatic ways
4 with specific audit clients.

5 There was a 2001 report which said
6 that, as a general rule, companies were paying
7 \$2.69 in consulting service fees for every
8 \$1.00 they were paying in audit fees, but at
9 certain companies you see this much more
10 dramatic skewing. And you can see some of the
11 examples here; KPMG's audit of Motorola, \$3.9
12 million for the audit, \$62.3 million for other
13 services.

14 And, obviously, these were the
15 extreme examples but they weren't isolated
16 examples. There were actually a fairly
17 surprising number that had sort of this
18 dramatic skewing between the role of the audit
19 and the role of the consulting services.

20 And at that time, Arthur Wyatt,
21 who had been with Arthur Andersen for years
22 gave a speech at the AAA Conference in 2003.

1 He's actually looking back now, a
2 retrospective of what he'd seen happen over
3 those years leading up to Enron, and he talks
4 about how the firm leaders in this environment
5 where consulting services were becoming more
6 important had failed to recognize how the
7 widening range of services was impairing the
8 appearance of their independence, but also how
9 certain services were changing the internal
10 culture of the firms, which is something I
11 think Mike was getting at with his comments
12 earlier; that he said in that environment you
13 started to see within the firms a growing
14 focus on revenue growth and profit margins,
15 and that, as a result of that, that the
16 auditors were more willing to take on
17 additional risk in order to maintain revenue
18 levels, that clients found it easier to
19 persuade auditors to see issues their way, and
20 as he said, healthy skepticism was replaced by
21 concurrence. So, this was sort of the
22 insider's view at that time of what effect

1 this growing role for the non-audit services
2 had played within the audit firms.

3 And one of the things that we saw
4 -- we tend to think -- you know, we talk about
5 Enron or WorldCom, in fact, at the period
6 right before Sarbanes-Oxley, we had seen just
7 a dramatic increase in the number of
8 restatements, so we'd gone from 33
9 restatements in 1990 to 157 in 2000 to 233 in
10 2001, so this was not -- you know, when
11 Congress started drafting Sarbanes-Oxley, yes,
12 they were intimately focused on Enron, but
13 they were also looking at a broader phenomenon
14 that had occurred where there seemed to be
15 indicators that the audit simply was not
16 providing the effective assurance that it had
17 in previous years.

18 So, in that environment and before
19 Sarbanes-Oxley Act, the SEC took some actions.
20 They had started throughout the '90s to start
21 raising questions about these consulting
22 services, both particular consulting services

1 that they thought were in direct conflict with
2 the auditing role, and with the amount of
3 money that firms were getting from the non-
4 audit services.

5 In July 2000, they famously
6 proposed their rules to limit non-audit
7 services. They actually had a list of non-
8 audit services that they wanted auditors not
9 to be able to provide to audit clients. They
10 also addressed some of the issues with regard
11 to financial relationships between the
12 auditors and their audit clients, such as
13 receipt of contingent fees. And in that
14 regard, they added an express prohibition on
15 contingent fees.

16 Now, we've seen in the current
17 environment where we're talking about audit
18 rotation, mandatory rotation, a dramatic
19 response from the accounting firms in
20 opposition to that proposal. It is nothing, in
21 my view, compared to -- maybe we haven't seen
22 it all yet, but compared to the response that

1 they launched to the SEC rule proposal on
2 these non-audit services. Massive lobbying
3 campaign, really sort of scorched earth
4 rhetoric, they were going to members of
5 Congress, getting them not only to write
6 letters to the SEC in opposition, but to
7 include riders on Appropriations Bill to
8 defund the effort if the SEC insisted on
9 moving forward with the independence rules.

10 And in the end, the response was
11 that the SEC significantly watered down those
12 rules, so they took certain of the services
13 off the prohibited list, including internal
14 audits, financial system design. They opened
15 up loopholes in some of the other services
16 that were on the list in terms of the
17 definitions. And one of the things they did -
18 - the way the rule had initially been written,
19 it spelled out certain principles for
20 determining auditor independence, so that,
21 beyond a list of prohibited services, you'd
22 also have sort of a general principles-based

1 standard for what was and what was not a
2 permitted service. And that was moved out of
3 the language of the rule itself and into sort
4 of a more guidance role, sort of making it
5 less prominent, less enforceable.

6 And then shortly thereafter, Enron
7 implodes, and in imploding brought renewed
8 attention to this issue, in part because Enron
9 was sort of Exhibit A for all of the things
10 that people had been talking about for years,
11 for decades even, when they talked about
12 issues of concern about lack of independence
13 in the independent audit.

14 So, there came out in various
15 different reports evidence that Arthur
16 Andersen had been aware at various different
17 times of questions, had had serious questions
18 about some of Enron's accounting, had
19 dismissed it as not material, had perhaps
20 helped design some of the transactions that
21 were keeping debt off the balance sheet,
22 viewed the audit engagement that Enron is too

1 big a client to lose, certainly for that
2 particular office, had been both the internal
3 and external auditor and had lobbied heavily
4 against having internal audit on the list of
5 prohibited services, had been Enron's auditor
6 since 1985, so long tenure, had the revolving
7 door so that the Chief Financial Officers,
8 Chief Accounting Officers at Enron were
9 alumni.

10 And the press accounts at the
11 time, they talk about this chummy atmosphere,
12 so Andersen had office space at Enron, and the
13 Andersen employees were wearing the Enron T-
14 shirts and they're drinking from the Enron
15 coffee mugs, and they're going on the Enron
16 ski trips. And they describe a culture in
17 which there doesn't appear to be any sort of
18 meaningful cultural division between the
19 company being audited and the auditors who are
20 responsible for that review.

21 So, just quickly, I mean, Enron
22 was sort of the Exhibit A, but there were a

1 number of contemporary examples -- there were
2 a host of accounting scandals at the time.
3 There were a number of contemporary examples
4 where you saw the same kind of things;
5 auditors who were applying for jobs at the
6 company they were auditing while conducting
7 the audit; compensation based on the auditor's
8 ability to cross-sell non-audit services.

9 And then, again, I won't run
10 through them all again, but again Waste
11 Management was another example where really
12 every single one of these features that people
13 were focusing on as a concern about auditor
14 independence was evident in that particular
15 case.

16 So, it was in that environment
17 that Congress set about writing the Sarbanes-
18 Oxley Act. And at the time, certainly, if you
19 go and look at the legislative record there is
20 a huge amount of testimony that's focused on
21 this issue of: how do we promote auditor
22 independence?

1 And the Senate -- the report for
2 the Senate Banking Committee, Steve probably
3 wrote it, says: "The issue of auditor
4 independence is at the heart of this
5 legislation. Public confidence in the
6 integrity of financial statements of publicly
7 traded companies is based on the belief in the
8 independence of the auditor from the audit
9 clients."

