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Public Company Accounting Oversight Board
(PCAOB)

Auditor Independence Tax Services Roundtable

July 14, 2004
10:02 a.m. - 3:58 p.m.

Capitol Hilton
1001 16th Street, N.W.
Presidential Ballroom
Washington, D.C. 20036

Page 2	<p>1 ATTENDANCE</p> <p>2 WILLIAM J. McDONOUGH, Chairman, PCAOB</p> <p>3 CHARLES D. NIEMEIER, Member, PCAOB</p> <p>4 DANIEL L. GOELZER, Member, PCAOB</p> <p>5 ROBERT BURNS, SEC</p> <p>6 DONALD NICOLAISEN, SEC</p> <p>7 ANDREW BAILEY, SEC</p> <p>8 TOM OCHSENSCHLAGER, American Institute of Certified</p> <p>9 Public Accountants</p> <p>10 JAMES L. BROWN, Crowe Chizek and Company LLC</p> <p>11 DAMON SILVERS, AFL-CIO</p> <p>12 RICHARD ANGELONE, American Bankers Association</p> <p>13 DEAN UMINSKI, Crowe Chizek and Company LLC</p> <p>14 PATRICIA WALTERS, CFA Institute</p> <p>15 MARK ANSON, CALPERS</p> <p>16 LYNN E. TURNER, Glass Lewis</p> <p>17 MICHAEL GAGNON, PricewaterhouseCoopers LLP</p> <p>18 BELLA RIVSHIN, PCAOB</p> <p>19 GREG SCATES, PCAOB</p> <p>20 DOUGLAS CARMICHAEL, PCAOB</p> <p>21 THOMAS RAY, PCAOB</p> <p>22 NICK CYPRUS, Interpublic Group of Companies</p> <p>23 DAVID SHEDLARZ, Pfizer, Inc.</p> <p>24 JIM BRASHER, KPMG LLP</p> <p>25 CONO NAMORATO, Internal Revenue Service</p>	Page 4	<p>1 PROCEEDINGS</p> <p>2 [Beginning time: 10:02 a.m.]</p> <p>3 MR. McDONOUGH: Ladies and gentlemen, would</p> <p>4 you take your seats, please? Ladies and gentlemen,</p> <p>5 would you please take your seats?</p> <p>6 Good morning, ladies and gentlemen. It's my</p> <p>7 pleasure, Bill McDonough, the Chairman of the PCAOB, to</p> <p>8 welcome you to this Roundtable Discussion on Auditor</p> <p>9 Independence and Tax Services.</p> <p>10 In creating the Public Company Accounting</p> <p>11 Oversight Board, Congress gave the Board the job of</p> <p>12 overseeing the auditors of public companies in order to</p> <p>13 restore the public's confidence in the fairness and</p> <p>14 objectivity of auditors' opinions. After a number of</p> <p>15 accounting and other financial reporting scandals, the</p> <p>16 public had good reason to doubt the credibility of the</p> <p>17 profession, and, in particular, to doubt whether</p> <p>18 accounting firms showed appropriate objectivity in</p> <p>19 their audit work.</p> <p>20 Shortly after the Congress passed the</p> <p>21 Sarbanes-Oxley Act, in early 2003, the Securities and</p> <p>22 Exchange Commission responded to those concerns by</p> <p>23 amending its rules related to auditor independence.</p> <p>24 You'll recall, the Act was passed at the end of July</p> <p>25 '02, and the SEC responded very quickly.</p>
Page 3	<p>1 ATTENDANCE</p> <p>2 MARK EVERSON, Internal Revenue Service</p> <p>3 PAUL KOREN, Goldstein Golub Kessler</p> <p>4 COLLEEN SAYTHER, Financial Executives International</p> <p>5 MARK WEINBERGER, Ernst & Young LLP</p> <p>6 WALTER McNAIRY, Dixon Hughes</p> <p>7 SCOTT BAYLESS, Deloitte</p> <p>8 BRUCE WEBB, McGladrey & Pullen, LLP</p> <p>9 ELLIOT SCHWARTZ, Council of Institutional Investors</p> <p>10 BARBARA ROPER, Consumer Federation of America</p> <p>11 JEFFREY C. STEINHOFF, U.S. Government Accountability</p> <p>12 Office</p> <p>13 BILL GRADISON, Member, PCAOB</p> <p>14 KAYLA J. GILLAN, Member, PCAOB</p> <p>15</p> <p>16</p> <p>17</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p>	Page 5	<p>1 Consistent with the Sarbanes-Oxley Act, these</p> <p>2 rules of the SEC prohibit auditors from performing</p> <p>3 certain non-audit services for their public-company</p> <p>4 audit clients. And the Commission's new rules also</p> <p>5 require that all other audit and non-audit services,</p> <p>6 including tax services, be approved by the company's</p> <p>7 audit committee.</p> <p>8 Since the Commission adopted these rules, new</p> <p>9 concerns relating to auditor independence have come to</p> <p>10 public attention. These new concerns relate to the tax</p> <p>11 services and products that audit firms provide to their</p> <p>12 clients and to senior executives of those clients,</p> <p>13 including extremely aggressive, if not abusive, tax</p> <p>14 strategies that may, by their nature, impair the</p> <p>15 objectivity of the auditor.</p> <p>16 I believe I can speak for all our Board</p> <p>17 members when I say that we have not yet determined</p> <p>18 what, if any, changes in the rules on auditor</p> <p>19 independence are needed to address these new concerns;</p> <p>20 rather, we are holding these -- this roundtable</p> <p>21 discussion to explore the various types of tax services</p> <p>22 that accounting firms offer and to examine whether</p> <p>23 those services have an impact on the objectivity and</p> <p>24 the appearance of objectivity of an auditor who</p> <p>25 provides those services to an audit client.</p>

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1 For example, we want to know whether tax-
 2 shelter work and tax-compliance work produce different
 3 auditor independence implications. We also want to
 4 understand better how tax and audit functions interact,
 5 both in small audit firms and in large audit firms.
 6 This should be a very engaging and productive
 7 discussion, and we are delighted that so many
 8 participants from such a variety of backgrounds are
 9 here today to contribute.
 10 I want to say a special thanks to my friend
 11 Commissioner Everson, and Cono Namorato, of the IRS,
 12 for participating in our discussion. We are very
 13 fortunate to have the benefit of your special expertise
 14 here today.
 15 I also want to thank our colleagues from the
 16 SEC -- Chief Accountant Don Nicolaisen, as well as Bob
 17 Burns and Andy Bailey -- for joining us today. On the
 18 issue of auditor independence, the Sarbanes-Oxley Act
 19 makes us partners in our efforts to restore confidence
 20 and to protect the interests of investors. I believe
 21 it's very important that the SEC and the PCAOB work
 22 together on this issue, and your presence here today
 23 helps us join cause in that effort.
 24 I'll be turning the discussion over to Doug
 25 Carmichael, who will chair today's meeting, who will

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1 guide us through our program. But, before I do that,
 2 I'd like to ask my fellow Board member and dear friend
 3 Kayla Gillan to offer a few opening remarks.
 4 Kayla.
 5 MS. GILLAN: Thank you, Mr. Chairman, my
 6 fellow Board members and all of our wonderful guests
 7 here today.
 8 First of all, I really would like thank all
 9 of you for taking the time to be with us today to
 10 discuss this important topic. We know how valuable
 11 your time is, and we really greatly appreciate your
 12 willingness to give us a bit of your time and a bit of
 13 your wisdom.
 14 The issue of auditor independence is one that
 15 has been near and dear to the hearts of many people in
 16 this room. In my previous life, I was general counsel
 17 of CALPERS, and, in that role, strongly advocated
 18 strengthening of auditor independence. In fact, during
 19 the legislative process that led to the enactment,
 20 Sarbanes-Oxley, investor advocates focused on the need
 21 for the auditor to be as independent as possible from
 22 his or her audit client. And there's no doubt, in my
 23 mind at least, that this support from the investor
 24 community is one of the main reasons that Title 2 of
 25 the Act contained a list of prohibited non-audit

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1 services.
 2 If you would indulge me and let me put my
 3 investor hat back on for a second, I think it's quite
 4 clear to say that there's probably no other single
 5 accounting or auditing issue as important to investors
 6 than that of auditor independence. And why is that?
 7 Well, it's really very simple. If an auditor's opinion
 8 is not based on an independent, objective, and
 9 professionally skeptical examination of the financial
 10 statements, then there's no reason for anyone to -- in
 11 the investment community or otherwise, to believe the
 12 numbers. Moreover, if you ask investors, most of them
 13 would say that they simply do not believe that a firm
 14 can be truly independent, objective, or appropriately
 15 skeptical when they have a large economic incentive, by
 16 ways of fees for non-audit services, to make the client
 17 happy.
 18 The next opinion I give, I have to publicly
 19 acknowledge that it's based on a somewhat biased
 20 perspective, but I cannot pass up the opportunity to
 21 acknowledge the efforts of my former colleagues in this
 22 area. It's often very easy for individuals at
 23 organizations to talk a good game about corporate
 24 governance. It's the "cool" thing these days to be a
 25 corporate governance expert. But, at some point, in my

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1 opinion, they either have to put up or shut up. And,
 2 too many times, internal or external pressures keep
 3 these people from following through on their
 4 principles. Well, despite much controversy and
 5 criticism, CALPERS has put up, casting thousands of
 6 proxy votes in opposition to directors who think it's
 7 okay to allow an auditor to also be a consultant.
 8 Now, I'm not here to pass judgement on
 9 whether every negative vote was one that I would have
 10 made if the decision had been mine alone to make, but I
 11 do strongly believe that these actions are making a
 12 difference in the market.
 13 And one need only look at last week's Wall
 14 Street Journal to see how actions by investors can
 15 change corporate behavior. According to the Investor
 16 Responsibility Research Center, the IRRC, we've seen a
 17 sharp decline in fees that companies are paying their
 18 auditors for non-audit services. In 2001, for example,
 19 it was reported that 72 percent of the fees audit firms
 20 recovered from their audit clients were for non-audit
 21 services. In 2002, the IRRC reported that this dropped
 22 to 55 percent. And last year it dropped to 42 percent.
 23 It seems very clear to me that the reason for
 24 this 30 percent point reduction is primarily due to a
 25 recognition by corporate auditor committees that the

<p style="text-align: right;">Page 10</p> <p>1 owners of their companies simply see too great a risk 2 that the auditor may provide a wink and a nod on 3 financial statements in exchange for additional 4 consulting work. Investors have spoken, and the market 5 has heard them, and now it's time for this Board to do 6 our job. And that's what today is all about, to hear 7 your views as to whether, if anything, additional work 8 is necessary. 9 And, again, I thank you all for your time and 10 your commitment and your candor today. 11 MR. McDONOUGH: You will not be surprised to 12 hear that each of our Board members has very strong 13 views on a variety of topics. And the wonderful thing 14 is that on every major policy issue, we have voted 5-0 15 in favor. The debates can be rather intense -- 16 (Laughter.) 17 MR. McDONOUGH: -- before we've reached that 18 point. 19 We have the great good fortune to have with 20 us, as I mentioned, Don Nicolaisen. The Office of 21 Chief Accountant is the major point of contact between 22 the SEC and the PCAOB, and we're very fortunate to have 23 such a sensible, reasonable gentleman as the Chief 24 Accountant. 25 Don.</p>	<p style="text-align: right;">Page 12</p> <p>1 issues. As the PCAOB engages additional staff with 2 expertise in these areas, I expect that a great number 3 of the independence interpretive issues that currently 4 are handled by my office appropriately will migrate to 5 the PCAOB. 6 The roundtable today is a welcome 7 introduction to the PCAOB's involvement in auditor 8 independence. By choosing to begin with the area of 9 tax services, PCAOB is showing its willingness to 10 address, in a public forum, controversial issues that 11 are of interest to investors, and the PCAOB should be 12 commended for doing so. 13 Tax services have been a fundamental part of 14 the accounting firms since the inception of the 15 profession. In recent years, however, the nature and 16 extent of these services changed. Firms began 17 formulating highly engineered tax products that were 18 not designed for a particular client, but, instead, 19 were marketed to numerous potential buyers, with the 20 firm taking a percentage of each buyer's profits from 21 the product. Over time, the IRS and others have found 22 several of these products to be overly aggressive, or 23 outright abusive, tax shelters. Personally, I believe 24 that no accounting firm should be in the business of 25 selling these kinds of tax products to their audit</p>
<p style="text-align: right;">Page 11</p> <p>1 MR. NICOLAISEN: Thank you, Chairman 2 McDonough, members of the Board, panelists. I'm 3 delighted to be with you this morning. 4 I think everyone knows that auditor 5 independence is an important component to restoring 6 investor confidence, and I sincerely do appreciate the 7 invitation to participate in today's public roundtable 8 on the auditor independence implications of an 9 accounting firm providing tax services for an SEC audit 10 client. 11 As you know, the Commission historically has 12 adopted its own rules and interpretations regarding 13 auditor independence issues. The Sarbanes-Oxley Act of 14 2002 emphasized the importance of auditor independence, 15 codified many of the positions expressed by the 16 Commission in 2000, and gave the PCAOB, subject to SEC 17 oversight, the authority to make auditor independence 18 part of its standard-setting inspection and 19 disciplinary programs. 20 While the Commission's staff -- my staff, in 21 particular -- will continue to provide companies and 22 audit committees with guidance on auditor independence 23 issues, I look forward to the PCAOB expanding its role 24 in becoming the primary standard-setter and the primary 25 source of advice and guidance to auditors on these</p>	<p style="text-align: right;">Page 13</p> <p>1 clients. 2 I look forward to the discussion today. I 3 have to tell you, I'm particularly interested in 4 understanding the views of the participants on the 5 issues of an accounting firm providing tax services to 6 executives of audit clients in a firm marketing 7 aggressive tax shelters to its audit clients. 8 As always, these remarks and any others from 9 the SEC staff today, are our own individual comments, 10 and do not necessarily reflect the views of the 11 Commission or our colleagues on the staff. 12 Thank you, once again, for allowing us to 13 participate. 14 MR. McDONOUGH: Thank you, Don. 15 We are also very grateful that the GAO, an 16 important ally of ours in good causes, is here, Jeff 17 Steinhoff, representing them. Jeff, welcome. Thank 18 you for being here. 19 And now I will turn the floor over to our 20 very distinguished chief auditor, Doug Carmichael. 21 Doug will manage the meeting for the rest of the day. 22 Doug, to you. 23 MR. CARMICHAEL: Thank you, Chairman 24 McDonough. 25 We do want to get the views of everyone at</p>

