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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

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WEDNESDAY
MAY 15, 2013

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The Standing Advisory Group convened at the Westin City Center Hotel, located at 1400 M Street, Northwest, Washington, D.C. at 8:30 a.m., Martin Baumann, Standing Advisory Group Chairman, presiding.

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14 MR. SCATES: Thank you, Marty. As Brian Degano
15 and Nick Grillo are joining me, I'll first introduce
16 this.

17 As Chairman Doty said in his remarks, the Board
18 repropose for comment a new standard on related parties.
19 There's three elements here. First, the standard itself
20 would replace the existing standard AU Section 334. The
21 second part is amendments. We're repropose amendments
22 with respect to the auditor's identification and

1 evaluation of significant unusual transactions. In the
2 third element are other amendments to existing standards
3 of the PCAOB. And one of those items has to do with
4 respect to the auditor's assessment of a company's
5 relationships and transactions with its executive
6 officers.

7 As a backdrop here, the standard itself, the
8 original proposal went out on February 28th of 2012. It
9 was also discussed, you might recall, at last year's SAG
10 meeting in May.

11 We received 37 comment letters. And the Board
12 repropose this standard and these amendments for two
13 principal reasons: One being we did -- like I said, we
14 received comments on the original proposal. Generally
15 the commenters were in agreement with our approach,
16 however, they did have some good recommendations. We
17 listened. And for example, some of the commenters said
18 that the auditors are not responsible for identifying
19 related parties. We agree. That is first and foremost
20 with the company, with management. Management is
21 required to identify the related parties, all
22 transactions and relationships with those related

1 parties. We believe the auditor's responsibility is to
2 evaluate the company's identification, the accounting for
3 and disclosure of those transactions. So it's the
4 auditor's responsibility to evaluate what management has
5 done.

6 The second reason we repropose it is, as Marty
7 mentioned earlier in his remarks, this original proposal
8 out on February 28th, but that was prior to the enactment
9 of the JOBS Act. So in this reproposal we are now
10 seeking comment specifically with respect to empirical
11 data and other information that will help us and assist
12 us in making a decision as we go forward. We want to get
13 information on economic considerations and information
14 about the applicability of this reproposal with respect
15 to emerging growth companies.

16 The comment period ends on July
17 8th. And what I'd like to do now is to turn it over to
18 Brian Degano and he will go over a few aspects with
19 respect to the related party standard and the amendments
20 with respect to significant unusual transactions. Brian?

21 MR. BAUMANN: Before Brian speaks I just want to
22 make one comment just to make sure that what you said

1 isn't misunderstood.

2 The original proposal, the way it was drafted put
3 a sort of burden that it was the auditor's responsibility
4 to identify related party transactions without really
5 acknowledging management's primary responsibility that
6 they have to do that.

7 Having said that, the auditor still has a
8 responsibility to evaluate management's identification
9 of related parties and determine whether there are any
10 unidentified related parties or related party
11 transactions. So there are still significant auditor
12 responsibilities in this audit standard in that regard.

13 Brian?

14 MR. DEGANO: The repropoed standard is designed
15 to strengthen existing audit procedures for identifying,
16 assessing and responding to the risk and material
17 misstatements associated with a company's related party
18 transactions. And some of the key requirements in the
19 repropoed standard are that the auditor will be required
20 to perform procedures, to obtain an understanding of the
21 company's relationships and transactions with its related
22 parties, perform specific procedures for each related

1 party transaction that's either required to be disclosed
2 in the financial statements or that is determined to be
3 a significant risk, perform specific procedures when the
4 auditor determines that a related party or relationship
5 or transaction with a related party previously
6 undisclosed to the auditor exists. We've already talked
7 about one of the next ones, evaluating whether the
8 company has properly identified its related parties and
9 relationships and transactions with related parties. And
10 lastly, communicating to the audit committee the
11 auditor's evaluation of the company's identification of
12 accounting for and disclosure of its relationships and
13 transactions with its related parties.