10 So, when you look at the Sarbanes-
11 Oxley Act, there's a section of the Act, Title
12 II, that is called "Auditor Independence." And
13 it's there that you find -- so, they took the
14 SEC rules that they had previously approved on
15 prohibited non-audit services and they both
16 codified it and basically restored the
17 original list, added back in the things that
18 had been deleted, closed the loopholes that
19 had been added into the definitions of the
20 various different services. They added in the
21 concept of audit committee preapproval of
22 audit and non-audit services, mandatory

1 partner rotation. I mean, you all know the
2 list, all of the things that we've been
3 talking about since SOX that have been put in
4 place to improve the independence and
5 oversight of the audits.

6 There are also, scattered
7 throughout the legislation in other places,
8 provisions that definitely distinctly relate
9 to this issue. For example, the provisions
10 making audit committees responsible for
11 appointing and paying the auditor, overseeing
12 the conduct of the audit, strengthened
13 independence and financial expertise
14 requirements for audit committees, and not
15 least, the PCAOB responsibility both to set
16 standards in this area and to inspect for
17 compliance with those standards and bring
18 enforcement actions for violations of those
19 standards.

20 I throw this slide up here just to
21 make the point, if you look at the legislative
22 history, there was a lot of testimony in which

1 people recommended independence reforms that
2 are not included in SOX. There was strong
3 advocacy at that time for things like a total
4 or much broader ban on provision of non-audit
5 services to audit clients, mandatory rotation
6 of audit firms. There were discussions of
7 ideas about how you could put a third-party,
8 like an exchange or someone else into the role
9 of hiring the auditor so that the -- get rid
10 of the client pays model, more robust
11 provisions related to cooling off period. So,
12 even at the time when SOX was adopted, there
13 was a pretty extensive record in favor of
14 going beyond the reforms that were on auditor
15 independence that were actually included in
16 the legislation.

17 And then we came to
18 implementation. And I'd sort of forgotten
19 before I went back and got out my files on
20 this just how really annoyed I was at the
21 time. It's nice to know that I'm not just
22 cranky now, I was back then equally distraught

1 that when it came to the SEC to implement some
2 of the rules on the legislation, a number of
3 things that the audit firms didn't win from
4 Congress, they got almost immediately from the
5 SEC. So, there had been an issue of: could you
6 pre-approve non-audit services through
7 policies and procedures? Congress had said no,
8 SEC said yes, and they not only said yes, but
9 they said pre-approving through policies and
10 procedures was just as good as explicitly
11 individually approving them.

12 The SEC, in their initial rule
13 proposal had talked about the role that the
14 principles for auditor independence would play
15 in an evaluation of the approval of non-audit
16 services, the final rule, any suggestion that
17 audit committees were expected to look at
18 those principles for independence in
19 evaluating audit services was gone.

20 There was also the change I --
21 there were some others, but the change I
22 mentioned earlier, there was no requirement in

1 SOX that the SEC go back and look at these
2 categorizations, these disclosures firms were
3 required to provide about what they were
4 paying for audit and non-audit services. But
5 the accounting firms lobbied heavily to get
6 those definitions changed, and what they did
7 then is go in and take a number of services
8 and either classify some audit-related
9 services, the audit services and more of the
10 non-audit services into an audit-related
11 category, so that what was left in the pool of
12 non-audit services was much smaller. And,
13 also, any ability to compare pre and post-SOX
14 this percentage of fees for audits and non-
15 audit services sort of went out the window.

16 And Jonathan, I'm pretty sure it
17 was Jonathan Weil, wrote a column at the time
18 when this had come up, the SEC was describing
19 its rules, and they said that they had adopted
20 these changes in response to public comment.
21 And the SEC, he said, asked who outside the
22 audit firms had suggested the change? The SEC

1 official said it would be a good time to move
2 on to a new topic. This was something that was
3 actually strongly opposed by the investor
4 groups in the proposal but was adopted in the
5 final rules.

6 So, right after the -- shortly
7 after this all went through the implementation
8 process, we actually got our hands on this
9 document, and it happens to be an Ernst &
10 Young document. There's no reason to believe
11 Ernst and Young was alone with this. This just
12 happens to be where we got the documentation;
13 how they were presenting this new
14 responsibility to audit committees for their
15 clients. How you're -- let us provide you with
16 our guidance on how you should fill your role
17 in approving non-audit services, in which they
18 suggested that it was perfectly fine for the
19 audit committee to just rubber-stamp through
20 policies and procedures whole classes of
21 services, suggesting that the SEC did not
22 intend, having taken it out of the final

1 proposal, that the non-audit services be
2 reviewed in light of these principles for
3 auditor independence, and encouraging the
4 clients to group virtually everything into
5 this audit-related service category.

6 So, at that point, you know, that
7 soon after the adoption of SOX, a lot of these
8 provisions that had been placed in the
9 legislation were weakened. Now, that doesn't
10 mean that audit committees followed this
11 guidance. You know, I'm not here to suggest
12 that this then became common practice, but my
13 point is that at a point when the SEC could
14 have sent the message that they were really
15 serious about this, they sent a very different
16 message. And we don't know what the effect was
17 on how those decisions were being made at
18 companies at that time.

19 And then beyond that -- I'm just
20 going to go quickly through these, because
21 everybody knows that. Beyond that, you have
22 this authority for the PCAOB in terms of

1 setting standards, conducting inspections,
2 enforcement, and they have used that authority
3 in all three categories since the Act was
4 adopted and they were created.

5 They did new standards on tax
6 services that had been hotly fought during the
7 legislative battle, and they came back looking
8 at at least limiting advice about tax shelters
9 and some other related issues. They've also
10 taken a number of enforcement actions since
11 they were established. Kelvin actually went
12 through all of the enforcement actions related
13 to auditor independence and professional
14 skepticism and looked at what some of the
15 allegations were in those cases, and what the
16 sanctions. Did you want to add anything?

17 MR. BLAKE: Sure, just to give you
18 a break. As a state regulator who does both
19 compliance audits where I issue deficiency
20 comments to help the investment advisor or
21 broker dealer better run their practice and
22 provide better services to the investor. Also,

1 as an attorney where I bring enforcement
2 actions, I was very encouraged by the PCAOB's
3 track record, I guess, not only in issuing
4 perhaps hundreds of thousands of deficiency
5 letters where you try to encourage the audit
6 companies to better serve the client and the
7 public, but also in the number of enforcement
8 actions brought by the PCAOB. And in those
9 enforcement actions, which there are 47 total,
10 27 of the 47 involved violations of
11 professional skepticism. And that shows how
12 seriously you take that type of violation.