<p style="text-align: right;">Page 14</p> <p>1 the table on the important topics we're going to 2 discuss. Talking with some of you beforehand, I know 3 there's no shortage of views on this topic. 4 In order to have an orderly discussion, 5 though, we are going to follow our normal roundtable- 6 discussion procedures. We prepared a briefing paper, 7 in anticipation of the roundtable, that includes the 8 subjects and questions we're going to cover. Greg 9 Scates, the associate chief auditor, and Bella Rivshin, 10 assistant chief auditor, will briefly introduce each of 11 these topics and related questions, and then we'll 12 invite you to make a comment or -- and any other 13 remarks you want. We're also going to project each 14 question on two screens in the room to that everybody 15 will see what they are. 16 If you'd like to speak, we'd ask you that you 17 please indicate that by standing your name card on end 18 so that we can call on you. There are a lot of people 19 around the table, and we'll need to do that to proceed 20 in an orderly fashion. 21 When you do speak, please identify yourself. 22 It's going to be important for the other people that 23 are in the room, not at the table, to understand who is 24 speaking, and for those who are listening online to 25 understand that. So while it might seem a little</p>	<p style="text-align: right;">Page 16</p> <p>1 The Board's primary mission is to oversee auditors 2 of public companies, protect the interest of investors. 3 And as Don Nicolaisen mentioned in his remarks, auditor 4 independence is a most important component of restoring 5 investor confidence. We certainly share this view on 6 the importance of auditor independence. 7 Traditionally, the SEC has promulgated rules 8 describing independence requirements concerning 9 accountants who perform financial-statement audits in 10 public companies or issuers. The current SEC rules on 11 auditor independence are based on four overarching 12 principles, which state that an auditor's independence 13 may be impaired if the relationship, one, creates a 14 mutual or conflicting interest between the accountant 15 and the audit client; two, places the accountant in the 16 position of auditing his or her own work; three, 17 results in the accountant acting as management or an 18 employee of the audit clients; or, four, places the 19 accountant in a position of being an advocate for the 20 audit client. The SEC reiterated the importance of 21 those guiding principles in its February 2003 22 rulemaking release. 23 So throughout the discussion, we would ask 24 that you consider the following points in each specific 25 tax-service area that's discussed. Are these</p>
<p style="text-align: right;">Page 15</p> <p>1 redundant to do that since your name tag's right in 2 front of you, please do identify yourself when you 3 speak. Try to cover the topics as efficiently as you 4 can. We do have a lot of people, and we do want to 5 hear from all of them. 6 We're going to divide our discussion today 7 into three sessions. After we get started, 8 momentarily, we're going to continue until noon. We're 9 going to take a one-hour break for lunch, and then 10 we're going to resume the discussion at 1:00. We will 11 have an afternoon break. We anticipate that around 12 2:45, for five minutes. And we will conclude on time, 13 at 4:30. 14 During the last 10 to 15 minutes of the 15 program, we're going to provide people that are in the 16 audience an opportunity to ask any roundtable 17 participants that they want questions, and we're going 18 to ask that, to indicate their desire to do that, they 19 fill out an index card. Those will be provided. And 20 you can return the index cards, with your name, e-mail 21 address, and question, at any time during the day. 22 One last item for those of you who have cell 23 phones and Blackberries, which I think is most people. 24 Please make sure that they're silenced. 25 Now they want to get started.</p>	<p style="text-align: right;">Page 17</p> <p>1 overarching principles useful in considering the 2 appropriateness of tax services performed by the 3 auditor for its audit client? Are there other 4 overarching principles that should be applied to tax 5 services? 6 Before we move ahead and discuss specific tax 7 services, would anyone like to comment on the 8 overarching principles and their applicability? 9 (No response.) 10 MR. CARMICHAEL: Okay, let's move, then, into 11 the discussion. 12 Okay. Sorry, Barbara. Barbara Roper. 13 MS. ROPER: Barbara Roper, with Consumer 14 Federation of America. I'll jump in here, and I may 15 talk at some length, because I probably am not going to 16 have that much to say once you get into the details of 17 specific services, where I have less expertise. 18 The argument that tax services are -- somehow 19 operate outside these basic principles, I think, is 20 based on a completely flawed and faulty premise. The 21 first argument that puts forward is that Congress 22 specifically singled out tax services as permissible. 23 This is a misreading of the legislative history. 24 Congress specifically singled out tax 25 services as being in need of review by the audit</p>

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1 committee. There was a recognition on Congress's part,
 2 based on the hearings that they'd held leading up to
 3 the legislation, that tax services were complicated,
 4 that some of them were fairly straightforward and
 5 didn't appear to create independence problems, and that
 6 some of them created potentially serious independence
 7 problems. And Congress used some restraint in not
 8 trying to draw that line itself, recognizing that that
 9 was probably not appropriate to try to do through
 10 legislation, but they singled out tax services as
 11 requiring careful review by audit committees for this
 12 very purpose, that audit committees would apply the
 13 standards of -- the basic principles of auditor
 14 independence to these services.
 15 That was the context in which this provision
 16 was added to the legislation. It was based on the
 17 letter that Chairman Levitt had written to audit
 18 committees asking them to -- you know, urging them to
 19 review non-audit services in light of these principles
 20 and other factors. It was based on testimony that
 21 indicated that that was a service that the audit
 22 committee preapproval process could, and should, serve.
 23 The second argument that gets put forward is
 24 that there is a long history of auditors providing
 25 these services. There's two problems with that. One

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1 is that, as has already been mentioned, the nature of
 2 the services now being provided under the name tax
 3 services has significantly changed. The other is that
 4 the audit just simply doesn't have value if it's not
 5 independent. And it doesn't matter if these services
 6 have been provided a long time, if they compromise
 7 independence, they need to be banned.
 8 The third argument that gets put forward is
 9 that these services are subject to particular unique
 10 laws and regulations, and that they're subject to the
 11 potential for a government audit, and that that should
 12 give us extra assurance. It does no such thing. Those
 13 laws are designed to protect the tax process, not the
 14 audit. And it may provide some assurance that
 15 conducting the audit doesn't interfere with providing
 16 the tax services, but they provide no comparable
 17 assurance that providing tax services does not
 18 interfere with the audit.
 19 And so the basis for saying that these
 20 services are, sort of, specifically outside those
 21 principles, I think, is completely flawed, and just
 22 needs to be completely reevaluated.
 23 MR. CARMICHAEL: Patricia Walters.
 24 MS. WALTERS: I would definitely agree with
 25 the premise that these principles apply, and I guess

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1 that that was my -- and so I have -- it's somewhat of a
 2 question. I guess that was my premise in arriving and
 3 that since no one seemed to object to these the next
 4 question, my understanding was (inaudible) principles.
 5 And so in some sense, given the previous remarks, I
 6 would like some confirmation that that is the case. I
 7 certainly believe that these principles apply to tax
 8 services, and that we should use those principles in
 9 analyzing the issues that are coming forward. And if
 10 that isn't an agreed premise in this roundtable, I
 11 think (inaudible).
 12 So I actually (inaudible) question
 13 (inaudible).
 14 MR. CARMICHAEL: Yeah, I think that we can
 15 confirm that we'd like to apply the basic principles.
 16 Past practice indicates that there may be differences
 17 in views on how that should be applied. So I think one
 18 of the things that we're going to ask is that, in
 19 considering these overarching principles, we'd like
 20 your views on whether their application to certain tax
 21 services indicates that there is an impairment of the
 22 auditor's independence, and your reasoning in that
 23 process, as we take up each of the individual tax
 24 services.
 25 Bruce Webb.

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1 MR. WEBB: Bruce Webb, Director of Auditing
 2 and Independence for McGladrey & Pullen.
 3 I agree that the overarching principles would
 4 apply to all services provided by the auditor.
 5 However, I think we need to bear a few additional
 6 things in mind as we think our way through that, how
 7 they apply. And I'm not begging for a different
 8 application. I'm simply stating that CPAs are experts
 9 in accounting, auditing, and taxes.
 10 That the tax services are subject to the
 11 general requirements of ethics interpretation 101-3,
 12 which was adopted by the Board as part of the interim
 13 independence standards, and under those requirements,
 14 all non-audit services, including tax services, would
 15 impair independence unless they are overseen by
 16 management, and they would impair independence if the
 17 auditor were to perform any management functions or
 18 make any management decisions.
 19 It is my belief that issuer-specific
 20 transaction-based tax compliance and tax advisory
 21 services will generally fall within the overarching
 22 principles.
 23 MR. CARMICHAEL: Okay, thank you.
 24 I do want to remind people to directly speak
 25 into the microphone; otherwise, the -- your voice won't

<p style="text-align: right;">Page 22</p> <p>1 be heard on the online Webcast or to some people in the 2 room, for that matter. 3 Michael Gagnon. 4 MR. GAGNON: Thank you. My name is Mike 5 Gagnon. I'm from PricewaterhouseCoopers. My 6 background and responsibility in the firm is risk 7 management compliance, which includes independence -- 8 Is that better? Sorry. I feel like I'm 9 about to lean over the table here. 10 I think it's a very interesting and, I think, 11 a very important discussion to have about how to apply 12 the principles to tax services broadly. Whether it's 13 compliance services, planning services, advisory-type 14 tax services, I think it's very important to start with 15 the framework of the principles. 16 I think that it is also important, as I think 17 the -- certainly the Commission espoused in its rules 18 in 2002/2003 -- that the context and facts and 19 circumstances associated with the provision of tax 20 services be considered and evaluated. It is very 21 important -- and, I think, different today -- than we 22 have experienced up to at least recent history, to 23 recognize the responsibility of audit committees as 24 they consider and evaluate and, in fact, pre-approve 25 the services that auditors provide. I think it's</p>	<p style="text-align: right;">Page 24</p> <p>1 effectiveness of that process. 2 MR. CARMICHAEL: Lynn Turner. 3 MR. TURNER: Thanks, Douglas. 4 I actually like the four principles. Having 5 been one of the people involved in actually writing 6 them, I thought they were actually really good. 7 (Laughter.) 8 MR. TURNER: But they actually really don't 9 come from the SEC rules. If you go back to the AICPA's 10 Code of Professional Conduct, that's where they all 11 came from. They actually come out of the profession. 12 And I think, to that extent, the AICPA and profession 13 had done an excellent job of establishing what those 14 principles should be. 15 So I think the principles are good. There 16 was no question that -- when we initially adopted the 17 four principles, that they were to apply to work that 18 the auditor did in the tax area. I think that Mr. 19 Carmichael raised the appropriate question. The 20 question is, then, How do you implement them in the tax 21 area and make the proper determination? 22 To that extent, in the last year or so, the 23 SEC staff has done, I think, a very good job of 24 outlining the type of information that should be going 25 to the audit committees for their consideration, the</p>
<p style="text-align: right;">Page 23</p> <p>1 important that audit committees are provided with 2 information, full disclosure for the context, the facts 3 and circumstances associated with the provision of 4 these services, as well as the framework of the 5 principles so they can properly evaluate it. I think 6 all of that is critically important. 7 But I do think, certainly in a direct 8 response to some of the commentary, there is an 9 important relationship between the provision of tax 10 services and the auditor's responsibility, which I 11 think, in the context of the basic principles, needs to 12 be understood and recognized. 13 I do think -- I do believe -- and we're going 14 to touch upon it, I think, during the course of the day 15 as we discuss tax services in the context of an 16 auditor's responsibilities -- I do think the 17 fundamental provision of tax services does, in fact, 18 enhance the audit process. And I think we'll get into 19 that during the course of the day. But in the context 20 and the framework of the principles, I believe it's 21 very important to understand that backdrop, that the 22 two are connected, but that the auditor has the 23 ultimate and primary responsibility for the report on 24 the opinion on the financial statements. But the tax 25 services frequently enhance the efficiency and the</p>	<p style="text-align: right;">Page 25</p> <p>1 things that Mr. Gagnon just mentioned. I think they do 2 play an important role with respect to that. I'm not 3 sure the audit committees today are getting that level 4 of detail information in what's coming up to them, and 5 I hope that that becomes part of the PCAOB inspection 6 process, to see if, in fact, the auditors are providing 7 that level of detail up to the audit committee so that 8 they can exercise the type of oversight and involvement 9 in the process -- and judgement, that Mike just 10 mentioned, which I think was appropriate -- because I 11 actually don't think audit committees are getting that 12 level of detail that the SEC specified, which was 13 actually excellent. 14 But, overall, no question, when we passed the 15 rule, these were meant to apply to the tax service. 16 Then the question became, Where do you turn around and 17 cut the sausage, so to speak? 18 MR. CARMICHAEL: Mark Weinberger. 19 MR. WEINBERGER: Thank you. My name's Mark 20 Weinberger. I'm with Ernst & Young. And I'm a tax 21 guy, so my firm is probably squirming that I'm 22 commenting on this independence issue right now. But I 23 would agree with what Lynn Turner just said, and 24 others. And I think, Barbara, you laid out the issue, 25 as well, when you described the arguments, the pro and</p>