14 And as Greg mentioned, we made several change to
15 the repropoed standard, and those include clarifying the
16 relationships with the risk assessment standards. So
17 commenters had requested clarification of this and the
18 new standard clarifies that the specific risk assessment
19 procedures performed pursuant to the repropoed standard
20 are done in conjunction with the risk assessment
21 procedures required by Auditing Standard No. 12.

22 Second, clarifying the auditor's responsibility

1 to evaluate if the company has properly identified its
2 related parties. And commenters wanted some
3 clarification on this. And as has been pointed out, in
4 the staff's view the clarifications recognize that the
5 company is responsible for the preparation of the
6 financial statements, including in the first instance the
7 identification of the company's related parties. And the
8 auditor begins the audit with all the information that
9 they obtain from management.

10 A third area where we made some changes from the
11 originally proposed standard is allowing additional
12 auditor judgment. And one example of that is that the
13 repropose standard no longer includes a requirement that
14 the auditor treat each previously undisclosed related
15 party transaction identified by the auditor as a
16 significant risk.

17 As Greg mentioned, there's also repropose
18 amendments regarding significant unusual transactions,
19 and those repropose amendments are designed to improve
20 the auditor's identification and evaluation of a
21 company's significant unusual transactions. And I won't
22 go through all of these, but some of the key requirements

1 are that the auditor be required to perform specific
2 procedures to identify a company's significant unusual
3 transactions, perform specific procedures to obtain an
4 understanding of the business purpose of those identified
5 significant unusual transactions, and then some other
6 procedures to enhance the auditor's evaluation of the
7 business purpose of those identified significant unusual
8 transactions.

9 And the key changes made in this part of the
10 proposal were to enhance the linkage between the
11 repropoed standard and the repropoed amendments to
12 better show the complementary nature of the auditor's
13 efforts regarding its work on a company's significant
14 unusual transactions and a company's related parties.
15 So for example, the repropoed standard includes a
16 footnote which notes to the auditor that the information
17 obtained in identifying and evaluating a company's
18 significant unusual transactions could identify
19 information that indicates that undisclosed related
20 parties might exist. So we've tried to improve the
21 linkage between those areas.

22 I'll turn it back over to Greg for the other

1 repropoed amendments.

2 MR. SCATES: The last item has to do with the
3 other amendments we're repropoing. What I wanted to
4 focus on has to do with respect to the auditors'
5 understanding or risk when they perform their risk
6 assessment procedures. They need to gain an
7 understanding of the risk associated with the executive
8 officers' relationship with the company. That would be
9 all relationships including compensation arrangements
10 with the company. The executive officers are related
11 parties, so this repropoal complements the repropoal
12 on the related party standard.

13 And when we first went out with the original
14 propoal back in February of 2012, we were somewhat
15 surprised when we got the comments in. We were expecting
16 to get a significant amount, you know, a number of
17 comments on related parties and significant unusual
18 transactions. And we did, but unfortunately there were
19 some that were -- the press misread what we were
20 propoing and that we wanted to -- we did clarify in this
21 repropoal the auditor is not going to opine, the auditor
22 is not going to make any type of determination or any

1 recommendation with respect to compensation arrangements.
2 That clearly resides with the board of directors of the
3 appropriate company. So we did clarify that in this
4 reproposal.

5 We thought it was clear before, but we went back
6 and put the pen to paper and made it even a little more
7 clear, that the auditor's responsibility here is, with
8 respect to its risk assessment process, to ensure that
9 their audit procedures address any heightened risk with
10 respect to the executive officers' relationships with the
11 company.

12 Now what I'd like to do is to open it up for a
13 SAG discussion similar to what we did with respect to the
14 proposal on reorganization of our standards. Any
15 comments that we make will be a part of our rulemaking
16 docket, but we'd like to have an opportunity now for you
17 to -- if you have any comments or any questions, please
18 raise your tent cards.