13 But I was also encouraged by the
14 level of sanctions imposed by not only --
15 against not only the accounting firm where you
16 have in many instances revoked the
17 registrations of the accounting firms, but
18 also against the accounting professionals,
19 where you have barred many of the accounting
20 professionals for engaging in violations of
21 independence or professional skepticism. So,
22 I was truly encouraged by the actions taken by

1 the PCAOB. Thanks.

2 MS. ROPER: So, you know, that's
3 sort of the history of how we got to where we
4 are today, which reflects both some -- as I
5 said, some long-simmering concerns, some
6 persistent pushback from the audit firms
7 against any suggestion that dramatic reforms
8 were needed, steps by Congress, by the
9 regulators to address certain of the issues,
10 and yet here we find ourselves today hearing
11 from the PCAOB, from international regulators
12 that they're still very concerned about what
13 they're seeing in terms of lack of
14 professional skepticism, objectivity,
15 independence in the audits of public
16 companies. And in the interest of time, I'm
17 not going to dwell on these except to say that
18 we're talking not just about problems in small
19 audit firms, audits of small companies, they
20 involve some of the largest issuers. And they
21 see a direct connection in many of these cases
22 between the serious deficiencies that are

1 found and the lack of professional skepticism
2 in the conduct of the audit.

3 One of the other things that has
4 come out in some of the inspections are
5 materials -- marketing materials in which the
6 auditor is described as a partner with a role
7 of supporting the issuer, where they would
8 stand by the conclusions reached and not
9 second-guess our joint decisions.

10 Now, I don't want to put too much
11 emphasis on marketing materials, but this is
12 actually something we've heard over the years
13 a number of times, which is this idea -- it's
14 come up in some of these -- like the
15 Complexity Commission, this notion, or SAG
16 discussions. We shouldn't be second-guessing
17 professional judgments. But I think to me, at
18 least, and maybe I'm alone in this but the
19 point of the audit is to second-guess. It
20 doesn't mean it always second-guesses and
21 differs but it is, in fact, sort of a -- it
22 should be an independent second look at the

1 issues, not just finding a way to support
2 management's position.

3 And then there have been a number
4 of specific examples out of recent inspection
5 reports, folks at the PCAOB and at some of the
6 European and Australian auditor oversight
7 boards. I thought it was interesting in the
8 Netherlands where the Authority for the
9 Financial Markets did -- took a look at the
10 audits of Big Four firms and found issues
11 related to professional skepticism. Their
12 conclusion was that a fundamental change of
13 conduct is necessary to improve the quality of
14 audits. The point being that both here at the
15 PCAOB and at the European Commission, the
16 suggestion has been made that we're not
17 talking about something where we need to be
18 sort of tweaking the system, useful as that
19 might be, but we're talking about something
20 where regulators are suggesting that
21 fundamental changes are needed to address what
22 they see as a very serious problem.

1 In the European Commission, I look
2 at their response to the financial crisis as
3 if they're having their Enron moment. A lot of
4 the issues that they're seeing in the wake of
5 the financial crisis mirror the responses we
6 heard after Enron, and some of the policies
7 that they're looking at in terms of limits on
8 provision of non-audit services are similar to
9 the issues that we addressed earlier in the
10 U.S. and are looking at now.

11 So, meanwhile, we have at the
12 PCAOB the Concept Release that came out where
13 we've had a little interest, 630 comment
14 letters as of mid-March, which if not a record
15 has got to be up there in terms of the level
16 of interest it's prompted. And the comment
17 period is still open, so it's not too late.
18 And then we had last week a two-day roundtable
19 here devoted to this topic.

20 Now, in the interest of full
21 disclosure I should say that I have not, in
22 fact, read every one of the 630 comment

1 letters, though I have at least browsed all of
2 the public statements from the two-day hearing
3 which is no small accomplishment. There were
4 how many speakers, 40 whatever. And some of
5 them I read in depth. And what I've tried to
6 do on the next series of slides is give a
7 sense of what messages come out of those
8 comments, because I think the hearing did a
9 good job of at least getting all the various
10 different viewpoints out into the public.

11 So, I mean, I think you see
12 there's a vast majority of commenters agree
13 that the combination of enhanced audit
14 committee responsibility, improved
15 communication between auditors and audit
16 committees, and not least PCAOB's inspection
17 and remediation authority have improved the
18 quality of audits and of financial reportings.

19 There's hardly anyone who fails to
20 acknowledge up front that they think they've
21 seen improvement since Sarbanes-Oxley was
22 adopted. Beyond that, though, you get this

1 sort of the spectrum of views from a sense
2 that really everything is pretty much okay,
3 that maybe we -- it might be appropriate to do
4 some tinkering with the system, but really the
5 system is working just fine as it is, to at
6 the other end of the spectrum people who still
7 see just a fundamental breakdown, a
8 fundamental lack of independence and a need to
9 radically reform, get rid of the client pays
10 model. And in the middle a group of people who
11 agree system is improved but there needs to be
12 some fairly significant reforms adopted. And
13 it's actually in that middle category that I
14 put the advocates of mandatory rotation
15 because while that's being viewed as sort of
16 a radical proposal that's out there right now
17 compared to some of the other suggestions that
18 are on the table it's really sort of in the
19 middle range of working within the existing
20 system rather than trying to go after the
21 client pays business model in a more
22 fundamental way.

1 So, I threw in the slides, and
2 since you can read I won't feel the need to
3 read them to you. A series of some -- pulled
4 out just some of the quotes from different
5 statements that are representative of those
6 different viewpoints.

7 I thought this one was interesting
8 just because it comes from a different sort of
9 perspective, but it says, "From the
10 perspective of auditor psychology the question
11 before the Board is easy and obvious. Of
12 course, the current system undermines auditor
13 independence. Indeed, the very notion that the
14 current system allows for truly independent
15 audits is laughably implausible."

16 So, as I say, at one end
17 everything is working fine. It makes me look
18 like a Moderate. I love it. And Chuck Bowsher,
19 you know, it's timely and somewhat overdue
20 that the SEC and PCAOB consider additional
21 issues that would further strengthen auditor
22 independence in addition to the ones enacted

1 in Sarbanes-Oxley legislation. I think it's
2 sort of indicative of the middle ground in
3 this discussion.

4 And then there were some --
5 there's much more than this, but there were
6 some comments within the letters on specific
7 issues. For example, Arnold Wright had
8 research -- we've talked a lot about the role
9 of the audit committee, research that
10 indicates that management rather than audit
11 committees still plays the dominant role in
12 decisions about hiring and firing the auditor.
13 Well, given that that was something that SOX
14 specifically set out to change, if that's
15 true, then that sort of invites the question
16 of what we need to do to revisit what could be
17 done to make that more effective.

18 And then again the issue that was
19 raised earlier of expanding advisory
20 practices, including into areas that are less
21 aligned with traditional audit and tax
22 practices.