<p style="text-align: right;">Page 26</p> <p>1 con. These principles, as I understood, and always 2 understood it, were clearly part of the 2000 rulemaking 3 the SEC did. They were part of the discussion, 4 obviously, in Sarbanes-Oxley. They were part of the 5 rulemaking most recently by the SEC in determining what 6 is and is not a committed service. 7 And so, we would agree the real question is 8 -- I would agree the real question is, How do you apply 9 it to tax services? And Scott Traub recently wrote a 10 letter and said, you know, it's -- the tax services, 11 the application is tempered by the arguments that 12 Barbara laid out in -- when she started talking. And 13 for all of us around the room to have this debate is 14 helpful, but, as Lynn said, when the audit committees 15 sit down to try and apply these principles to tax 16 services, which are explicitly allowed in the rule, it 17 becomes much more complicated as they try and do it. 18 And if there's any guidance or clarity, I think that's 19 foremost importance in terms of this new process that 20 was set up by Sarbanes-Oxley and the SEC rules working, 21 because as others have said previously, the audit 22 committees are taking their responsibilities extremely 23 seriously, for good reason, and they're trying to work 24 through all these issues. And the more clarity, I 25 think, the better. So --</p>	<p style="text-align: right;">Page 28</p> <p>1 -- while I do think the four principles have to be 2 applied, and applied with reason, you also have to come 3 back and say, "It wasn't that these things are okay so 4 you can just vote and approve it," it was, "You have to 5 exercise judgement, using those four principles, and 6 then decide whether it's in the investor interest that 7 these services get provided or not provided." 8 MR. CARMICHAEL: Jim Brasher. 9 MR. BRASHER: (Inaudible.) 10 On behalf of the KPMG, I would like to thank 11 the Board for hosting today's roundtable discussion. 12 We believe the public interest is well-served by having 13 a public dialogue about the auditor's responsibilities 14 in connection with the auditing of public registrants. 15 We also believe that the provision of tax advice, tax 16 services, of public registrants serves the public 17 interest by permitting the auditor to conduct an 18 efficient audit in respect to tax matters. We believe 19 the public interest is well-served because the audit 20 committee has to review and approve the provision of 21 all tax services rendered by the audit firm, which may 22 not be the case with respect to tax services rendered 23 by other tax-service providers. 24 We look forward to an exchange of views of 25 how we can further improve the integrity of the system</p>
<p style="text-align: right;">Page 27</p> <p>1 MR. CARMICHAEL: Lynn, did you want to 2 respond to that? 3 MR. TURNER: Well, I'd just like to follow up 4 on one thing that both Mark and Barbara mentioned that 5 I think is important. As audit committee member, I've 6 gotten brochures and information from the firms that 7 has explicitly said that Sarbanes-Oxley, in essence, 8 approved and said you could do all this tax work, and 9 there's nothing wrong with it. I think those 10 statements are actually grossly misleading to audit 11 committee members. 12 What Sarbanes-Oxley says is that these things 13 are, in fact, subject to the judgement of the audit 14 committee. It's not that Sarbanes-Oxley said they were 15 okay, or not okay; it's that we're going to subject 16 them to the judgement of the audit committee, which I 17 think is why it's so important that the PCAOB make sure 18 that the audit committees are getting the information 19 at the level of detail that the SEC has said, so that 20 they can make informed decisions. 21 And I think it is misleading when the firms 22 come out and go to the audit committees and say, 23 "Sarbanes-Oxley has said this is okay, so you can just 24 go ahead and pre-approve it." That's not what was 25 written into, and intended by, the law. And I think it</p>	<p style="text-align: right;">Page 29</p> <p>1 and to strengthen public confidence. 2 MR. CARMICHAEL: Okay. 3 Jim Brown. 4 MR. BROWN: Jim Brown, Crowe Chizek. 5 I just wanted to mention, there's one other 6 area in which these four principles are very useful. 7 And in my firm, we agree with them, we think they're 8 very relevant. When we took a look at the services we 9 provided to registrants, we said, "We need to go 10 through and scrutinize and screen everything we do." 11 So, as a policy issue, we used these four in deciding, 12 as our first step, what we could and couldn't do. So 13 they're also very useful in that regard, and we would 14 support continuing with these principles. 15 MR. CARMICHAEL: Jeff Steinhoff. 16 MR. STEINHOFF: Jeff Steinhoff, from the new 17 Government Accountability Office. Our name was 18 changed, last Thursday, from the General Accounting 19 Office. So we have a new name. The same initials, 20 though. 21 (Laughter.) 22 MR. STEINHOFF: I support the four 23 principles. I think they set a high bar. I think the 24 purpose of this meeting really is to help set the bar. 25 I'm not sure if it's providing clarity to the</p>

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1 principles themselves, or saying, "Where is that bar to
 2 be set?"
 3 What I think is difficult here is that the
 4 auditor can bring lots of expertise, and they could
 5 bring expertise in bookkeeping, but they're not
 6 permitted to "keep the books." So I think, in looking
 7 here, at tax services, one must look at how that bar is
 8 to be applied here, and so that boards have very clear
 9 guidance as to what that means. And none of these
 10 really speak to who is the best to provide a tax
 11 service, or who is the most efficient, or who knows the
 12 most about it. They really deal with relationships.
 13 And in setting the bar, I think that these provide a
 14 very good foundation for applying against that
 15 particular service, or against any service.
 16 MR. CARMICHAEL: Thank you.
 17 We certainly are going to be taking up the
 18 application of the principles as we go through the
 19 services, so I'll just ask Mark Anson to make the final
 20 comment on this topic.
 21 MR. ANSON: Douglas, thank you.
 22 I'm Mark Anson. I'm here today to represent
 23 the California Public Employees Retirement System.
 24 I think the final comment I'd like to make,
 25 as we go through this introductory period, is that

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1 integrity of the financial statements is paramount to
 2 investors. I'm here representing one of the largest
 3 investors, not only in the United States, but around
 4 the world. Investors, creditors, regulators, we must
 5 be able to rely upon the information that's contained
 6 in the financial statements. Anything that impinges
 7 upon the independence of the auditor impairs the
 8 integrity of the financial statements.
 9 And as we review the 16 questions that are
 10 teed up today, I think we should keep in mind that
 11 auditor independence is synonymous with financial-
 12 statement integrity.
 13 Thank you.
 14 MR. CARMICHAEL: Okay, I'd like to move to
 15 the first question. So, Greg, can you lead us through
 16 that?
 17 MR. SCATES: Thank you, Doug.
 18 As many of you are aware, companies calculate
 19 their liability for various federal, state, and local
 20 taxes on tax schedules that form a basis for the
 21 amounts appearing in a company's annual financial
 22 statements. In auditing these income tax accounts, the
 23 auditor is required to obtain reasonable assurance that
 24 all tax accounts are fairly stated, with appropriate
 25 disclosures, in the financial statements.

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1 This brings us to our first question. Who
 2 prepares the tax schedules and related documentation:
 3 the issuer, a third party, or a combination of
 4 professionals? And the next question, Do the answers
 5 to these questions differ depending on the relative
 6 size of the company?
 7 Comments?
 8 MR. KOREN: My name's Paul Koren. I'm a
 9 partner at Goldstein Golub Kessler. We are a medium-
 10 sized accounting firm in New York City, a small, but
 11 important, SEC practice. That question is particularly
 12 sensitive to our practice.
 13 MR. CARMICHAEL: Could you speak more
 14 directly into your mic, Paul, please?
 15 MR. KOREN: That question, obviously, is
 16 extremely significant to our practice. Our clients
 17 generally don't have sophisticated in-house tax
 18 specialists. Nevertheless, we are very cautious with
 19 regard to accumulations of data, and we insist that our
 20 clients, or a third party, would always produce the
 21 information.
 22 So it would be -- it would be something that
 23 we would feel challenged if we were to go past the
 24 principle of -- you know, of doing bookkeeping or
 25 auditing our own work.

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1 MR. SCATES: Lynn Turner.
 2 MR. TURNER: On this one, I've seen it done a
 3 number of ways. Back where -- when I was at -- a CFO,
 4 we actually had our own tax people who prepared the tax
 5 schedules and all the related tax documentation. We
 6 did our own tax return, but then had the accounting
 7 firm, who also did the audit work, actually then review
 8 the tax return in conjunction with their review on the
 9 tax accrual, although they usually got around to
 10 reviewing the tax return subsequent to the actual tax
 11 accrual, because of timing. So the process would be,
 12 we'd do the tax accrual, do all the schedules, they'd
 13 review that, then we'd do the tax return, and they'd
 14 come in and review the tax return when we were done.
 15 Where I'm currently at as a board member, the
 16 process works pretty much the same, because the company
 17 has their own sophisticated tax department. I think
 18 the larger the companies get, that's pretty much the
 19 way my experience has been with the process. On the
 20 other hand, when I was with my former firm, I was in
 21 offices where there were only nine or ten of us in the
 22 office, or just 30 of us in the office, much like a
 23 smaller firm -- more so out in Heartland America. And
 24 in some of those cases, we would actually go through
 25 and do the audit; and then, quite frankly, at the same

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1 time we were doing the tax accrual, we'd almost do the
 2 tax return, although that really wasn't as relevant for
 3 public companies. Most public companies of any size
 4 had the sophistication to do that on their own. But
 5 there were some smaller companies that I've worked on
 6 as an audit partner where we would do the tax accrual
 7 and tax return, and help them out to that extent.
 8 So I think it differentiates based on size
 9 and the degree that the company wants to do it. The
 10 one issue that you get -- can get into, kind of, a
 11 concern about is when the larger company decides to
 12 outsource that function to someone. You have to be
 13 very careful there to make sure that's not going to
 14 your auditor.
 15 MR. SCATES: David Shedlarz.
 16 MR. SHEDLARZ: As we all can probably
 17 appreciate, this is a complex undertaking, and one
 18 which is critically important to get right. And having
 19 the expertise on hand to do that properly, in terms of
 20 maintaining, as someone cited earlier, the integrity of
 21 the financial statements, is clearly one of the
 22 objectives.
 23 For a large firm, like Pfizer, we have the
 24 internal resources, as Lynn has outlined, to do that
 25 for our own account. And so we have a fairly large

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1 staff that has a high degree of specialization and
 2 capability in the global tax matters that touch us,
 3 given the nature of our worldwide operations.
 4 I also can imagine, as Lynn has highlighted,
 5 that, for smaller and mid-sized companies, this is a
 6 difficult undertaking. And I think it's important, as
 7 we go through this, to understand that it's critically
 8 important to have the right expertise in place to
 9 balance out against the complexities which are inherent
 10 in dealing with these tax matters, and also in terms of
 11 ensuring the integrity of the financial statements. I
 12 can well imagine that, for smaller and mid-sized firms,
 13 it's more evenly distributed, in terms of people who
 14 have the expertise in this particular area, including
 15 the participation of their outside accounting firm.
 16 MR. SCATES: Permit me to ask another
 17 question along these -- on this topic here. Do the
 18 answers to these questions depend on the size of the
 19 accounting firm? Does that have an impact, the size of
 20 the accounting firm?
 21 MR. GAGNON: The size of the firm or the size
 22 of the issuer?
 23 MR. SCATES: No, the actual accounting firm.
 24 Jim Brown.
 25 MR. BROWN: Jim Brown, at Crowe Chizek.