19 Denny Beresford?

20 MR. BERESFORD: Thanks. I'd like to comment on
21 the communications with the audit committee, and I guess
22 going in both directions. First of all, the point that

1 was made on one of the slides about the requirement to
2 communicate to the audit committee, the auditor's
3 evaluation of the identification and so forth, again, I
4 think that's well-intentioned, but it simply adds to the
5 normal communications that would be under -- I guess it
6 is Auditing Standard 16. One of my comments on what led
7 up to that document was that this is becoming somewhat
8 of a boiler plate communication that just has an awful
9 lot of content that sometimes doesn't get a lot of
10 attention because there's just so much of it. Depending
11 on the particular company, assuming that this would be
12 in writing, I believe that the document -- I didn't see
13 in the 200 pages that it said it had to be in writing.
14 Maybe I missed that, but --

15 MR. BAUMANN: It can be oral.

16 MR. BERESFORD: Pardon me?

17 MR. BAUMANN: It can be oral.

18 MR. BERESFORD: Okay. But I assume that probably
19 because of inspections or otherwise that most auditors
20 would probably put this in writing, and depending on the
21 company, it could be a lot of pages. It could be quite
22 a bit of information that could be in here. And frankly,

1 it's not a lot of information that I think that would be
2 critically important to most audit committees. I think
3 that some parts of it might be informative to the extent
4 that it would otherwise be disclosed in the financial
5 statements. Obviously that would be important. Other
6 information may or may not be too important.

7 The other requirement that the auditor asks the
8 audit committee or the chairman whether they are aware
9 of related party transactions, I suspect the common
10 response would be something like, gee, I thought that was
11 your responsibility to go out and find those during your
12 audit or ask management for that. I'm being a little
13 facetious, but the audit committee chair would probably
14 have some very general knowledge, and clearly if they
15 were aware of something at kind of a high level, they
16 could respond, much the same as they would respond to the
17 requirement on fraud. I mean the typical response is,
18 gee, again, if there's something huge that had hit the
19 company, they'd respond, but they're not aware of kind
20 of the day-to-day small-type things.

21 And so again, I think both of these things are
22 things that are requirements that aren't going to

1 necessarily create a lot of activity, I guess you might
2 say. And I do get concerned that perhaps in the interest
3 of improving or getting the audit committee involved with
4 the auditor that we not have -- you know, might say every
5 new standard involves still one more communication being
6 added to the list that creates even more of a boiler
7 plate communication that doesn't get paid attention to.

8 MR. BAUMANN: Thanks. Greg, you may have further
9 comments.

10 And, Denny, I appreciate your comments and
11 concerns.

12 We think this is an area that is an important
13 dialogue between the auditor and the audit committee.
14 Some of the most prominent frauds over the last decade
15 have involved transactions with related parties that in
16 some cases were disclosed in footnotes, but clearly it
17 seemed neither the auditor nor the audit committee -- or
18 certainly the investors at the end of the day who lost
19 a lot of money didn't really understand what would happen
20 in certain circumstances with respect to these related
21 party transactions and how significant the impact was.
22 Enron being a poster child for that, but Tyco and many

1 others are well known.

2 So we think that discussion of evaluation of the
3 related party transactions, the risks there, certainly
4 the auditor can evaluate. Some of them are normal
5 transactions and they didn't present any difficulty, but
6 when there are unusual relationships that cause a
7 potential transfer of cash or shares between the company
8 and the related party under adverse circumstances, the
9 complexity of those transactions, I think the audit
10 committee would benefit from that dialogue.

11 So we've put it out in the reproposal for
12 comment. I think we had it in the proposal actually for
13 comment. I don't think we got many negative comments on
14 that aspect of it, but again we appreciate those
15 comments.

16 Someone else?

17 MR. SCATES: Loretta Cangialosi?

18 MS. CANGIALOSI: Thank you. Just two comments,
19 one on what Denny just said.

20 I would say, you know, I appreciate what you're
21 trying to do, and it makes a lot of sense because, as you
22 just stated, for significant and complex transactions you

1 definitely would want the audit committee to know. But
2 for standard stuff that really does not have a
3 significant impact or a company that does not have
4 significant related party transactions, just to have this
5 in there seems like you're just kind of tossing in
6 something that doesn't necessarily add a lot of value.
7 So that was just one comment.