1 And then you see the same
2 divisions play out when you look at the
3 comments specifically on mandatory rotation.
4 You have the range from strong opposition
5 particularly among certainly the audit firms,
6 and to those who think it does -- that
7 mandatory rotation doesn't go nearly far
8 enough. So, too far, not far enough, maybe you
9 have, in fact, found Goldilocks' Golden Mean.

10 When you look at those who support
11 mandatory rotation, you have -- so, you know,
12 some of the comments about getting a fresh
13 viewpoint, I thought Peter Clapman's comments
14 were particularly interesting because he's
15 been through it. And he says, "Having
16 participated in three auditor rotations the
17 results were better audits, similar costs, and
18 none of the dire consequences being argued by
19 many of the commentators against the PCAOB
20 Concept Release."

21 So, the positives that people tend
22 to focus on are a new viewpoint, fresh

1 viewpoint, and that limiting auditor tenure
2 might -- if they have less to lose auditors
3 might be more willing to challenge management.

4 There were -- among those who were
5 generally supportive, there were those who
6 were supportive with some reservations that
7 mandatory rotation was really the complete
8 answer. They saw it as a first step, or might
9 make things better, but it wasn't really going
10 to fully address the issue of auditor
11 independence.

12 And here again you get a quote,
13 Max Bazerman at Harvard Business School who
14 says, "The choice should not be between the
15 status quo and the reforms being proposed;
16 rather, the choice should be between whether
17 our society wants independent audits, or
18 whether it does not."

19 And I think this, again, is back
20 to that sort of initial point. We have an
21 assumption about what we say we want in
22 independent audit, and yet we don't actually

1 pursue policies that are designed to create a
2 truly independent audit, was his point, I
3 think.

4 Among the commenters, a number of
5 commenters, probably a majority of commenters
6 who are opposed to mandatory rotation, the
7 basic arguments are it impinges on the
8 authority of audit committees, it increases
9 costs and disruption, and it could undermine
10 audit quality particularly during the
11 transition to a new auditor.

12 There are also some more specific
13 concerns raised that there might -- it might
14 create an incentive for audit firms to invest
15 -- sorry, reduced incentive. I was going to
16 say that made no sense at all. Reduced
17 incentive for audit firms to invest in the
18 audit relationship when their time horizon is
19 short. There were concerns, specific concerns
20 raised that there aren't always enough audit
21 firms available for certain companies, that
22 not all audit firms have the same level of

1 expertise in all issue areas, so there were
2 some sort of practical concerns raised about
3 the workability of the approach.

4 And then, as I said, there were
5 some who opposed mandatory rotation not
6 because they thought it went too far, but
7 because they thought it didn't go far enough.
8 And among these is Jack, whose last name I
9 won't try to pronounce. Thanks, I always get
10 it wrong. Who has a proposal that he's put
11 forward for, as he would say, to try to align
12 the interest of auditors with shareholders in
13 a more fundamental way.

14 And then just beyond that, if you
15 go through the audit, the comment letters and
16 the comments at the roundtable, you know, when
17 we were at the last SAG meeting I said
18 something about don't just tell me if you're
19 against mandatory rotation, don't just tell me
20 why you're against it, tell me what you're
21 for. And the reality of these comments is
22 there are a lot of suggestions in here about

1 what people are for, so even opponents of
2 mandatory rotation have put out a number of
3 very concrete specific suggestions that they
4 think would help to improve the independence
5 and professional skepticism.

6 Some of them have suggestions that
7 are specifically related to making the
8 rotation model more workable, such as
9 requiring a dual audit by two firms in the
10 year preceding the transition starting with
11 just large financial institutions, requiring
12 more reporting by the outgoing auditor.

13 There's another whole set of
14 proposals that I've called tweaks to the
15 existing system. And I don't actually -- I
16 realized when I was looking back at it, that
17 sounds derogatory, and I don't mean it as a
18 derogatory term. I actually think there are a
19 lot of really useful suggestions on this list
20 that regardless of what the Board decides on
21 the broader issue of mandatory rotation are
22 things that ought to be under consideration.

1 And I did a terrible job of organizing them.
2 There's no logic to the way this list is
3 thrown together. I just started pulling them
4 out of letters and threw them onto the list.
5 But I encourage you to look through them with
6 some detail, because on there I think there
7 are some that are interesting. And one of them
8 that came up in a number of contexts, for
9 example, is -- reflects this desire to get
10 more information to audit committees about the
11 results of PCAOB inspections. So, we have --
12 there's a lot of discussion about creating
13 some sort of system that would permit the
14 PCAOB inspectors to discuss directly with
15 audit committees the results on a confidential
16 basis.

17 And, you know, some of the things
18 you would expect about improving training, and
19 communication, some that I found troubling
20 because it seemed to me that they were things
21 that were already required by law. But, at any
22 rate, as I say, I would encourage you to go

1 through them.

2 One of them -- this last one I
3 thought was also interesting. The suggestion -
4 - I don't know if this is realistic in terms
5 of resources, but that audit committees could
6 request the PCAOB perform an enhanced
7 inspection of the audit of their company and
8 report the results, which I actually think, if
9 it were workable, would be something that
10 might be an interesting idea to try.

11 There are a number of other
12 suggestions that are variations on the notion
13 that rather than go to sort of a complete
14 formal mandatory rotation, you have more
15 frequent process for putting the audit out for
16 bid. So, SEC Chairman Breeden has a suggestion
17 where he said rather than having mandatory
18 rotation at 10 years, you'd have a
19 presumption, rebuttable presumption that after
20 10 years independence had been impaired. And
21 prior to that time, the audit committee would
22 either have to at that point either rotate the

1 firm or explain why it had chosen not to do
2 so, what its reasons were. And for the largest
3 such audits he suggests that you could have a
4 PCAOB inspection in the seventh year. And
5 where they found serious problems they could
6 require rotation. But where there were no
7 problems identified, the period would start to
8 run again, so the audit firm could be
9 reappointed and that process would start to
10 run again.

11 Former SEC Chairman Pitt had a
12 similar example, and he talked about having
13 audit committees do more -- to consider more
14 frequently whether to retain the audit firm
15 and to document in a pretty concrete way under
16 appropriate guidance what was the basis for
17 their decision. And, again, he had a provision
18 where audit committees could be required to
19 dismiss their auditors where there's a PCAOB
20 finding of troubles. And then a further
21 example.

22 And then there were a couple of

1 people who suggested, as I said, taking the
2 more radical approach of changing the business
3 model. Jack Bogle from the Vanguard Group
4 talked about trying to find a way to make the
5 institutional investors -- organize them to
6 take more responsibility for overseeing the
7 audit. He didn't spell out what he thought
8 that might look like, but suggested that. And
9 then, as I say, Jack offered a pretty detailed
10 proposal for having financial statement
11 insurance.