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1 I'm not certain the answer depends on the
 2 size of the firm, the audit firm. I think it's much
 3 more dependent on the size of the company. As I think
 4 Mr. Everson would acknowledge, or anybody else here,
 5 that the IRS rules are very complicated, and many small
 6 public companies don't have the expertise to properly
 7 figure out how they should comply with the tax laws.
 8 So they would rely more on somebody -- typically, in
 9 the past, it's been the auditor who's in there and has
 10 taken a look at the numbers, and has the responsibility
 11 to attest to the accuracy of the numbers in the
 12 financial statements. They would rely on the auditor.
 13 And I think there's a very clear recognition that there
 14 is a size difference. Large companies don't have that
 15 reliance on the auditor or on someone else. The small
 16 companies don't have the expertise, frankly, to get it
 17 done right. And if we want proper compliance with the
 18 tax laws, they need help from someplace. So it really
 19 depends on the size of the company, not the firm.
 20 MR. SCATES: Pat Walters.
 21 MS. WALTERS: Hi, I'm Pat Walters. I
 22 represent the CFA Institute, formerly known as the
 23 Association for Investment Management and Research. We
 24 are a professional organization of approximately 70,000
 25 investment professionals worldwide. We award the

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1 chartered financial-analyst designation.
 2 Usually, I have lots of opinions about the
 3 questions before me. Today, I feel like I'm going to
 4 have a lot more questions for people around this table
 5 than I have opinions, although, I would expect, by the
 6 end of the day, I'll have a few opinions.
 7 There seems to be an assumption in the
 8 answers that have been given, with respect to this
 9 particular question, that the third party or external
 10 professionals who are assisting the issuer in preparing
 11 your tax returns must be the audit firm. The only
 12 accounting experience I have, personally, other than
 13 teaching accounting, is working for a tax accountant.
 14 This tax accountant did nothing but taxes, and he would
 15 shudder at the thought of having to do an audit. He
 16 only did that until he got his CPA, and then he went to
 17 do what he thought, what was interesting.
 18 So in some sense, in response to a statement
 19 by a gentleman across the room from me, whose name I
 20 can't read from here, I agree that audit firms or
 21 accounting firms have lots of expertise in them. They
 22 have people who know tax, and they have people who know
 23 financial reporting, and they have people who know how
 24 to do audits. Those people are generally not the same
 25 person, and that those who spend their time reading the

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1 Journal of Taxation really aren't good at answering
 2 audit questions, and aren't good at answering financial-
 3 reporting questions. They know how to do taxes.
 4 So it's a question for the people around the
 5 table who have been responding so far, Why can't a firm
 6 -- why can't an issuer contract with someone else,
 7 other than their auditor, to provide the expertise that
 8 they may need in preparing their tax returns? As an
 9 individual, I go out, and I have a tax accountant, and
 10 I have to rely on the fact that that person is a tax
 11 professional. If I wanted someone to do my audit, I
 12 don't see why that would have to be the same person.
 13 So I'd like a little elucidation from the auditors and
 14 tax accountants around the table.
 15 MR. SCATES: Mark Weinberger.
 16 MR. WEINBERGER: Thank you.
 17 Patricia, in answer to your question
 18 specifically, I guess, you know, I think it's a
 19 commonly held view that the registrars have to prepare
 20 their own statements, their tax accounts, and, for
 21 financial purposes, the auditors cannot prepare them
 22 and then audit them. And as was said already, in the
 23 larger companies, you're finding internal expertise
 24 that can do that. We are seeing, in the smaller
 25 companies -- and smaller is not small, like five

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1 persons; smaller is a billion to five billion, we're
 2 talking lower-, you know, middle-market kind of
 3 companies -- are actually having to go out where they
 4 don't want to, or can't, spend the resources to have an
 5 internal resource to do that -- going out and finding a
 6 third party, and the third party is not their auditors.
 7 In many cases -- in all cases, I assume -- if they're
 8 going to have a third party, it's not their auditor.
 9 So there are actual firms that do this,
 10 specifically -- whether they're law firms or CPA firms
 11 or firms that do auditing for other clients -- that is
 12 going on in practice.
 13 MR. SCATES: Bruce Webb.
 14 MR. WEBB: Bruce Webb, McGladrey & Pullen. I
 15 think I'm the name Pat couldn't read.
 16 I would just like to, sort of, comment in
 17 response to Greg's question, and something that Pat
 18 said, regarding, you know, Does size of firm make a
 19 difference? I don't think size of firm necessarily
 20 makes a difference, in terms of whether or not the
 21 auditor prepares the tax schedules. And I'm a little
 22 confused, by the way, by the question, as to whether
 23 we're talking about schedules that are involved in
 24 doing the computation and making the provision for the
 25 financial statements, or whether we're talking about

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1 the schedules that form the basis of the return,
 2 itself. I think those are different activities and
 3 would have different rules.
 4 However, I will say that, in our firm, which
 5 is, you know, a substantial firm, we have a lot of
 6 auditors who are also very expert in tax services, and
 7 generally supervise both services for clients, whether
 8 they be issuers or not issuers. I think the smaller
 9 the firm, the more likely it is that the CPA wears more
 10 than one hat. I think the larger the firm, the more
 11 likely it is that you'd find yourself either in an
 12 auditing or a tax -- auditing and accounting or tax
 13 niche. So that's -- for what that's worth.
 14 MR. SCATES: The reference to the tax
 15 schedules is those schedules that are prepared in
 16 connection with a financial-statement audit.
 17 Scott Bayless.
 18 MR. BAYLESS: Scott Bayless, with Deloitte.
 19 Having participated with Lynn Turner in
 20 drafting the principles, I certainly endorse use of
 21 those principles. And I think, in our experience,
 22 we've seen that audit committees are using those
 23 principles in their evaluation of tax services.
 24 With respect to the issue of who's preparing
 25 the schedules and returns, I think it's important to

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1 remember that, one, auditors are required, by their
 2 professional standards, to ensure that management has
 3 the appropriate expertise to do their own tax-return
 4 preparation, and that's an important element that the
 5 audit committee and the auditors take into
 6 consideration in consultation regarding the provision
 7 of services.
 8 Secondly, in terms of the importance of
 9 having the auditor involved in the tax services, is the
 10 notion that the auditor, by that involvement, enhances
 11 audit quality. And the consultations and the issues
 12 with respect to tax compliance are certainly issues
 13 that are everyday issues. They're not issues that can
 14 be decided once a year, at the end of the year, but
 15 that involve continuous consultation as the company
 16 undertakes transactions and business events during the
 17 year. And, although the tax expertise may differ by
 18 the size of the company, each company has particular
 19 issues that they need to seek out the professional
 20 advice of tax experts.
 21 The worst scenario that you could end up
 22 with, though, is a scenario in which the auditor,
 23 having been consulted at the end of the year by a third-
 24 party tax preparer, disagrees with that tax preparer's
 25 views, and ends up in a scenario where you have a

<p style="text-align: right;">Page 42</p> <p>1 financial-statement restatement or a difference in the 2 application of taxes at a subsequent period of time. 3 MR. SCATES: Lynn Turner. 4 MR. TURNER: We just -- at Glass Lewis, we've 5 done a couple surveys of tax services that relates to 6 audit services, both on the Fortune 500 companies, as 7 well as 1800 companies that go down below that, so 8 you're getting pretty well into the Russell 3000, which 9 would probably take you down to companies of a couple- 10 hundred million in market caps. So you're starting to 11 get down into -- from a public-company perspective, 12 definitely -- smaller-sized companies, well beyond the 13 Fortune 1,000, even. And some of our findings were 14 interesting, in that I expected to actually see the 15 smaller companies using their auditors more for tax 16 services, because just my experience had indicated that 17 was what I thought I would see. And yet when we 18 actually ran the statistics, based on 2002 and 2003 19 data, that's not what we found. We found about a 20 quarter of the Fortune 500 companies that we looked at 21 -- we looked at 461 out of the 500, which were most of 22 the public ones -- and the audit -- the tax work was 23 very nominal, or zero, at about a quarter of those. 24 And I doubt anyone around the table is going to turn 25 around and tell us that those audits that they were</p>	<p style="text-align: right;">Page 44</p> <p>1 coming to the markets, frequently a client will come to 2 us and say, "We're planning initial public offering. 3 Our auditor is a local firm, doesn't have sophisticated 4 auditing experience. And we would like you to consider 5 being our auditor for our SEC work. But because we've 6 had a long-term relationship with our local firm, we 7 want them to continue to do the tax work." And that, 8 of course, make sense. 9 We find, though, after a number of years, the 10 client typically will come to us and say, "We think 11 we'd like you to do the tax work, too, because we think 12 it would be more efficient. You understand us better, 13 you have more insight into what we are doing." And so 14 it tends to morph into where we actually begin to do 15 both services. 16 MR. SCATES: Barbara Roper. 17 MS. ROPER: Just briefly responding to 18 something Mr. Bayless said, I can actually imagine a 19 worse scenario, which is that, at the end of the year, 20 the auditor disagrees with the advice given by the tax 21 expert, but doesn't say anything, because the tax 22 expert's from his own firm, and to do so would be to 23 call into question the work of his firm, which is why I 24 think auditor independence is an important 25 consideration for these services.</p>
<p style="text-align: right;">Page 43</p> <p>1 doing on a quarter of those weren't high-quality 2 audits. So I don't know that you've got to do this to 3 ensure a quality audit, because there are a quarter, 4 and that percent is growing. 5 But when we looked at that for the other 1800 6 companies, that number had gone up a little bit more, 7 to about 31 percent were actually using their audit 8 firm for very little or nominal tax work, and actually 9 the tax work on the 1800, as percentage of the audit 10 fee, was lower than it was for the Fortune 500 11 companies. So it was not, quite frankly, what we 12 expected to find; and, if anything, not what you'd 13 expect in relation to the Fortune 500 companies, who 14 tend to have that expertise in-house. And the fact 15 that you've got 500 -- over 550 of those companies that 16 use their auditor for nominal tax work out of about 17 1800 clearly indicates that you were able to do this 18 without using your auditor to provide that expertise in- 19 house. It's either that or we've got a lot of lousy 20 audits out there, and I don't think we have a lot of 21 lousy audits out there. 22 MR. SCATES: Paul Koren. 23 MR. KOREN: I actually see that statistic 24 from another viewpoint. Anecdotally, since we're an 25 auditor of relatively small and usually new companies</p>	<p style="text-align: right;">Page 45</p> <p>1 MR. SCATES: Tom Ochenschlager. 2 MR. OCHSENSCHLAGER: Yes, thank you. I'm Tom 3 Ochenschlager, with the AICPA. I'm the Vice President 4 of Taxation. And previously, as recently as last year, 5 I was with Grant Thornton for almost 25 years. So I've 6 had some practical experience, and also some experience 7 from the association side of things. 8 I just want to, sort of, circle back, tagging 9 onto to what Scott had said a few moments ago, and also 10 I think in response to what -- the issue that Pat had 11 raised, that -- why we don't use -- why companies don't 12 -- it's not better to use an outside consultant on tax 13 matters, rather than the auditor. And Scott mentioned, 14 and just to elaborate on that a bit, the advantage -- 15 first of all, you can do that, of course, and many 16 firms to, and there are statistics that we've alluded 17 to here that show that that's an increasing trend, 18 perhaps because audit committees are being more 19 diligent in their duties, to use outside consultants. 20 But -- so that's clearly a choice, and I think we'll 21 see it being made maybe more often in the future. 22 But one of the primary reasons for using the 23 auditor for these functions is the point that Scott 24 brought up, and that is that there's a continuous 25 relationship between the auditor and the client,</p>

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1 because they're required to do quarterly financial
 2 statements, there will be tax reviews that are done on
 3 a quarterly basis, so issues -- tax issues will be much
 4 more likely to be spotted during the -- during the
 5 course of the examination by the auditor than they
 6 would be if it was relied -- if we relied totally on
 7 the management of the firm to spot the issues and then
 8 call in an outside third advisor.
 9 Now, when an audit firm does spot an issue, a
 10 tax issue -- whether it be favorable or unfavorable for
 11 the client -- during their quarterly reviews, they
 12 would bring that up before the audit committee, and
 13 presumably the audit committee could then, even after
 14 the issue has been identified, farm it out to a third
 15 party, an independent third party. But the advantage
 16 of having the auditor onboard with the tax expertise is
 17 that these issues are much more likely to be spotted
 18 much earlier in the process, and eliminate a lot of the
 19 year-end confusion, which Scott had referred to
 20 earlier.
 21 MR. SCATES: Mike Gagnon.
 22 MR. GAGNON: Thank you.
 23 The -- just want to address the statistics
 24 that Lynn mentioned a short while ago, where, I think,
 25 a quarter of large companies and about a -- almost a

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1 third, 31 percent, of the, sort of, mid-cap companies
 2 do not use their auditor for tax services. Maybe
 3 unlike Lynn, I don't find that is particularly
 4 surprising. I don't think it impacts the point of
 5 enhancement of the audit process in auditor
 6 effectiveness where tax services are provided by an
 7 auditor, and it doesn't mean that, in the one quarter
 8 or one third that the audits are not effective. And I
 9 know you weren't suggesting that. But it is enhanced.
 10 It's difficult for me to imagine an audit
 11 partner, who is responsible for the audited financial
 12 statements, not relying upon tax expertise within the
 13 global organization, particularly for large companies,
 14 where the environments are very, very complex, very
 15 difficult. And the transparency involved, where deeply
 16 credentialed experts in the area of taxation, in the
 17 many areas of taxation, in advising and helping and
 18 assisting the auditor in the audit process, has to
 19 enhance the audit process. And I think there's also an
 20 efficiency point, from clients' perspective, where that
 21 expertise is also brought to bear from an organization
 22 where there is deep knowledge, deep expertise of the
 23 organization, and the two work together. So I wouldn't
 24 -- I wouldn't suggest that the audit quality is
 25 detracted when they're not involved, but it's difficult

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1 for me to see how an audit partner wouldn't really rely
 2 and use the expertise.
 3 I think there's also one last point of
 4 transparency, in the sense that where that is that
 5 expertise embedded in an organization, particularly in
 6 a -- when a -- when that organization is involved in
 7 the audit of a very large, complex, global
 8 organization, the transparency involved in the early
 9 notice, the timely notice of issues, in terms of the
 10 audit process, also enhances the tax-reporting process.
 11 So I think there's -- there is that benefit, as well.
 12 MR. SCATES: Well, we have four more people
 13 that would like to speak. We'll start with David
 14 Shedlarz, and we'll conclude with Bruce Webb, and then
 15 we'll move on with the next topic.
 16 David.
 17 MR. SHEDLARZ: From the issuer's-community
 18 perspective, I guess I would second a lot of the things
 19 that Mike just went through. In fact, I'd be pretty
 20 concerned if the outside audit firm didn't know, pretty
 21 intimately, about the tax structure, especially of a
 22 global, complex concern. And that's not something you
 23 can do from afar. There is great utility, in terms of
 24 certain tax advice, which is actually given to the
 25 company, that enhances the working knowledge, the