8 My second comment really has to do with the
9 significant unusual transactions. And again, here I
10 support, you know, kind of the whole evaluation,
11 obviously, of what we're trying to do. What I would say
12 is just be careful of the knock-on effects in the
13 inspection process when we look at significant unusual
14 transactions because there are complex and significant
15 transactions that you know you really want to pay
16 attention to. Actually you want to pay attention to all
17 of them, but some of them are very obvious. Okay?
18 Company decides to sell a bunch of products. You know,
19 what's the business purpose? Well, it's pretty obvious.

20 So I think, you know, when this comes off in
21 practice, trying to not have heavy documentation around
22 the obvious versus clearly what you want them to get into

1 around these significant unusual transactions, which are
2 complex things that don't quite make sense, you
3 definitely want them to get into. So that would be my
4 only caution there.

5 MR. SCATES: Thank you, Loretta.

6 And, Gaylen Hansen?

7 MR. HANSEN: Previously unidentified related
8 parties is what I wanted to ask about. So in the
9 original proposal then those were identified as
10 significant deficiencies and additional work was going
11 to be required. And it seems like we've come out of that
12 based on the comments, so I'm not sure what the standard
13 is saying on previously unidentified related parties.
14 It seems to me like something should be required. And
15 I'm not reading on that anything in here that that gets
16 picked up. Is it judgment only then in those
17 circumstances? So that was one question that I had, if
18 you'd maybe comment on.

19 And the other one is on compensation
20 arrangements. It seems to me that -- and I'm all for
21 where you're going on this with executive officers,
22 especially bonus sorts of arrangements that are tied into

1 earnings, but it seems to me like some of that, isn't it
2 already picked up in AU-316 or SAS 99 considerations?
3 So I don't know if it's just the linkage, or are we
4 trying to write parallel with AU-316?

5 MR. SCATES: I'll take the last one first,
6 Gaylen. AU-316 does not specifically address on point
7 the issue here, and the issue here is, we believe, in
8 order to carry out an appropriate risk assessment process
9 early on in the audit the auditor needs to gain a good
10 understanding, a thorough understanding of the
11 relationships that its executive officers -- and again,
12 it's that population of executive officers -- those
13 relationships with the company. The auditor needs to be
14 aware of all of the relationships, and not just the
15 compensation arrangements, any relationship the officer
16 has with the company. That way the auditor can
17 appropriately assess the risk and then carry out and plan
18 his or her audit accordingly once they've made that
19 assessment. That's not really brought out in 316, but
20 now we want to bring it out through amendments to AS-12.
21 And I think that would be appropriate. And we think it's
22 appropriate to do that.

1 Your first question though, Gaylen, I'm not sure
2 -- you were talking about the unidentified related
3 parties?

4 MR. HANSEN: Previously unidentified related
5 parties that I gather you at some point pick up on that
6 hadn't been disclosed to you by management and have some
7 concerns about those and have to dive into it. But now
8 you don't?

9 MR. SCATES: Yes. Well, those were brought out
10 in the standard, in the reproposal. And that once if an
11 auditor comes across and identifies a new related party
12 or a new relationship that the auditor's not aware of,
13 then that is obviously a serious concern to the auditor
14 and then the auditor is going to have to reassess the
15 risk associated with that. And also the auditor is going
16 to then have to obviously bring that to the attention of
17 the audit committee, because that is a serious concern
18 in that the auditor was never made aware of it. And so
19 there is a breakdown within the controls of the company.
20 And if the management's not aware of it, or if they were,
21 why did they not disclose it to the auditor? So there
22 are some very serious concerns there. And we

1 specifically pointed that out and made that a part of
2 this reproposed standard.

3 MR. HANSEN: If I might follow up then. One
4 other thing that I noticed in going through these
5 materials is circulating a list of related parties to the
6 engagement team. It doesn't say when. And I think it
7 would be strengthened a little bit if that was done early
8 in the engagement during risk assessment. You know, if
9 you become aware of it at the end of the audit, I mean
10 it may not be worth as much as if it came out earlier.