12 Now, that's something that the EU
13 looked at and dismissed as not really sort of
14 ready for prime time. But his -- he makes a
15 pretty compelling case that you'd have --
16 you'd be using market incentives to -- would
17 be aligned to create more reliable reporting,
18 because you have the insurer who wants to
19 minimize losses so they're interested in
20 promoting good reporting, and they will set
21 their premiums based on what they see as the
22 risk, and issuers who want to lower their

1 premiums who will then --

2 MS. SIMPSON: Oh, I'm so sorry. I
3 apologize. But I'm just saying perhaps the
4 gentleman addressed this, but the problem here
5 is that that's still coming out of shareholder
6 funds. I mean, just like D&O insurance, you
7 just pay for -- it's like litigation. You
8 know, you pay the first time when you lose the
9 money, and you pay again when it's the -- so
10 unless there's some other source of funding
11 that's supplied you're just picking your own
12 pocket.

13 MR. SONDHI: I'm sitting here as an
14 investor. I now have to pay for the insurance
15 company, I've got to pay for the auditor.

16 MS. SIMPSON: And you alleviate the
17 duty on the directors to get it right.

18 MS. ROPER: So, clearly not a
19 popular idea with this crowd.

20 MS. SIMPSON: The sidelines.

21 MS. ROPER: So that is designed to
22 give you an idea of sort of the scope of ideas

1 that have been put on the table around what
2 the PCAOB could or should be doing to enhance
3 independence, objectivity, and professional
4 skepticism.

5 And just to sum up, there were two
6 quotes that I thought were worth pondering
7 before I throw it open to you all for your
8 broader discussion. One is from a Washington
9 Post editorial. I think it was probably
10 written by Sebastian Mallaby back -- it was
11 back during the Enron era when Congress was
12 considering SOX. And he wrote, "There's a
13 price to regulation. When you tell companies
14 not to hire their auditors you may distort the
15 job market. When you force them to rotate
16 audit firms, you impose real costs, but the
17 efficient allocation of capital depends on
18 accurate bookkeeping, and the books won't be
19 accurate so long as auditors remain conflicted
20 or corrupt. In this contest between audit
21 firms, business models, and the public's
22 interest in disclosure surely somebody will

1 take the public's side."

2 And then more recently, Jonathan
3 Weil writing in a large article about MF
4 Global and Olympus, he writes, "So many large
5 companies have blown up after getting the all-
6 clear from a Big Four accounting firm that
7 many people regard auditor opinion letters as
8 a joke. The biggest fear for the Big Four
9 cartels should be that some day investors will
10 become so fed up that they demand the status
11 quo be chucked entirely figuring they've got
12 nothing left to lose. We're not there yet, but
13 give it time. If the auditing profession can't
14 figure out a way to re-instill value in its
15 most basic product even terrible solutions may
16 start to look like drastic improvements."

17 So here are just some discussion
18 questions that I've thrown together for you to
19 consider, but I throw the floor open to all of
20 you.

21 MR. HEAD: This is, obviously, out
22 of all the things today and not that I have

1 been bashful today because I have not, but of
2 all the things today this is probably one
3 where I'm the most passionate about, because
4 I've been on both sides. I've been an external
5 auditor for a Big Four firm. I started
6 internal audit functions, I've helped create
7 and start enterprise risk management
8 functions, and I currently serve as a Chief
9 Audit Executive for a registrant, TD
10 Ameritrade.

11 And there's -- my first bottom
12 line is I wholeheartedly agree, which this is
13 a very, very well done, thought out
14 presentation, and thank you very much for
15 that, and very balanced and fair, so thank
16 you. That I do think we want to be careful not
17 to address the symptom, and try to address
18 true root causes. So, my headline would be I
19 think audit rotations is addressing a symptom,
20 not a root cause.

21 But then, as you say, well, what
22 would you do? That's nice, Mike, that's great,

1 but what would you do? I really feel some of
2 the root causes that if addressed would make
3 audit rotation a non-issue which is addressing
4 non-audit services and making -- not that they
5 don't provide non-audit services to other
6 clients, but to that client, it's nothing but
7 audit services.

8 I really, really think there's a
9 model that's somewhat of a hybrid of several
10 of these where there could be a pay dues and
11 someone like a PCAOB actually makes the hiring
12 decision of the firm for a registrant, but
13 it's not that an insurance policy -- the
14 company would be paying into a pool, and the
15 audit committee and the PCAOB maybe would have
16 some mechanism of jointly considering hiring
17 the firm, a recommendation coming from PCAOB
18 based on a bid process, and the audit
19 committee selecting it. And that based on
20 performance indicators, and the performance
21 over a period of time, be it five or ten
22 years, and then at the end a reassessment of

1 the firm, how did they perform? Was there
2 consequences if they hadn't?

3 I think part of the bidding
4 process should be a PCAOB examination of that
5 firm and the results of that reported directly
6 back to that audit committee. And as part of
7 what the registrant is paying to -- if it's
8 not PCAOB, another entity of some kind. And
9 that if the performance has been good, and the
10 results of that audit at the end of whatever
11 period of time are good, then based on a
12 competitive bid process they would be the
13 leading candidate because they have the
14 requisite knowledge, they have the accumulated
15 audit knowledge, and they could and should be
16 rehired. And address from that aspect, I think
17 forcing an audit rotation and leaving it --
18 leaving the other things unaddressed, again,
19 I think is taking aspirin for a fever versus
20 addressing that the firm that's hired may be
21 and could very well be the best, most
22 qualified firm to do that audit. And by

1 forcing the audit committee to fire them every
2 six, or seven, or ten years makes no logical
3 sense to me. It should be based on
4 performance, results of the audit, the audit
5 quality, and how you put the things in place
6 to insure that does have objectivity and
7 independence, not force a symptom to address
8 the ultimate solution.

9 And the one thing that I have not
10 heard enough about here is in a well organized
11 governance structure for a company that has
12 the audit committee overseeing all audit
13 services including a qualified internal audit
14 function that is complying with the
15 professional standards that have been
16 established by the Institute of Internal
17 Auditors and they reporting from a functional
18 and fiduciary point of view directly to the
19 audit committee can serve a very important
20 role in assessing management's opinion on
21 internal controls, assessing the effectiveness
22 of the external auditor's role, and be another

1 I'll call it objective because unless they
2 were paid for not by the company, some people
3 get hung up on the term independent. I don't.
4 I think it can be independent and objective if
5 the Chief Audit Executive is evaluated by the
6 audit committee and the audit committee
7 chairman, that they're reporting directly,
8 that they're qualified, they have the right
9 training, they have the right background, they
10 have the right resources, and they can
11 complement and add a lot of assurance and
12 comfort for the audit committee and
13 shareholders if they're structured right. And
14 that partnership between that and addressing
15 some of the root cause I think is a much
16 stronger path to go than forcing a mandatory
17 rotation just because that could be legislated
18 and it ignored all the other things that are
19 really, in my opinion, root causes.