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1 integrity, and the level of comfort we should all have,
 2 in terms of the ability to deal with inherited
 3 complexity of tax matters, not only in the United
 4 States, but also on a global basis. And so I think
 5 there is a tremendous benefit here we can't lose sight
 6 of, we can't let the statistics run counter to, and
 7 that is the involvement of the outside accounting firm.
 8 And anything of this level of sophistication is highly
 9 desirable, in terms of getting the end result we all
 10 want, and are all looking for, on an ongoing basis,
 11 which is transparency, timeliness, and integrity to the
 12 accounting and financial statements.
 13 If my outside accounting firm is too far
 14 afield of what's going on, from a complex tax
 15 perspective, then I think their ability to deal with
 16 those dimensions is going to be significantly
 17 curtailed. You could provide for those services on the
 18 outside. I think, to a certain extent, you run the
 19 consequence, in terms of not having as close an
 20 association that you need to have, in terms of
 21 understanding the inherent complexities of what goes
 22 on, especially as it relates to global tax matters.
 23 MR. SCATES: Colleen Sayther.
 24 MS. SAYTHER: Thank you, Greg.
 25 First, I wanted to say that I think most

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1 companies agree that having auditor independence is
 2 important for a high-quality audit. Also, I think most
 3 companies agree that having the auditor, as David so
 4 articulately put, perform some of the tax services,
 5 creates a better quality, and is more efficient.
 6 However, I think we may be confusing those
 7 points with what the question says. And I think, Greg,
 8 when you mentioned that it's talking about tax
 9 schedules and related documentation associated with the
 10 financial statements, I know of no instance where the
 11 audit firm would prepare the tax schedules associated
 12 with the financial statements, and then audit that. So
 13 I just wanted to make sure that we were clear. And I
 14 think Mark made that point earlier, that there is a
 15 definite -- I see a definite distinction between, you
 16 know, other tax services and the preparation of
 17 schedules to support the financial statements.
 18 MR. SCATES: Jim Brown.
 19 MR. BROWN: Jim Brown, Crowe Chizek.
 20 I agree we've, sort of, perhaps, moved away
 21 from the issue up there that we see, about tax
 22 schedules. But when we're talking about statistics, I
 23 guess you could look -- there's a lot of statistics out
 24 there, and you can argue that, well, the cup's half
 25 full or the cup's half empty. Or, I guess, in the

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1 statistics that we heard a moment ago, the cup's two-
 2 thirds full and one-third empty in the relationships,
 3 because some companies do it, and have a successful
 4 audit, and others don't. Regardless of where the
 5 statistics work out, I think we'll all be able to deal
 6 with whatever the circumstances are.
 7 But I did want to mention -- to throw some
 8 more statistics in here. There's an interesting study
 9 by three academicians that's coming out soon in a
 10 journal, and they're well-respected academicians. They
 11 actually came up with a conclusion here, and they said
 12 that -- if I can just read this -- "third, we find tax
 13 services fees are typically negatively associated with
 14 restatements, and that the association is statistically
 15 significant." What they mean by "negatively
 16 associated" is that the higher the tax-services fee,
 17 the more tax services obtained, the fewer restatements
 18 in those companies. Said the other way, the companies
 19 that had more restatements didn't use their auditor for
 20 tax services as much.
 21 So that's an interesting article that -- you
 22 know, like anything, you have to deal with all the
 23 different elements back and forth, and come up with a
 24 policy decision. There's a lot of stuff on both sides.
 25 MR. SCATES: Bruce Webb, you'll have the

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1 final word. We'll need to move on then.
 2 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 3 I just wanted to follow up on a comment that
 4 Tom Ochenschlager made. And I think it's important,
 5 as we deal with this subject matter, to recognize that
 6 audits are done in a different fashion than they were
 7 20 years ago, or perhaps even ten years ago. With the
 8 increased responsibility for management and the
 9 auditors for the quarterly financial statements and the
 10 responsibility to assert and attest to the
 11 effectiveness of internal control over financial
 12 reporting, audits are becoming much more of a
 13 continuous process. And an auditor is foolish if they
 14 don't get out and examine, not only the accounting, but
 15 the tax implications of transactions, sort of on a
 16 contemporaneous basis, as well as internal control.
 17 And, clearly, the SEC independence standards, nor
 18 standard number 2, neither preclude the auditor from
 19 consulting with the issuer or providing advice as to
 20 the application of accounting principles or advice as
 21 to improvements that could be made in internal
 22 accounting control. Similarly, I think providing
 23 advice as to the tax implications of specific
 24 transactions is part of that process.
 25 MR. SCATES: Lynn Turner.

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1 MR. TURNER: Just coming back to the question
 2 you asked about, Who does the schedules? Again, I have
 3 seen, on the smaller companies, where the auditor has
 4 done the schedules and has done the tax accrual, and
 5 then has done the tax return, because the small company
 6 just doesn't have that expertise in-house. So I think
 7 it does vary by the size of the company as to how much
 8 is done until they're able to get their own people on
 9 staff that has that expertise.
 10 MR. GRADISON: Lynn, could you repeat that?
 11 I couldn't hear you. I couldn't hear --
 12 MR. TURNER: I'd be happy to.
 13 (Laughter.)
 14 MR. TURNER: My -- and I apologize -- my
 15 experience has been, as you get into the smaller
 16 companies, including the smaller public companies --
 17 and keep in mind, your own annual report just said we
 18 have about 15,000 companies out there. By the time you
 19 get past the Russell 3,000, you are into small
 20 companies these days. And not much of the market cap
 21 is there, but, in terms of numbers, it's a large number
 22 of companies being subjected to audits.
 23 In those, because they don't have the
 24 expertise in-house, I would say people tend to -- and
 25 the other people from industry can chime in here -- but

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1 I would say that, once you get up probably over about a
 2 half a -- oh, maybe 300 million, half a billion in
 3 revenues, you start to build your own internal tax
 4 people that have the expertise in-house and be able to
 5 stay on top of things that are going on, and do the
 6 planning and all that you need to do. But before you
 7 hit that size, when you're smaller, it's just more
 8 efficient and easier to -- and most people -- most
 9 companies, I think, do, in fact, then just go to their
 10 accounting firm, or to an accounting firm, to get that
 11 expertise.
 12 And I think you can get the expertise and
 13 have people stay on top of it for you regardless of
 14 whether you're doing tax or not. I've had situations
 15 where we did audit work, but not the tax work, quite
 16 often, quite frankly, when we were joint-venturing with
 17 a smaller firm. The smaller firm would do the tax
 18 work, and, quite frankly, was probably better than us
 19 at servicing and keeping them up to speed on the tax
 20 work than we could have been doing in a big firm. And
 21 so we'd do the audit, take on that piece of it; they'd
 22 do the tax work. But I've also seen where we did the
 23 tax work, and other firm turned around and did the
 24 audit work. And, in both cases, I think the auditors
 25 and tax people both did a very good job.

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1 I don't think that you have to have the same
 2 firm doing both audit and tax to stay on top of things
 3 and get a good service provided to the company. But as
 4 you get into those smaller companies, as you get past
 5 the Russell 3,000, certainly once you get past the top,
 6 probably four to five-thousand public companies, then
 7 you're into situations where I think you'll find that
 8 if the auditor is doing the tax work, they're also
 9 probably doing the tax accrual, and they're doing the
 10 schedule, and they go through the audit, and as they
 11 wrap it up, they'll wrap up the tax return. They're
 12 probably doing the tax work for the owners of the
 13 business, as well, if they're doing it all. And so
 14 it's probably, in those situations, a situation where
 15 they would have to figure out what they were going to
 16 do if it wasn't their auditor turning around and doing
 17 it.
 18 That's why I was surprised by the statistics,
 19 that as we moved out of the Fortune 500 and 1,000, we
 20 actually saw that they were going out to -- in even a
 21 larger percentage, to someone other than their auditor
 22 for the tax firm, although I've got to tell you, I've
 23 seen some small firms, boutique firms that operate in
 24 tax that are just superb and excellent. And perhaps
 25 that why they're doing it.

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1 MR. SCATES: Let's go ahead and move to the
 2 next topic.
 3 We would like to have a discussion of the
 4 various types of tax services that an accounting firm
 5 might provide. Although these services are grouped in
 6 general categories, there is an overlap among the
 7 various types of tax services.
 8 Let's first take a look at tax compliance.
 9 Tax compliance generally involves preparation of
 10 federal, state, and local income tax returns. Tax
 11 compliance also includes payroll and sales tax returns,
 12 as well as returns for employee benefit plans.
 13 Our first question, or group of questions:
 14 If a public company does not have the in-house
 15 expertise to prepare tax returns and related documents,
 16 are there benefits to the company and its investors to
 17 engage the auditor to perform such work? Are there
 18 disadvantages to engaging a tax specialist other than
 19 the auditor? And our third question, What kinds of fee
 20 structures are used for tax compliance services?
 21 Damon Silvers.
 22 MR. SILVERS: I'm Damon Silvers. I'm
 23 associate general counsel at the AFL-CIO.
 24 This discussion, kind of, already happened,
 25 to some degree, and I want to, sort of, treat it as

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1 though it was somewhat continuous.
 2 We have heard the concept, I think, this
 3 morning, already, that there are small companies --
 4 small, like five billion market cap -- that don't have
 5 in-house expertise on their tax problems. We have
 6 heard that there are big companies that are so big that
 7 their tax problems are so complex that no company could
 8 have internal expertise, and that they have to go get
 9 external expertise because they are so big. We have
 10 heard that the auditor needs to do the tax work to be
 11 able to understand enough about the company to be able
 12 to do the audit.
 13 This -- these sorts of statements trouble me,
 14 because when Sarbanes-Oxley was in the process of being
 15 adopted, the AFL-CIO was extremely concerned about the
 16 general subject of auditor independence, but believed
 17 that the sort of tax preparation and compliance
 18 services that are the subject of this question really
 19 did seem to be, kind of, sensible things for the
 20 auditor's expertise to be used in. And we were
 21 prepared to support an approach that allowed, in
 22 general, tax consulting to continue after Sarbanes-
 23 Oxley, because there would be a series of limiting
 24 principles that would ensure that this type of
 25 consulting was narrowly applied to tax compliance.

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1 I think, frankly, we were naive. And I think
 2 that the list of questions that follows this one, and
 3 the types of things described as, quote, "tax
 4 consulting," shows the depth of our naivete in
 5 accepting this approach and the way in which it's, sort
 6 of, been carried off into the wild blue yonder;
 7 notwithstanding the sorts of limitations that that we
 8 had thought, at that time, were in place. I think that
 9 those limitations have not been explicated enough to
 10 give them real teeth.
 11 And we're now having this discussion about
 12 the necessity -- whether there is a necessity of doing
 13 the sort of services that we originally thought were
 14 rather innocent. And I don't think anyone can deny
 15 that there is some benefit to companies in
 16 consolidating professional services, that having two --
 17 having one firm try to understand your firm -- your
 18 company, the issuer, is cheaper than having two of them
 19 trying to do so. Although, I think that the more
 20 heavily structured the audit firm is, the more the tax
 21 practice and the audit practice begin to resemble two
 22 firms, in any case.
 23 The real issue is, What is the price you're
 24 paying? The real -- I think there are two issues. One
 25 is, How serious is that benefit, really? And some of

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1 the arguments that I just went through in the beginning
 2 of my remarks make me doubt the seriousness of the
 3 benefit, because I don't -- those arguments just don't
 4 sound credible to me, and it sounds like people are
 5 exaggerating things. And that is worrisome.
 6 And the -- and then the second question is --
 7 there is some -- because there is some benefit. I
 8 don't doubt that. And I think that the existence of
 9 that benefit was what led us to be more accepting of
 10 this approach originally. If there is this benefit,
 11 what is the cost? What is the cost, in terms of both
 12 the overall independence of the auditor and the audit
 13 process. And what is the cost of it with respect to
 14 the independence and the effectiveness of the audit of
 15 particular aspects of the company's financials that are
 16 related to the tax work?
 17 MR. SCATES: Jeff Steinhoff.
 18 MR. STEINHOFF: I want to first state that,
 19 in the discussion this morning, there's been a very
 20 broad brush placed on tax services, and I think there's
 21 many services being provided. And to the extent the
 22 board can lay out all the types of services, which I
 23 think with these first two questions you were trying to
 24 get to, I think you can be in a position to really
 25 place more clarity on this issue.

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1 I will say that it gets down, in many cases,
 2 to the degree. The comment Bruce made before about
 3 providing routine advice is much different than
 4 actually carrying out the function. And I think the
 5 standards and the four principles here would permit
 6 routine advice.
 7 There is no question that the knowledge of
 8 the auditor and the knowledge of the business, in doing
 9 the audit, would provide a real advantage to the
 10 auditor in providing this service, and perhaps to
 11 management. But, as I mentioned earlier, you can take
 12 this to many areas. We faced this in GAO when we were
 13 establishing our independence standards, and we had a
 14 lot of very small local governments, small nonprofits,
 15 where they basically said the following, "These
 16 entities are so small, they can't really keep their own
 17 books. So it's better for the auditor to do that.
 18 They can't really make their own payroll disbursements;
 19 it's better for the auditor to do that for them, too."
 20 And on and on and on. And, at the end of the day, they
 21 were saying, "Federal Government, you're getting a
 22 better result because you've got trained professionals
 23 making sure the books and records are being properly
 24 maintained. They're also doing the audit, but that's
 25 all right, because they've made sure it's done right."