11 MR. SCATES: We agree with you on that, Gaylen.
12 We anticipate it would be earlier. That's a good point.
13 We may have to clarify that, that we expect that to be
14 early on in the risk assessment process.

15 Damon Silvers?

16 MR. SILVERS: I just want to speak in general in
17 strong support of what you're doing here. You know, it
18 was mentioned a couple of moments ago that unusual
19 related party transactions were very significant in the
20 collapse of a number of large-cap firms 12 years ago.
21 There are some more recent examples, starting with Lehman
22 Brothers, where these issues were very consequential.

1 And I think that the proposed resubmitted standard gets
2 at, at least to my non-expert eye, the key thing here,
3 which is that in each of these cases, at the time that
4 the companies were entering into these arrangements and
5 seeking to characterize them in ways to keep them off
6 their financial statements or to hide them in footnotes
7 and the like, there was always at the time an argument,
8 and it was an argument of course that in a number of
9 these circumstances turned out to be so thin that
10 criminal proceedings resulted, but ex ante there was
11 always an argument for why they could be treated this
12 way.

13 And I think what the Board has identified and
14 it's instructing auditors to do is to say, you know,
15 listen, you have a responsibility when extraordinary
16 arrangements of this kind are underway to identify them
17 and call them to the audit committee's attention in a way
18 that will ensure enhanced scrutiny. And that seems to
19 me to go right to the nature of the kind of looking-the-
20 other-way mentality that develops in these circumstances.
21 And the consequences on related party transactions, both
22 for the companies involved and their investors, and for

1 the larger U.S. economy over the last 20 years has truly
2 been on a scale I think that might have been unimaginable
3 in the past.

4 I think the same thing is true in a different
5 sort of way in relation to executive compensation. While
6 executive compensation has not directly led to profound
7 global economic crisis in the way that one might argue
8 related party transactions have, on the other hand
9 improperly accounted for executive compensation is
10 profoundly corrosive to the corporate governance system
11 and to the whole body of relationships that underlie
12 effective functioning of public companies. And again,
13 I think, the Board in this proposal has really identified
14 the right way to ask auditors to look at it and to
15 scrutinize it.

16 And so a lot of this I think is long overdue and
17 I really want to commend the staff and the Board for
18 taking it on.

19 MR. SCATES: Thank you, Damon. And now Roman
20 Weil?

21 MR. WEIL: In just a second I'm going to focus on
22 the second bullet point from the bottom of slide 15.

1 I'll get there in a second, but that's where I'm going.

2 I have never audited anything for a living, so
3 take that as a given. And now I'm about to commit an
4 incidence of H.L. Mencken's law, which says whenever A
5 injures or annoys B on the pretense of saving or
6 improving X, then A is a scoundrel. So I am A and the
7 staff is B and the X is the auditing profession.

8 Can we get slide 15 up there, and look at the
9 third bullet point, second bullet point from the bottom?

10 So I'm thinking I'm an auditor and I'm going to
11 be annoyed by that second bullet. I'm thinking about
12 fraud. I don't have an obligation to find fraud, but if
13 I find it, I got to report it. What am I supposed to do
14 in the audit? I don't have an obligation here to find
15 the related parties; that's management's job, but I got
16 to go find it anyway. Clarify the responsibility. I get
17 the feeling that this is like a side letter. How is an
18 auditor supposed to find the side letter that is a
19 primary way of committing fraud in revenue recognition?
20 They're not supposed to be there. Management is supposed
21 to seek them out. The auditor doesn't have a
22 responsibility to seek them out. But if the auditor

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1 finds it, he's got to report it. But we're not giving
2 the auditor guidance of what to do, and when is enough,
3 and when you can't get sued for it.

4 So the auditor's responsibility to figure out
5 whether the related parties are not being disclosed, I
6 think you got to be clear about where the limits of the
7 auditor's responsibility end so we're not going to get
8 more lawsuits against auditors. And then I wonder how
9 come the auditors aren't saying this? Why is the
10 outsider, the non-auditor the one who's worried about
11 this? So I may be completely off base.