20 So, thank you for listening to me.

21 I'm obviously very passionate on this topic.

22 MR. HARRIS: Thank you. Bob.

1 MR. TAROLA: Barbara and group,
2 thank you for distilling down three days or
3 more of interviews and sessions. It was --
4 now, I don't have to go back and read it all
5 so I appreciate that. But I agree with Mike in
6 terms of getting the root cause, but I don't -
7 - to me, the root cause is the business model.
8 And you have an industry that has a public
9 franchise that has barriers to entry, that no
10 audit committee in their right mind would say
11 I want the cheap audit, not the good audit.
12 So, you have a high demand for services in a
13 very structured industry.

14 The product is independence,
15 objectivity, and professional skepticism, so
16 it seems strange to me that some firm wouldn't
17 take advantage of that situation and step up
18 and basically put forward themselves as that
19 kind of product, not the product of a whole
20 website full of services. And in doing so, and
21 maybe that's where the regulators come in,
22 there's no -- I'm having trouble seeing the

1 disadvantage of moving toward I don't want to
2 say audit only, audit focused, audit
3 insurance, whatever you want to call it, but
4 a way to improve the public's view of the
5 capital markets, and fulfill their public
6 franchise. I don't think they're inconsistent.
7 I don't think making money is inconsistent
8 with that, so I'm a little at odds with the p-
9 - sort of the position being taken.

10 MR. HARRIS: Tony Sondhi.

11 MR. SONDHI: Thank you, Steve. I'm
12 just wondering about the discussion we've had
13 and the evidence you've shown about the split
14 between the audit fees and the non-audit fees.
15 There's a very simple principle in financial
16 reporting that says when you sell two things
17 in a bundled arrangement you can't take what
18 you said the value of each of those was,
19 you've got to figure out what the real value
20 is. So, I think that the audit firms who are
21 supposed to be applying the standard seem to
22 be playing a game with that, too.

1 So, I wonder is it they're
2 deliberately keeping the amount of the audit
3 fees down when you look at the extent to which
4 there's a difference. And I understand that it
5 wouldn't necessarily apply if you were talking
6 about non-audit fees that are sold to a
7 company -- to a firm that you're not auditing.
8 I understand that, but there's an interesting
9 question, I think, in there. I think that they
10 have deliberately played this game with
11 respect to the audit fees.

12 MS. ROPER: So, it's an interesting
13 question. So, pre -- in the initial
14 disclosures, when they first did the
15 disclosures were they deliberately making the
16 audit fee look lower than it was by
17 classifying a bunch of things as not part of
18 the audit fee?

19 They certainly lobbied hard during
20 the rulemaking process to get as much as
21 possible thrown into the audit fee category,
22 presumably because now non-audit fees were --

1 non-audit services were now blackballed, and
2 because the audit committees were expected to
3 look at this issue of proportion between audit
4 fees and non-audit fees.

5 Suppose you look at that
6 proportion in terms of thinking about conflict
7 of interest, so I don't know what -- you know,
8 the incentives have clearly changed in that
9 period between how you want to present the
10 numbers.

11 MR. SONDHI: I think the point
12 really is that you can -- by saying that we
13 are doing X number of things, we'll call all
14 of these audit, but the fee we're charging is
15 much lower. And I think that's the deliberate
16 part of it. So, it's not really a question of
17 what gets called what. That's something that
18 I think is very, very difficult to accept from
19 that perspective.

20 I think the other point that you
21 made which is very important to keep in mind
22 is the weakening of the financial expert

1 requirement. I think that's a critical area.
2 And, again, no surprise that they did that,
3 but it's clearly there, because you can see p-
4 on the other hand, I must say that it also
5 reminded me of the comment by the head of the
6 audit committee for Enron who said that
7 management was -- and he was a chaired
8 professor at Stanford, who said that he didn't
9 know why he would have to check anything.

10 MS. ROPER: Well, there was -- I
11 remember right -- there was right around that
12 time, and I couldn't -- I didn't take the time
13 to dig it out, there was language that went
14 out sort of post-Enron, pre-enactment of
15 Sarbanes-Oxley that clearly some law firm had
16 put out that basically audit committees were
17 using to disclaim any responsibility for any
18 kind of oversight of the numbers. We just sort
19 of look at what's given us, and we don't --
20 so, it seemed to us at the time that there was
21 -- that audit committees were a pretty slender
22 read on which to pin our hopes for reform. And

1 then when they did the rules, as you say, on
2 financial experts there was a concern that if
3 they set the standard too high, or least
4 that's how it was presented, that if they set
5 the standard too high they wouldn't have
6 enough candidates to serve on those positions,
7 which may be a legitimate -- I don't know.

8 MR. SONDHI: But they could phase
9 it in.

10 MS. ROPER: Right.

11 MR. SONDHI: It's not as if you
12 have to do it right away. And it's not as if
13 that couldn't be built. It's not as if there
14 aren't people out there.

15 MS. ROPER: And if you look at what
16 the suggestions are now, particularly from the
17 audit firms in this area of how we can improve
18 the existing system, improving the expertise
19 of audit committees, improving the resources
20 they have available to them, improving
21 training are all sort of up in there. We're
22 still back to this notion of how do we make

1 this audit committee oversight function work
2 better.

3 MS. SIMPSON: Thank you very much
4 to the group. I apologize. Thank you very much
5 to the group, and to the previous group. I
6 didn't get a chance to compliment you, either.
7 This is such a useful day.

8 I have a question which is -- goes
9 back to what's happening in the European
10 Commission. And I know I rattled off a few
11 points before we talked about going concern,
12 but I'm going to make a statement of the
13 bleeding obvious, as they say in London, which
14 is the Big Four at the center of attention
15 here are the same Big Four at the center of
16 attention in Europe. So, the -- what the
17 European Commission thinks it's tackling
18 include an issue of independence, but they're
19 looking at it in a rather more integrated way.
20 And I think there's an advantage for that.

21 So, first of all, they're saying
22 what's the purpose of their reforms? And

1 remember what they're doing, they're proposing
2 to ban non-audit consulting, to make rotation
3 mandatory, and a string of other things. So,
4 whether this all happens and they get it
5 through, I don't know. But the same Big Four
6 are having to deal with that agenda in Europe.
7 It's the same networks. And this is why they
8 think they have to put this package of reforms
9 forward.

10 So, one, a lack of choice for
11 audit clients resulting from high
12 concentration levels, in essence, an
13 oligopoly. Two, systemic risk if one of the
14 Big Four collapses. Three, possible conflicts
15 of interest and issues around the independence
16 of auditors. Four, doubts around the
17 credibility and reliability of the audited
18 financial statements of banks and other
19 institutions and listed companies. These came
20 in for heavy criticism during the crisis.