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1 And I think what you have to really make a
 2 determination here is, are these four overarching
 3 principles going to be applied differently to tax
 4 services than they are to every other service that a --
 5 an accounting firm can provide? And I think you're
 6 going to have to take the maybe 15 -- 10, 15, 20,
 7 whatever the different types of services being provided
 8 -- and look at each type of service, because I think
 9 there certainly are some that clearly fall into the
 10 routine advice. And I would even say sometimes helping
 11 the client prepare the return, if the client doesn't
 12 know what line to put the numbers on, I think that's
 13 more of a ministerial duty, personally, and would be
 14 what I would call routine technical advice. But I
 15 think you're going to have to take the different types
 16 of services and probably address each type of service.
 17 MR. SCATES: Nick Cyprus.
 18 MR. CYPRUS: Yeah. Nick Cyprus, controller,
 19 Interpublic Group.
 20 First, let me just make myself clear that I'm
 21 really addressing tax-compliance services, because
 22 there's other services we'll talk about later. But if
 23 I think about an auditor preparing original tax returns
 24 or schedules, and we all, I think, agreed that we agree
 25 to the overarching principles, then I don't know how it

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1 doesn't put the independent accountant in a position of
 2 an advocate for the client, in a position of
 3 management, and even in a position of potentially doing
 4 their own work. So if I think about compliance
 5 services, actual preparing returns on behalf of the
 6 client, you know, I think I'd come out -- and this is
 7 my personal view -- that says it's probably not the
 8 thing I'd want my auditor to do. I think that's very
 9 different -- and I think it's our job either to provide
 10 in-house expertise or third-party expertise to help us
 11 do that. At the Interpublic Group, we do have a tax
 12 department that does that work.

13 But if we go on to futures -- and I won't
 14 talk about it yet, but when we go on, later on, to
 15 advisory services and knowledge of where we do need our
 16 auditors, I would say, just like -- if I have a tax
 17 issue or an accounting issue, just like I go to my
 18 auditors to get an accounting policy, even if I come up
 19 with, "I think this is the kind of accounting we need
 20 to do," I like to know, from my auditors, "Do you agree
 21 with me?" It would be the same thing on a tax event --
 22 if I'm doing a merger, if I'm thinking about a tax
 23 strategy -- and this is the position I want, I want to
 24 make sure that, at the beginning, not at the end, I
 25 consult my auditor, just like I do with my accounting,

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1 to make sure that we're in sync on this, that these are
 2 the right things to do.

3 And so I see it very differently when I think
 4 about the compliance services than when I think about
 5 tax planning and advice services.

6 MR. SCATES: Mark Weinberger.
 7 MR. WEINBERGER: Thanks, Greg.
 8 This really goes to this question, in
 9 particular, and a series of questions that we have
 10 coming up, which is where we evaluate or attempt to
 11 talk about the advantages and disadvantages of using
 12 your auditor for tax services. And, Damon, you said
 13 that some of the claims about the benefits seem
 14 exaggerated to you. And when you talk about it in the
 15 abstract, it's very hard to come out with a specific
 16 answer, because it is abstract and there are no, you
 17 know, across-the-board rules that are going to address
 18 every situation.

19 But Sarbanes-Oxley, with vesting the power in
 20 the audit committee, who has all the facts and
 21 circumstances before them to make this determination,
 22 really puts those people and the audit committee in the
 23 -- on the line to make these decisions. And, frankly,
 24 I'll be honest, from what we see going on in the
 25 marketplace -- I apologize, I'll use a baseball

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1 analogy, but last night was the All Star game -- that,
 2 in the past, the tie goes to the runner in baseball.
 3 If you get to the base at the same time as the ball,
 4 you -- the tie goes to the runner and you're safe. And
 5 I think the auditor got the call every time there was a
 6 tie in the past, generally, because of the
 7 relationships, the efficiencies, the understanding of
 8 the business.

9 Now, as the audit committees are evaluating
 10 all the services in more depth, with their new
 11 responsibilities, we're seeing the trends that we
 12 talked about earlier, where more and more audit
 13 committees are deciding when it is and is not
 14 appropriate to use the auditor for what services. And
 15 we're seeing that in the numbers that have been
 16 suggested.

17 In some cases, it will absolutely not be in
 18 the interest of the issuer to use their auditor, if for
 19 no other reason, the process is much more elongated.
 20 Obviously, you have to go in for preapproval, you have
 21 walk through the -- the tax function has to bring the
 22 idea to the audit committee, they have to go through it
 23 all, the audit committee has to bless it, then it goes
 24 to the proxy statement; the numbers are then put into
 25 proxy, if you're the auditor and you do the work;

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1 you're going to get public scrutiny from investor
 2 groups. That is a good thing. Sarbanes-Oxley thought
 3 that was a good thing. But maybe an issuer will think
 4 that that's something that's just -- takes too long,
 5 and so maybe if we don't use the auditor, we don't have
 6 to go through those processes.

7 But, in some circumstances, they're still
 8 going to decide to use the auditor, and, principally,
 9 it could be because geographically they're located in
 10 countries across the world where they're better able to
 11 serve them, and they have to make sure they have risk
 12 policies in place in each of those countries; and other
 13 firms may not have the operations in each of those
 14 areas to be able to serve them all across the globe.
 15 Certain firms have more expertise; in particular,
 16 regulated industries and the like. And to get the best
 17 knowledge and expertise, they may want to go to a firm
 18 that has that, even if it is their auditor; and, in
 19 other cases, they won't.

20 So what I would say is this. When we talk
 21 about the advantages and disadvantages, I think it's
 22 right to say -- it's hard here to sit and say what they
 23 are, but when you know the facts and circumstances,
 24 applying it to your individual issuer, it becomes
 25 easier.

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1 MR. SCATES: Dean Uminski.
 2 MR. UMINSKI: Dean Uminski, with Crowe
 3 Chizek. I'm in charge of our state and local tax
 4 practice. And I've been on both sides of the fence, as
 5 a consultant and, in industry, as a buyer of services.
 6 And I guess, when I look at the issue here,
 7 with tax compliance, I'm focusing on the word
 8 "expertise." And as a buyer and as a previous buyer
 9 and as a provider of services, I think that's a key
 10 word. Who brings the right expertise to the table?
 11 Tax laws are becoming very complicated -- not only
 12 federal, but state and local. And I agree with what
 13 Mark just said, over there, in that geography plays a
 14 role. There's a lot of things that play a role in this
 15 -- cost, efficiencies. But I think the underlying
 16 concept is, Who has the right expertise to get this
 17 work done, and in the right manner, that you're
 18 complying with the law?
 19 MR. SCATES: Mark Anson.
 20 MR. ANSON: Mark Anson, from CALPERS.
 21 A moment ago, Damon Silvers mentioned cost,
 22 and I think that's a good thing to focus on,
 23 particularly since it's a question that's posed here at
 24 the end of question number 2, Are there disadvantages
 25 to engaging a tax specialist other than the auditor?

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1 Well, certainly one of the issues we hear frequently
 2 from corporations with whom we hold dialogues is that
 3 it's less efficient to hire someone other than the
 4 auditor, more costly. This same question, by the way,
 5 comes up, jumping ahead of it to question number 4, in
 6 the next discussion.
 7 Yes, there might be a higher cost by hiring a
 8 tax specialist other than the auditor, but CALPERS,
 9 over the last year, has made it very clear that if
 10 there is a higher cost, we are willing to pay that
 11 cost, as a shareowner in these public companies, to
 12 ensure the integrity of the financial statements.
 13 So as we talk today about independence and
 14 whether it's appropriate to hire an outside tax
 15 specialist -- and maybe there is a higher cost
 16 associated with that -- well, what's the benefit you
 17 get from that cost? What is the economic tradeoff?
 18 The economic tradeoff is preserving the integrity of
 19 the financial statements, which we, as an investor,
 20 must rely upon when we decide how to invest our
 21 capital.
 22 MR. SCATES: Elliot Schwartz.
 23 MR. SCHWARTZ: Elliot Schwartz, with the
 24 Council of Institutional Investors.
 25 That last comment was absolutely correct and

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1 very close to what I intend to say, which is, we have
 2 established a very bright-line test, which is to say
 3 that, the appropriate non-audit services that an audit
 4 firm ought to provide are zero, that the benefit of
 5 having a very clearly independent audit, one that can
 6 be trusted, one that establishes, you know, a clear
 7 level of independence, is very great. And any small
 8 cost associated with not having the benefit of auditor
 9 providing non-audit services is really relatively small
 10 compared to that higher level.
 11 I also want to associate myself with Mr.
 12 Steinhoff's comments about auditor independence.
 13 Although he suggested that we were, in essence, I
 14 think, standing on an slippery slope, where we're about
 15 to differentiate between many, many different kinds of
 16 non-audit services, whether it's tax planning or advice
 17 or compliance or whatever it is. As I said, our
 18 standard is that there should be really no non-audit
 19 services. I am very leery of the idea that we'll be
 20 able to differentiate and find shades of gray, put one
 21 service over the line and one service on the other side
 22 of the line. And so as we go through these services, I
 23 think we ought to be aware that they don't always have
 24 very clear borders.
 25 MR. SCATES: Lynn Turner.

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1 MR. TURNER: The -- Mark actually brought up
 2 a good analogy with respect to baseball and last
 3 night's game, despite who won.
 4 (Laughter.)
 5 MR. TURNER: But the notion that the tie goes
 6 to the runner, it's interesting to listen to these
 7 conversations, because we hear people start to talk
 8 about whether it's more efficient, cost beneficial, et
 9 cetera. But I think, at the end of the day, we've got
 10 to come back to how this meeting started, and that is
 11 maintaining the investor confidence in the integrity of
 12 the numbers in the financial statements. Because even
 13 if we have a great audit done, but there's a lack of
 14 confidence in those numbers, then what we're trying to
 15 achieve with the audit is totally lost.
 16 So from that perspective, I think we -- you
 17 need to keep in mind that when there's a tie, the tie
 18 has to go to the investor. The tie doesn't go to the
 19 company, and the tie doesn't go to the auditor; the tie
 20 goes to the investor. And, as Mark, next to me, has
 21 mentioned, time and time again we advise investors that
 22 now manage well in excess of ten trillion in capital,
 23 and time and time again they're willing to bear
 24 additional costs. But I actually don't think there is
 25 always additional cost. I've seen situations, time and

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1 time again, where when you go to another supplier,
 2 other than your auditor, including for tax work, you
 3 can get significant reductions in costs such that you
 4 turn around and benefit the investor by the lower cost,
 5 and you also benefit the investor by the enhanced
 6 independence of that situation, because the auditor is
 7 no longer doing the thing. And, in that case, I don't
 8 even think it's a tie; I think it's an automatic "go to
 9 the investor" in those situations. So this notion that
 10 you always are going to have a higher cost if you
 11 aren't with the firm that's doing your audit is, quite
 12 frankly, a big misnomer, and sometimes the differential
 13 in costs are substantial because you're trying to stay
 14 with one supplier. So I think you have to be careful
 15 with that notion.

16 When you get into these particular services,
 17 like, for example, the question that's back to tax
 18 compliance, I also think you have to understand that
 19 everything's not always black and white. Even when
 20 you're down to just doing tax returns. For example,
 21 when people -- when the firms were doing tax returns of
 22 companies where they had sold shelters, they were under
 23 obligations, under the code, to make certain
 24 disclosures in those tax returns with respect to
 25 shelters where they had taken certain positions, and

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1 yet we now know that, even in those situations, some of
 2 those disclosures weren't appropriately made. And so
 3 those raises -- those, in and of themselves, raise
 4 questions.

5 So I view it not so much as whether you're
 6 doing tax compliance or something along the lines all
 7 the way out to tax shelters; I view it more -- and I
 8 think at the SEC, they've typically viewed it -- if
 9 you've got a code in place, and it's probable, it's
 10 fairly highly likely that you could sustain your
 11 position with the IRS -- everyone, including myself, on
 12 their tax returns wants to take advantage of all the
 13 provisions in the code to minimize their taxes. We all
 14 turn around and do that. And that is fine, as long as
 15 it's clear and there's a high degree of likelihood
 16 you're going to be able to sustain that even when
 17 you're doing tax returns. But as you move down the
 18 channel from being probable -- you know, likely -- to a
 19 51-to-49 cut and then to less than 50 percent that
 20 you're going to be able to sustain your position with
 21 the IRS, when you drop below that 51/49 cut, I don't
 22 see how anyone can say that they're not being an
 23 advocate and breaking the basic principles, regardless
 24 of the type of service.

25 So, more so than the type of service, I look

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1 to see, Is there a direct conflict with the interest of
 2 the investors? And are you putting yourself, because
 3 of the positions you're taking, into a position of
 4 having to be an advocate for the company? And if
 5 that's the case, then I don't see how you can think any
 6 investor is going to view you as independent.

7 MR. SCATES: Okay, we have four other
 8 participants who would like to make remarks. I'd like
 9 to start with Damon, and we'll conclude with Colleen,
 10 and we'll move into the next topic before lunch.