12 MR. DEGANO: Well, I think one thing to keep in
13 mind here; and this is why we tried to make some
14 amendments here to emphasize the linkage between the
15 repropose standard on related parties and the
16 significant unusual transactions, is that one of the
17 underlying ideas here is that these efforts are
18 complementary. So looking for unusual transactions will
19 help the auditor identify an undisclosed related party
20 transaction. So we've given the auditor additional
21 information, specific procedures, specific procedures to
22 identify to unusual transactions, specific procedures to

1 evaluate them.

2 And one of the ideas is that the auditor in
3 looking for unusual transactions; transactions outside
4 the ordinary course, or that are otherwise unusual, could
5 include non-arms-length terms, that would be a population
6 that could include an undisclosed related party
7 transaction. And we're just sharpening the auditor's
8 focus to remain alert for things that indicate that an
9 undisclosed related party transaction exists. And when
10 they find one, then they have specifics procedures, like
11 Gaylen was asking about, that they have to perform for
12 each of those transactions that was previously
13 undisclosed to them that is a related party transaction.

14 So I think that's one of the key changes here in
15 the reproposal, and we're really emphasizing the
16 complementary nature between these two areas.

17 MR. BAUMANN: We have time for one more question
18 and then we're -- everybody's been very patient here.
19 Well, we have actually two questions. We've got Rick
20 Murray and then Bob Herz. And then we've got a group I
21 think that's ready for a break.

22 Rick?

1 MR. MURRAY: A quick clarification question. I
2 understand the logic and share the logic of expanding the
3 auditor's involvement in identifying related parties and
4 the consequences. The language seems to say; Brian, you
5 just described this, is if you run into something that
6 raises your curiosity, you've got to run it to ground
7 including the related party issue. There is some
8 language in the material here and in the proposal that
9 suggests there is also, independent of what you happen
10 to find, a separate responsibility to audit the integrity
11 of the list of related parties issued by management,
12 which is the other side of the coin of saying you look
13 at every party that there has been a transaction with and
14 audit to determine whether or not there is a relationship
15 that hasn't been disclosed. It sounded from this
16 discussion as though that's not really how far you plan
17 to take this, but the language seems to imply that you
18 do.

19 MR. DEGANO: Yes, there's no intent to send
20 auditors out looking for something that they would be
21 checking every single transaction to find. This is a
22 very targeted approach saying there are specific things

1 you do in identifying or in evaluating the company's
2 identification of accounting for and disclosure of its
3 related parties. There's a complementary area where the
4 auditor goes out and identifies and evaluates a company's
5 significant unusual transactions, and a third area that's
6 also complementary, the financial relationships and
7 transactions with the executive officers. Taken
8 together, this positions the auditor to do a more robust
9 effort on identifying undisclosed related party
10 transactions.

11 But one of the clarifications in the reproposal
12 is that the auditor will be doing work to examine the
13 accuracy and completeness of the company's identification
14 of its related parties. They'll be obtaining an
15 understanding of the company's process regarding its
16 related parties. They'll be doing other procedures such
17 as reading the minutes of the board of directors'
18 meetings.

19 And there's an appendix attached to the
20 reproposed standard that was in the proposed standard
21 that includes examples of information that could indicate
22 the existence of an undisclosed related party and sources

1 of information that could indicate the existence of an
2 undisclosed related party or transaction. And many of
3 the items in Appendix A were contained in the existing
4 standard, AU Section 334, and auditors are very familiar
5 with those sources of information and the procedures that
6 they perform. And they already perform many procedures
7 to test the accuracy and completeness of the company's
8 identification.

9 So we think this is just sharpening the auditors'
10 focus on these areas without sending them out looking for
11 something that is going to incur excessive costs.

12 MR. BAUMANN: Again we just have Bob Herz. And
13 then you said Lisa Roth is on the phone. So just those
14 two and then we definitely have to take our break. We
15 have other topics we have to get to this morning.