21 So, I think that something I put
22 really as a question to the PCAOB Board is,

1 are we in danger of trying to think about the
2 Big Four and the structure of this industry,
3 the business model, the numbers, the
4 oligopolistic, the dominance, I mean these
5 same Big Four, just to give you the numbers
6 from the European side. I mean, the dominance
7 is extraordinary.

8 The market share of the Big Four
9 for audits of listed companies is 99 percent
10 of the first C100, 95 percent of the C350, in
11 Germany two of the Big Four have the mandates
12 for 90 percent of the companies on the DAX 30,
13 and Spain all of the IBEX 35 are audited by
14 the Big Four.

15 So, ought we not to be thinking
16 about this from a regulatory point of view,
17 from a global side? So, if we're having -- if
18 Europe is battling all this out, and then the
19 PCAOB is battling it all out, and it's
20 actually the same networks, and the same
21 people we're dealing with, and the same global
22 economy, and the same capital flows, you know,

1 certainly for CalPERS, we're in all these
2 European markets as well as in the U.S. So, I
3 just feel we haven't had the opportunity to do
4 some joined up thinking.

5 So, I apologize for returning to
6 the same point later in the day, but the Big
7 Four are going to have to deal with mandatory
8 rotation after six years in Europe. It's
9 happened for good or ill. Surely, that sets a
10 different conversation over here about what
11 happens next.

12 MR. HARRIS: Well, to punt your
13 question in the interest of time, what I'd
14 like to do is, we've got 20 minutes left, and
15 we've got a number of cards up, so I want to
16 keep the cards up.

17 No, no, it's fine, but what I'd
18 like to do in wrapping up is for the people --
19 everybody to make recommendations in the
20 remaining time. So, rather than us asking
21 questions, I'm punting the question because
22 clearly we can't act in isolation. I mean, we

1 can but we've got to be cognizant of what's
2 going on throughout the rest of the world. But
3 why don't we go around the room, and to the
4 extent that -- Judge -- I don't want all the
5 tent cards to go down otherwise we can finish
6 five minutes early, or ten minutes early,
7 which is fine, as well.

8 Judge, you had a point, and to the
9 extent that anybody wants to make
10 recommendations to the Board in terms of what
11 you think we ought to be doing, in terms of
12 wrap-up, or bringing up any other issues as we
13 close out the day, that would be very helpful.

14 Now, you made the 1982 speech in
15 San Diego, and not a lot has changed since
16 there, so maybe you can take off on that.

17 JUDGE SPORKIN: I want to
18 compliment the PCAOB. I've been around a long
19 time, but this is one agency -- what I like
20 about it, it seems to be free of politics. You
21 seem to all want to be doing the right thing.
22 I have known you what, 50 years. I've known

1 Doty, I know Lew. I don't know the other two,
2 but I know that you all want to do the right
3 thing. We start out with that, so we've got
4 something good to build on.

5 The other thing that occurs to me,
6 we've got -- with auditors you've got two
7 issues, two problems. One, negligence, has
8 someone screwed up and they didn't find
9 something. And the other one is aligning their
10 interests with management. Okay?

11 The negligence one I think you
12 people, if you're not in control now, can be
13 in control of. That's the kind of thing that
14 the person didn't see some -- and, by the way,
15 you and the firm itself is interested in
16 rooting out negligence in a firm, so I don't
17 think that should be the big issue.

18 The real issue is the alignment.
19 The real issue -- and that -- we seem to be
20 going around the subject. We're saying it's
21 independence, it's this, it's that, it's the
22 other thing. And really it is, is alignment.

1 And what these auditors have to do is they're
2 like umpires in a game. They've got to call
3 the balls and strikes as they see them. They
4 cannot take -- just try to accommodate the
5 people -- the company they're working for.
6 That's got to be taken out of the game. You've
7 got to do that.

8 Now, you and your inspections,
9 obviously, ought to be looking for that
10 tendency. Are they then trying to put their --
11 give their support to the issuer, and trying
12 to do the kind of thing that I found in the
13 Keating case and whatnot, in which they
14 weren't doing their job. They weren't looking
15 and say hey, look, this is wrong. Okay? You've
16 got to root that out.

17 Now, what do you have to do here?
18 How are you going to get the good audit? Well,
19 that's really again up to you and the SEC. It
20 seems to me that you could do things two ways.
21 One, you can do a structural basis and do it
22 like in a bureaucratic way. And I'm not trying

1 to be too -- complaining about it, but the
2 other way you can do an exception basis.

3 If you now find that the firms
4 that you regulate are not doing what they're
5 supposed to be doing, you've got to take
6 action against them. And you can't be too big
7 to regulate. Even though there are only four,
8 you cannot be too big to regulate because our
9 system will fill that void. We will get
10 somebody else if we have to get rid of one to
11 do it.

12 So you say okay, yes, if you
13 perform you're going to continuing basis. And
14 one of the things I don't like about trying to
15 do on this rotation basis, it seems to me it's
16 like saying that if somebody is too good and
17 too smart he can't continue. That's not right.
18 In other words, if you have a firm that's
19 doing a good job and they've done it over the
20 years, and they've done all the things we want
21 them to do, there's no reason why they ought
22 not to be able to continue doing that. Our

1 system looks for excellence, and if people are
2 excellent they ought to be continued.

3 But really, that's really on -- I
4 say look at the exception basis. If somebody
5 isn't performing, then they ought to be
6 sanctioned. And you can put severe sanctions
7 on companies. You can say that you cannot
8 continue with that audit. They have to go out
9 and get another auditor, but it means that you
10 can't shirk your job, or the SEC can't shirk
11 its job. They've got to go -- and that will
12 take care of this problem.

13 I saw it done in my day. I hate to
14 go back to that, but I think we did a pretty
15 good job. Look, I brought in my day -- we sued
16 the auditors 28 times in the time I was there
17 because we didn't care. And we told them
18 certain times you can't go and take new
19 business, certain times you can't do certain
20 things, but you've got to have that -- if you
21 don't have that -- if that's not your goal, if
22 that's not your objective, then really, you

1 know -- and nobody can really find fault with
2 that. They could do all they want. They can't
3 go to Congress and say override the PCAOB if
4 you make a decision based on the facts, and if
5 you show that a firm has done something wrong
6 and they're not complying. And try that as
7 something you can do, you don't need any kind
8 of -- you don't need surveys, you don't need
9 anything else. You don't need legislation. All
10 you've got to do is do your job. When they
11 come in with a report, your people, look at
12 the report. If they don't measure up, take
13 your action.

14 MR. HARRIS: Spoken like a former
15 head of enforcement.

16 JUDGE SPORKIN: Saying it like it
17 is.

18 MR. HARRIS: Well, if people would
19 like to make concluding comments, I think now
20 is probably the time to go around. And if you
21 want to offer any suggestions, ask any
22 questions, please feel free.