11 Damon Silvers.

12 MR. SILVERS: Two comments, briefly. First,
 13 just to, sort of, re-emphasize something I said
 14 earlier, we initially looked at this area, preparation
 15 of returns, in the context of, you know, genuinely very
 16 small firms with limited resources, as a sort of benign
 17 one. The problem, I think, with it, though, is -- is
 18 that, while it's, sort of, practically benign, it does
 19 completely undermine the, sort of, conception of the
 20 audit process as separate from the managerial process,
 21 and that's the kind of cost I was referring to earlier,
 22 which, sort of, suggests that maybe this shouldn't be
 23 done.

24 Secondly, the question has been raised, I
 25 think, multiple times by auditors who are participating

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1 in this dialogue, of the need for companies in a, sort
 2 of, continuous fashion to be able to consult with their
 3 audit firm on tax issues in relation to the audit. And
 4 I would appreciate someone answering the following
 5 question about this.

6 If a firm, an issuer -- if an issuer takes
 7 the policy of not hiring the audit firm to perform any
 8 non-audit services, as some do, and negotiates an audit
 9 fee for audit work, and, in the course of their
 10 business, is interested in the audit firm's opinion
 11 about how they will -- about how they would react to a
 12 particular tax treatment of a particular transaction,
 13 and calls up their auditor -- you know, audit partner -
 14 - and asks them that question, what response would they
 15 get?

16 MR. SCATES: Tom Ochenschlager.

17 MR. OCHSENSCHLAGER: Yes. Tom
 18 Ochenschlager, with the AICPA.

19 A lot of the discussion about whether we
 20 should use auditors for the preparation of tax returns
 21 is focused on cost savings. And I subscribe to the
 22 idea that you probably do save costs because of the
 23 efficiencies. But I think there's also a quality
 24 issue. If you use the auditor to prepare tax returns,
 25 I think it's because of the auditor's familiarity with

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1 the culture, if you will, of the client, the financial
 2 information of the client, you're much more likely to
 3 get appropriate tax advice for the client than you
 4 would if you had an outside firm doing it. Not to say
 5 you don't have that option. But I'm just saying that's
 6 one of the advantages of using the internal auditor,
 7 that familiarity.

8 And I also think that it's particularly
 9 important in most accounting firms -- it should be true
 10 in all of them, really -- if they're giving tax advice,
 11 the tax return does have to tie to the provision for
 12 the financial statements. The provision is something
 13 that's signed off by the audit staff of the accounting
 14 firm. So you have, in effect, a vetting of whatever
 15 position the tax department of the audit firm would be
 16 taking with the audit staff. That has to be tied
 17 together. That's not true if it's an outside firm
 18 that's doing it. An outside firm would just do the tax
 19 return, and come what may, and it doesn't necessarily
 20 have to -- it should tie to the provision, but it
 21 doesn't always. And I've been in that situation, where
 22 we did the financial statements, and reviewed the tax
 23 provision; another firm did the tax return, and we had
 24 terrible times reconciling the two, because they were
 25 taking positions on the tax return that we didn't

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1 think, frankly, were appropriate, were too aggressive.
 2 So it can -- there can be a quality issue in
 3 addition to a cost-savings issue by using your auditor
 4 -- using the auditor as the tax-return preparer.

5 MR. SCATES: Colleen Sayther.

6 MS. SAYTHER: Colleen Sayther, from Financial
 7 Executives International.

8 I think I agree with Lynn's, you know,
 9 comment on using the term "always." And I think, you
 10 know, when we've used the term "always" with respect to
 11 costs and, you know, more efficient audits, et cetera.
 12 But we also have to be careful using the term "always"
 13 when we talk about all non-audit services as being --
 14 creating lesser-quality audits. And I think Tom
 15 actually articulated quite well what -- the point I was
 16 going to make, which is basically, you know, in certain
 17 instances it makes a lot of sense to have some of the
 18 tax services prepared by the auditor. It creates -- it
 19 does create efficiency, and, for the reasons that Tom
 20 mentioned with respect to communication, with respect
 21 to the audit side, I think it's vital. And I think the
 22 current process of having the audit committee vet those
 23 tax services and make a determination as to what's
 24 appropriate and what's not appropriate is the way to
 25 keep it.

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1 MR. SCATES: Okay, let's, before we take a
 2 break for lunch, let's move to next topic.

3 Many of the accounting firms also offer a
 4 variety of tax services, commonly referred to as "tax
 5 planning and advice," that many of the participants
 6 this morning have already alluded to. This type of
 7 service includes advice related to treatment of mergers
 8 and acquisitions, executive compensation, employee
 9 benefit plans, proposed or pending tax legislation, and
 10 international tax requirements, such as trade and
 11 custom duties.

12 Number four here, a group of questions, Are
 13 there benefits to the issuer and its investors to
 14 engage the auditor to perform such work? Are there
 15 disadvantages to engaging a tax specialist other than
 16 the auditor? And the last question, What kinds of fee
 17 structures are used for "tax planning and advice"
 18 services?

19 Jim Brasher.

20 MR. BRASHER: I think the advantage of using
 21 the auditor in this situation is that the provision of
 22 such services, you know, clearly has to be approved by
 23 the audit committee. They have oversight on behalf of
 24 the investors in this situation, and I think they can
 25 weigh, in their judgment, whether the provisions of

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1 such services is beneficial. Using a third-party
 2 provider, you know, that is not expressly provided for
 3 in the Act, that the audit committee has to approve
 4 such services. And I'm sure companies with (inaudible)
 5 probably do. There's many other situations where,
 6 frankly, tax directors and others would just as soon
 7 not go through the gauntlet of having preapproval by
 8 the audit committee. So I think that expresses the,
 9 you know, advantages and disadvantages of using the
 10 audit firm versus third party service provider. It
 11 comes back to the governance aspects of having, you
 12 know, the audit committee oversight with respect to
 13 provision of such services.

14 MR. SCATES: Jim Brown.

15 MR. BROWN: Jim Brown, at Crowe Chizek.

16 I wanted to mention one disadvantage of
 17 engaging a tax specialist other than the auditor, and
 18 that's probably best expressed in the analogy of
 19 opinion shopping. What you're likely to do is, you're
 20 likely to see a rush to the lowest common denominator,
 21 where the company says, "I want to account for
 22 something very aggressively. Now, if I can get either
 23 my auditor or my tax specialist or another tax
 24 specialist to say I can do this aggressively, then I've
 25 got a way to fight somebody saying you need to do it

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1 conservatively." So the more people that you allow
 2 involved to be able to counsel the company to say,
 3 "Here's how you need to -- here's how aggressively you
 4 can handle this," the more difficulty the rest of us
 5 have by saying, "You shouldn't do it that way. You
 6 should be more conservative."
 7 MR. SCATES: Damon Silvers.
 8 MR. SILVERS: Jim, I'm not sure I follow that
 9 argument. Currently, the company can get anybody they
 10 want. They can get an independent -- they can get a
 11 third party, they can do it internally, they can go to
 12 their auditor. The -- that sort of shopping is wide
 13 open today. The question is whether or not,
 14 systematically, the auditor gives the most aggressive
 15 answer and that companies move -- companies use the
 16 auditor in this area more than they should because of
 17 that. I'm not certain that I know the answer to that
 18 question, but that's the question. Today you can do
 19 anything. That sort of shopping is completely
 20 available to you, I mean, as an issuer. So I just -- I
 21 don't follow the -- I don't follow that reasoning.
 22 I'd also appreciate an answer to my question
 23 before, which is, If you don't provide non-audit -- if
 24 you don't provide non-audit services, and you get a
 25 call asking about the tax implications from an audit

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1 perspective, will the auditor take the call?
 2 MR. BROWN: Well -- Jim Brown here -- to get
 3 back and possibly to have quick answer on this, we're
 4 looking at what may happen. And there may be the
 5 situation where now the auditor is prohibited. PCAOB
 6 says we can't give tax advice, we can't get involved in
 7 these services. So now I'm facing the issue where I,
 8 as the auditor, have to express an opinion on the tax
 9 treatment of a transaction in the financials, but
 10 perhaps I'm prohibited from being involved in anything
 11 regarding the company's compliance with the tax law, or
 12 prohibited from giving advice. And now I'm put in a
 13 very difficult situation, where the company says, "Hey,
 14 we didn't engage you to do this. You can't give us
 15 advice on something like that." And some companies may
 16 -- in the world, real world out there -- try to use us
 17 as a lever against the auditor. So I'm trying to make
 18 certain that there's no unintended consequence here
 19 about prohibiting or restricting an audit firm from
 20 giving tax advice or doing tax compliance work when the
 21 company wants to use it against the audit firm and say,
 22 "I want to do something aggressively."
 23 MR. SCATES: Barbara Roper.
 24 MS. ROPER: Just back to the issue of opinion
 25 shopping. I think the key -- because we're talking

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1 about auditor independence here and not auditor
 2 efficiency -- is, if you get that advice, that
 3 aggressive recommendation, from the tax department of
 4 the audit firm, how likely is the auditor to call that
 5 advice into question? And he or she significantly less
 6 likely to call that advice into question than they
 7 would be if the advice came from a third party? And so
 8 this idea that there's a special risk to going outside
 9 to third parties to -- and you'll get aggressive
 10 recommendations, I don't think -- I don't think past
 11 experience necessarily bears that out, in terms of the
 12 -- some of the recent scandals, but also that the
 13 question is, When push comes to shove, will the auditor
 14 call that recommendation into question? And I think
 15 that becomes significantly less likely if the
 16 recommendation came from his own firm.
 17 The other thing, on the issue of tax advice
 18 and tax planning, I'll be honest, and I don't know
 19 exactly what gets -- what gets included under these
 20 various different headings. But I think there's a
 21 clear difference between getting the auditor's advice
 22 about recommendations that were made by someone else
 23 and getting the auditor's advice on how you should
 24 structure something, so that when they then come back
 25 and have to audit that issue, that -- I mean, it's one

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1 thing to get your auditor's advice, say, early in the
 2 process. As an auditor, say, "What do you think of
 3 this treatment that we're being advised to take,"
 4 versus, "How do you think we should do this?" Because
 5 then when they come back to do the audit, if they've
 6 told you how to do it, the idea that they're going to
 7 come back and then question that, I just think, doesn't
 8 bear up.
 9 And then, finally, in this discussion, we
 10 talk about efficiency and all these other issues. Our
 11 view is, independence trumps every other concern. And
 12 I'll go back to what I've said before. The audit has
 13 no value if it's not independent. And so where you
 14 have certain types of services that, maybe, sometimes
 15 create independence problems, and other times don't, I
 16 think it is perfectly appropriate to have the audit
 17 committee make that evaluation. Where you have certain
 18 types of services that are always going to require the
 19 auditor to service management or always going to
 20 require the auditor to be an advocate for their client
 21 or have a shared interest or conflicting interest, then
 22 I think it's up to the PCAOB to say, these services
 23 inherently violate the basic principles, just as the
 24 other listed prohibited services do, and it's the role
 25 of the board to enumerate those and prohibit them.

<p style="text-align: right;">Page 82</p> <p>1 MR. SCATES: Mark Everson. 2 MR. EVERSON: Yeah, thank you. I'm, 3 unfortunately, not going to be here after lunch, so I 4 did want to say a few things. And, Bill, I want to 5 thank you, of course, for putting this together and 6 being able to participate in this discussion. And my 7 remarks, as much as anything else, from our point of 8 view, are geared towards tax administration, which is 9 not your charge, but I think you can play an important 10 role in improving tax administration. So I ask you to 11 think about that. 12 The IRS doesn't touch every taxpayer, nor 13 should it. It relies on the integrity of professionals 14 to support the system of tax administration. I would 15 suggest to you that, just as this Board exists because 16 of the problems in corporate governance and 17 manipulation of financial statements, as many, if not 18 everybody in this room is aware, there was a real 19 problem, and has been a real problem, with the erosion 20 of tax compliance that has received growing attention 21 and, I would suggest to you, bipartisan concern in our 22 capital. 23 It's of such a degree that we, in 24 articulating our four service-wide enforcement 25 priorities, have singled out an element of it, this</p>	<p style="text-align: right;">Page 84</p> <p>1 products, and then, of course, the auditors. And it is 2 impossible for me to understand how an auditor can have 3 the same view of a transaction if the firm has an 4 economic interest in the success of the transaction, 5 which is clearly the case in many instances. 6 That having been said, I do recognize the 7 great difficulty in drawing the line between the 8 services that are planning and strategic, on the one 9 hand, and compliance on the other, because, just as 10 many have said, the requirement for expertise in making 11 those assessments, from an audit point of view, is 12 absolute and very much in our interest. So as you 13 grapple with this problem, I share the concerns that 14 have been expressed by many that you be not arbitrary, 15 and that you be very careful, as you try to find where 16 the lines are in this thorny problem that you have and 17 that I know will be dealt with wisely, and in a way 18 that will not just help the integrity of the markets, 19 but, I believe, if done properly, can also further the 20 integrity of our tax administration system. 21 So that's, sort of, where I see this. Thank 22 you. 23 MR. SCATES: Scott Bayless. 24 MR. BAYLESS: Scott Bayless, Deloitte. 25 I think those are excellent comments, and we</p>
<p style="text-align: right;">Page 83</p> <p>1 issue of the role of professionals. And one of our 2 four service-wide enforcement priorities at the IRS, 3 which guides our resource allocation and guides our 4 actions and is why Cono is here -- he's the head of our 5 Office of Professional Responsibility, which has been 6 reinvigorated, doubled in size, and we're going to keep 7 doing more -- but one of our four priorities is that we 8 want to assure that attorneys, accountants, and other 9 tax practitioners adhere to professional standards and 10 follow the law, which has not been the case in too many 11 instances. 12 I would suggest to you that, in looking at 13 this issue, Barbara talked about the fact that you go 14 down a corridor where the tax auditors worry about the 15 taxes, and not -- they're not worrying about the book 16 statement. I would suggest to you, however, that 17 the book auditors play a role in the integrity of the 18 tax compliance, and that we lost something through the 19 rush to what Don called these highly engineered tax 20 products because of the natural braking influence that 21 takes place when there are three parties involved in 22 these discussions rather than just two. And by "three 23 parties," I would mean the inside management, the 24 providers of the planning or strategic services that 25 are developing, at the extreme, these engineered</p>	<p style="text-align: right;">Page 85</p> <p>1 all appreciate those comments. Just in terms of 2 following up, I think you mentioned a very important 3 part of this process, and this is the process that was 4 set up by Sarbanes-Oxley, in that auditors of 5 companies, registrants, are observing in a very robust 6 fashion, and that is, the audit committee has a brake 7 to services. And, as you've indicated, the audit 8 committee is a brake to the services. In the 9 statistics that you've cited, Kayla, it is certainly 10 evident that the provision of tax services, and 11 certainly those services that are questionable or that 12 tend to go against the principles, have diminished 13 significantly over the last few years as the rules have 14 taken weight and registrants and audit committees 15 understand the import and the application of these 16 rules and the principles. 17 When you take a model that excludes the audit 18 committee from these considerations, what you've done 19 is exclude an important brake to the process of these 20 transactions and recommendations that are of concern in 21 other avenues of our government and our tax regulation. 22 If you have a continued involvement of the audit 23 committee as that brake, then what you've done is, 24 you've held each and every one of these services to a 25 standard by which it has to be robustly discussed,</p>