16 So, Bob?

17 MR. HERZ: On the related parties part of this
18 proposal, I just wondered whether it might in any way
19 impact on the auditor's responsibility or no
20 responsibility for other parts of SEC disclosure
21 documents. You know, for example in the periodic filings
22 there's a section, certain transactions. There are

1 disclosures related to transactions with affiliates. Of
2 course there are all the disclosures on executive comp
3 and CD&A and all of that. So, you know, the auditor now
4 has to kind of correlate the two of those and read those
5 and say, gee, those, you know, don't seem to be some way
6 in sync with what I found through my related parties
7 work, you know, the consistency of -- I read the other
8 parts and nothing came to my attention, or did come to
9 my attention.

10 MR. BAUMANN: Well, I agree that those are
11 sources of information that the auditor would look to in
12 terms of are there related party transactions or certain
13 types of transactions that I should certainly be aware
14 of to then apply audit procedures to. And it may lead
15 to what you just said, that maybe they're not
16 characterized correctly. If that's the case, then
17 auditors have other responsibilities with respect to
18 information that may not be characterized properly in
19 another document. So, yes, it has both aspects.

20 MR. SCATES: And also to add to that, Bob, in our
21 reproposal with respect to the company's relationships
22 and transactions with its executive officers, the auditor

1 would be required to read the most recent proxy
2 information statement. So at least again that's another
3 document that could inform the auditor.

4 And now we have Lisa Roth on the phone. Lisa?

5 MS. ROTH: Yes, thank you. Good morning. I'm
6 sorry I can't be there in person. I wanted to just make
7 two quick comments on the topic of the audits of broker-
8 dealers and the repropoed standard.

9 I just wanted to comment briefly that I don't
10 believe that the proposals are going to be applicable to
11 -- or I should say that they will be very difficult to
12 apply to about 90 percent of the broker-dealer
13 community, that percent of the community with fewer than
14 10 associated persons or employees. You know, the
15 obvious, they're not going to have an audit committee.
16 But I believe there are other nuances to this. These
17 proposals simply won't apply to that particular
18 community.

19 Secondly though, I'm really intrigued by this
20 question about whether or not the auditors of broker-
21 dealers should be required to evaluate the compliance
22 aspects of the related parties. My first instinct answer

1 was no they shouldn't because the issue of compliance of
2 the interrelated parties is already subject to a lot of
3 disclosure and subject to examination. I also believe
4 there are nuances to those interactions of related
5 parties; issues of jurisdiction, for instance, that are
6 complex and beyond the scope of what a financial auditor,
7 especially the auditor of a small broker-dealer would be
8 competent at without significant additional research and
9 study. And then also, because FINRA is very actively
10 involved in a project related to risk identification and
11 management.

12 However, all that said, I recognize that our own
13 regulators, FINRA in particular, hasn't been particularly
14 successful in identifying fraud and compliance issues
15 with respect to related parties. So I just wanted to
16 suggest that you actively communicate and engage in a
17 dialogue with FINRA about this topic, either for the
18 purpose of gaining confidence that the PCAOB auditors
19 don't have to engage in this aspect of analysis, or for
20 the purposes of identifying complementary reviews, areas
21 where your programs do or don't intersect in an way that
22 might help to identify fraud.

1 MR. BAUMANN: Thanks, Lisa. The reproposal has
2 a specific section where it talks about broker-dealers,
3 and we would expect to apply this standard to audits of
4 broker-dealers. But we ask questions of our commenters
5 to give us further information as to the applicability
6 of this standard to broker-dealers, any particular
7 challenges with respect to audits of broker-dealers that
8 we didn't recognize, or are there particular
9 relationships that are often common between broker-
10 dealers and other parties that they're affiliated with
11 that we should consider in enhancing the standards?

12 So we hope that you send in a comment letter and
13 we hope to hear from FINRA with respect to this standard
14 and broker-dealers.

15 With that, I'd like to wrap up this morning's
16 discussion of the standard-setting projects. We've had
17 a lot. I think people are ready for a break. We have
18 a number of important things yet to cover this morning.

19 Our break ended at 11:10 and it's now 11:15. So
20 with that, let's try to have an efficient break and be
21 back here in 10 or 15 minutes. Thank you.

22 (Whereupon, the above-entitled matter went off