1 MR. BLAKE: I just wanted to thank
2 Barbara for her leadership, and doing the vast
3 majority of this work. Thanks.

4 MR. HARRIS: I second that.

5 MR. STARR: We probably don't have
6 time to address this, but the panel on -- or
7 the Working Group on Audit Firm Practice and
8 Transparency had under other considerations a
9 question which was, should the PCAOB initiate
10 or issue a Concept Release on whether global
11 networks impact audit quality? And I would
12 have liked to have heard some of your thinking
13 on that.

14 MS. YERGER: We had no thinking on
15 it. We thought it was important, but we really
16 only decided to focus on those two items. I
17 think we kept it as a placeholder and
18 something, I think, of great value for
19 consideration by the Board, this group, and
20 others.

21 MR. STARR: So, when you say --

22 MS. YERGER: Decided we didn't have

1 time to address it. We thought it was
2 important, but kind of tabled it.

3 MR. STARR: Okay, thank you, Ann.

4 MS. ROPER: What they thought was
5 that you'd make a great Committee Chair for a
6 Committee for the next meeting to lead that
7 topic.

8 (Laughter.)

9 MR. STARR: Unfortunately, my views
10 express my views solely, and I can't do that.

11 MR. HARRIS: Well, be careful what
12 you wish for, as well. Does anybody else have
13 any concluding remarks?

14 MS. HILL: Just one thing, well,
15 two things. Tony, I think you had raised the
16 question were audit committees putting
17 pressure on auditors to keep their fees down.
18 And I will tell you that the answer is yes, in
19 all of the committee meetings I'm aware of
20 after the tremendous fees to comply with
21 Sarbanes-Oxley, then people started saying the
22 books are clear. And what you're doing is

1 status quo, and no, you can't raise your fees.
2 So that's been very much a reality.

3 I think the other thing, to
4 Barbara's point, you said that audit
5 committees were told by the auditing firms
6 what they could and could not do. And I would
7 just say that it really is -- it has been
8 governance lawyers, and internal counsel that
9 has interpreted the laws to the audit
10 committees and to the Boards in my experience.

11 MS. ROPER: Right. Can I clarify,
12 because what I said was something specific.
13 That an audit firm, and we had no reason to
14 believe it was isolated, put out an advisory
15 to its audit clients about its advice on how
16 they take on this new role of reviewing non-
17 audit services. And I think I was specific in
18 saying that we did not then assume because
19 they had done that that audit committees then
20 fell into line and followed their pattern. So,
21 I made a distinction between what the
22 literature was advising, how they were seeking

1 to use this process to achieve their ends, not
2 how audit committees --

3 MS. HILL: Okay. And they may
4 advise -- the reality is that that information
5 really does have to come from legal counsel.
6 One of the things that strikes me is that
7 shareholders have been very vocal about a
8 number of other things, so that if for some
9 reason shareholders feel they're not being
10 well served by the auditors, I can't imagine
11 they wouldn't speak out, or perhaps they
12 should. I mean, that -- again, shareholders
13 have an active role in that. But as the Judge
14 has said, as long as the company is being run
15 well, things are going well, they tend to be
16 very satisfied. That's not to say the Board is
17 always, so I think the Board has to continue
18 to take more responsibility, as well as the
19 audit firms. It is not difficult to find
20 financial experts to serve on the Board, so I
21 think we have to continue that. I think that's
22 a good practice, and that we should encourage

1 it.

2 MR. HARRIS: Thank you. Anne.

3 MS. SIMPSON: Thank you, and I
4 wholeheartedly agree with Bonnie. I think that
5 it is time for shareholders to step up. And if
6 we were to look at the votes cast on the
7 reappointment of auditors in recent years,
8 even where there had been grim, grim results
9 that had not been detected in advance, I think
10 we would all look rather ashamed that we
11 weren't paying more attention. So, I think
12 that's a place marker, the role of
13 shareholders and what shareholders could and
14 should be doing to back up the improvement in
15 quality.

16 And just for the record, to say I
17 would welcome the PCAOB looking at the
18 European Commission proposals, there's an
19 underlying, I think, shared interest in making
20 this work. We as global investors would
21 certainly find that extremely helpful. And
22 because you're dealing with the same people

1 through the audit networks it could actually
2 be efficient. It doesn't mean that Europe's
3 got it right, but it would -- I think we would
4 all benefit enormously from that coordination.
5 And if you think there's some work that we can
6 help with -- accomplish through this advisory
7 group, we'd be glad to contribute.

8 MR. FERGUSON: Let me just say that
9 we are very aware of what the European Union
10 is doing. We're in -- our people who do this
11 stuff are in contact with them. We have
12 discussions with them. We are in contact with
13 the Financial Reporting Council of the United
14 Kingdom, so we're -- and aware of the various
15 reports that are being done, so we're very,
16 very aware of that. I think we have not felt
17 it appropriate to put out public statements on
18 what other regulators are doing, but we are
19 very, very aware of that, and very aware --
20 it's part of -- one of the things that
21 motivates the many initiatives we're
22 undertaking, because we're aware that these

1 issues are being considered around the world.

2 MR. HARRIS: Brandon, then Ann,
3 then Brian.

4 MR. BECKER: At the risk of being
5 presumptuous, I think on behalf of the
6 Committee I would just thank the Board members
7 for the gracious extension of their time and
8 their willingness to engage with us. I thought
9 that the one consensus of the entire Committee
10 was how critical the Board's role is in
11 improving audit quality, and our view that by
12 improving audit quality the Board is making a
13 material contribution both to capital raising
14 and protecting investors, and we very much
15 appreciate your efforts and your willingness
16 to listen.

17 MR. HARRIS: Thank you very much.
18 Brian.

19 MR. CROTEAU: Thanks, Steve. I just
20 wanted to comment on a couple of things, a lot
21 of really good and helpful discussion today,
22 and I really appreciate that. I was encouraged

1 by some of the discussion, in particular,
2 relative to insuring we're focusing on root
3 causes not just symptoms. And some of the
4 discussion this morning relative to
5 inspection, process and reporting, and
6 thinking creatively about ways we can even
7 further leverage the results from inspection
8 work, and think about the types of reporting
9 that could be done under Rule 4010. I don't
10 think anyone mentioned it this morning, but I
11 know the PCAOB's Strategic Plan also has an
12 item in it relative to outreach on their
13 inspection reporting, as well, to think about
14 ways to continue and improve their inspection
15 reports, which is, I think, another important
16 area for consideration. So, again, thanks very
17 much for all the helpful input today and look
18 forward to continuing dialogues like this.

19 MR. HARRIS: And I want to conclude
20 where some members began. I want to compliment
21 Joanne Hindman on her really outstanding work
22 in pulling this together.