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1 disclosed, and talked about, in consideration of the
 2 principles, to ensure that auditor independence and the
 3 importance of investors in this process is maintained
 4 and (inaudible).
 5 MR. SCATES: Walter McNairy.
 6 MR. McNAIRY: Walter McNairy, with Dixon
 7 Hughes. I'm in charge of our firm's public-company
 8 practice. And we don't have many clients that are even
 9 200 million in market cap. Most of our clients are
 10 small-business and smaller than that.
 11 We have been consulted quite a bit from our
 12 public-company clients with respect to opportunities
 13 they have for specific tax-planning strategies that are
 14 pitched to them by other firms -- other professions,
 15 law firms, other accounting firms. And what we see is
 16 that our clients heavily rely on us for our advice on
 17 evaluating the opportunity, you know, what they should
 18 do -- help them sort through the issues.
 19 And since today's discussion is on
 20 independence, I think one of the reasons why they would
 21 call us, as their audit firm, and -- whether to not we
 22 do their tax returns -- is because, in that case, we
 23 are more independent than the party that is actually
 24 pitching the idea, because we would not have any
 25 financial interest in that transaction whatsoever. We

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1 would ultimately have to evaluate that transaction in
 2 terms of the audit and its impact on the audit, but I
 3 think that's just one example where we can assist our
 4 clients throughout the year -- quarterly basis or what
 5 have you -- on ideas that come to them, either
 6 internally generated or from the outside.
 7 MR. SCATES: Bruce Webb.
 8 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 9 I think Damon's asked a question, and he's
 10 asked it twice, and I think it deserves an answer.
 11 (Laughter.)
 12 MR. WEBB: So I'm going to give you the
 13 answer from my firm's perspective. And I think that I
 14 would expect my colleagues from the other firms
 15 represented around the table would give you a similar
 16 response.
 17 Of course if a client calls and says, you
 18 know, "My tax advisor has advised this. What do you
 19 think," of course you're going to respond. You have an
 20 obligation, as an auditor, to consider whether that
 21 position is in compliance with the tax laws and
 22 regulations. If it's not, you have -- in your opinion
 23 -- you obviously have illegal-act considerations and a
 24 whole host -- litany of guidance to follow. If you
 25 believe it's aggressive to the point where it's

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1 unlikely to be sustained, but not illegal, then you
 2 have a different set of criteria, and you would have to
 3 probably advise the client that while they can take
 4 that position on the return, assuming they comply with
 5 all disclosure requirements, they may have to adjust
 6 their tax provision in recognition with the fact that,
 7 in your view, it's unlikely to be sustained.
 8 So you can't dodge your audit responsibility
 9 as a result of someone else being the tax advisor or
 10 preparer.
 11 MR. SCATES: Thank you.
 12 Mike Gagnon.
 13 MR. GAGNON: I agree with those statements.
 14 And I, too, was going to address two points. One was
 15 the response to the question of, What happens if the
 16 auditor gets a call, and the auditor has not
 17 historically been involved in tax matters in serving
 18 the client? And, obviously, an auditor has a
 19 responsibility -- indeed, a duty -- to respond to those
 20 questions from the client.
 21 A concern that I would raise, though, is the
 22 quality and the depth of the response. Frequently,
 23 questions come up, from a tax perspective, at a client
 24 that are complex, that are driven by specific facts and
 25 circumstances at that client. And it is important to

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1 blend the expertise of an independent auditor as well
 2 as the credentialed expertise of tax advisors in
 3 properly responding.
 4 So there's no question that an auditor,
 5 indeed, would answer and respond to the questions in a
 6 manner that would be clearly an independent and
 7 objective view. There is also a concern that goes with
 8 that, of the quality and the depth of a response, and
 9 the auditor, with the tax advisors, would certainly
 10 need to gain an understanding of the specific facts and
 11 circumstances associated with the question.
 12 I think the other matter I'd like to address
 13 is whether or not an auditor would call into question a
 14 particular treatment for financial accounting purposes
 15 of a tax strategy or tax advice or some tax matter that
 16 the auditor might have been involved with originally,
 17 because that's a very important question from an
 18 independence perspective and from the perspective of a
 19 perception of independence, and certainly integrity of
 20 the financial statements.
 21 And I do think, in talking about and
 22 discussing and exploring that issue, it's important to
 23 draw some distinctions. I think, broadly, we'd all
 24 agree that auditor involvement in some of the notable
 25 tax strategies that have been in the press, and there

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1 have been some failures in the past, is not
 2 appropriate. I think we'd agree with that. And I
 3 think we'd agree, certainly, with the notion that
 4 having auditor involvement with some self-interest in
 5 these kinds of matters is not appropriate. I think you
 6 made that point earlier.
 7 That, at least in my mind, is different from
 8 what an auditor does on a global basis for global
 9 organizations, or local organization, in understanding
 10 the structure, the organization, the tax status of that
 11 organization, and making recommendations, advising the
 12 client on matters of what to do. Certainly, an auditor
 13 should and does discover matters where things may have
 14 been treated inappropriately. An auditor is -- from a
 15 tax perspective. And an auditor clearly will bring
 16 that to the attention of the client. The client needs
 17 to address that. I think there are benefits there,
 18 both from an IRS -- from a tax perspective, as well as
 19 from an integrity-of-an-audit perspective. Certainly,
 20 there are ideas -- tax ideas that an auditor or tax
 21 advisors may bring to a client's attention. And I do
 22 think certainly, it is absolutely true that an auditor
 23 signing the report on the financial statements, with
 24 audit advice, will, indeed, critically evaluate, from a
 25 financial-accounting perspective, how that particular

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1 track -- tax issue should be treated from a financial
 2 perspective. That's clearly important from an auditor
 3 perspective, but I think -- I do think the benefits go
 4 both ways.
 5 MR. SCATES: We're going to have to limit our
 6 remarks to three more participants so we can take a
 7 break for lunch.
 8 We'll start with Mark Weinberger.
 9 MR. WEINBERGER: Thank you. Barbara, I'm
 10 going to respond to your -- you've asked a couple of
 11 times, too -- and maybe, Mike, you were going to do
 12 this, as well -- the point you make about, How does the
 13 auditor come in and evaluate tax work that's done by
 14 someone in the firm? How could have independence?
 15 Aren't they just going to bless anything that's there?
 16 And what safeguards are in place to try and deal with
 17 that? And I'm not sure it'll be terribly satisfying to
 18 you, based on your question, but I'm going to give it a
 19 shot.
 20 Obviously, the audit firm has a
 21 responsibility to the investors or the issuer, and the
 22 client is the audit committee. We are with them all
 23 the time. We serve them. We meet with them regularly.
 24 The last thing we want to do is give them tax advice
 25 that's going to let them down and somehow result in

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1 either a penalty or result in some restatement of
 2 something that's going to happen. So there's a huge
 3 vested interested not to let that happen.
 4 In addition, the audit practice, obviously --
 5 if any of you have been involved in a tax firm -- you
 6 go to the auditor who's responsible for the account.
 7 They're protective of all the issues and the
 8 professional responsibilities, and are certainly not
 9 likely to roll over, at least that's not been an
 10 experience I've seen.
 11 In addition, the PCAOB has begun rigorous
 12 inspection processes to look at all of our work that we
 13 do for our audit clients, and evaluate our tax
 14 provisions and our tax work. And there's an additional
 15 governor there. And then finally is the audit
 16 committee itself, which is that, if there's a
 17 transaction that's large, or any transaction, there has
 18 to be preapproval, and the audit committee has to get
 19 involved if the auditor does the work, which is an
 20 additional governor that, again, would not be there if
 21 the auditor did not provide the work.
 22 So while maybe not terribly satisfying, I
 23 wanted to just have an opportunity to give you what my
 24 thoughts are and the governors that are in place.
 25 MR. SCATES: Tom Ochenschlager.

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1 MR. OCHSENSCHLAGER: Tom Ochenschlager, with
 2 AICPA. I want to make this short, because I don't want
 3 to be the one that runs us into lunch here. I'm as
 4 hungry as anyone.
 5 But it's a principle of internal controls, of
 6 course, that you have more than one person sign off on
 7 a transaction so that you minimize the possibility of
 8 incorrect -- a mistake, or even fraud. So I think the
 9 more people you have sign off on a particular
 10 transaction, the better -- presumably, the better off
 11 you are and the less likely you're going to have
 12 problems with it.
 13 And alluding to what I mentioned before, if
 14 the auditor is also providing the tax services, you
 15 really have four levels of review that they're looking
 16 at this transaction. You have, of course, the
 17 management itself, and tax specialist, which you have,
 18 whether it was the inside -- it was the auditor -- or
 19 outside. But if it is the auditor, you have these two
 20 additional levels of review that are very, very
 21 important, I think, and we shouldn't under-emphasize
 22 those. You'll have the review of the audit committee
 23 itself, presumably down into the transaction, we hope
 24 -- to understand the transaction to make sure they
 25 approve of it. And, secondly, you have the review that

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1 I had alluded to earlier, that if it is the audit firm
 2 that's providing the advice, the audit staff of that
 3 firm also has to sign off on the financial statement
 4 presentation of that.
 5 Now, we know that -- we wouldn't be here
 6 today if that worked perfectly in the past, but a lot
 7 of changes have been made, and I think we'll find that
 8 those four reviews will work much more effectively in
 9 the future.
 10 I submit that if you use outside tax advice -
 11 - and certainly that's anyone's prerogative to do so --
 12 but using outside tax advice, based on my experience
 13 where I've had the clients in that situation, you will
 14 get more aggressive positions from the outside
 15 preparer, because, frankly, they don't have the
 16 responsibility -- or the onus or whatever you want to
 17 call it -- of having to report it on the financial
 18 statements. So they can take a much more aggressive
 19 position than the internal -- than the auditor -- than
 20 the auditor would permit their own tax staff to take.
 21 That's been my experience.
 22 MR. SCATES: Pat Walters.
 23 MS. WALTERS: Pat Walters, CFA Institute.
 24 I think I'm last. And it would be nice if I
 25 was last, because what I'd like to do is reiterate what

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1 Barbara said when she first commented, at the beginning
 2 of this particular session. So far, a few themes have
 3 arisen in the discussion here today.
 4 The first seems to me that audit firms
 5 absolutely want to be able to provide tax services to
 6 their audit clients. It also seems to me that some of
 7 the arguments that have been put forth are not very
 8 convincing. Familiarity, for example. So it would
 9 seem to me that an outside tax specialist could become
 10 familiar with the company just as easily as a new audit
 11 firm would become familiar with a company. It all
 12 depends on what the issuer wants and expects and
 13 contracts for from the various external parties with
 14 whom it does business.
 15 There is no -- doesn't seem to me any reason
 16 why a third-party tax specialist couldn't be expected
 17 to have a continuing relationship, providing all kinds
 18 of advice and planning, as well as tax-compliance
 19 services, to the issuer. It also seems to me that --
 20 from the discussions around the table, that it is
 21 almost self-evident that an auditor would be in a
 22 better position to argue against tax advice, tax
 23 strategy, from an external party than it would be from
 24 their partners within a firm.
 25 It's also interesting -- and I'm glad that

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1 Mike brought up the whole concept -- whole concept of
 2 the financial-reporting effect. Every tax strategy,
 3 every tax decision, has a financial-reporting effect.
 4 It's inconceivable to me that companies do not want to
 5 know, in addition to the tax effect, what that
 6 financial reporting effect is. Certainly, any issuer
 7 that I have sat across the table for when arguing about
 8 a financial -- a new financial-reporting standard --
 9 what the effect on the financial statements of every
 10 decision they make is important.
 11 It seems to me that if the auditor is
 12 involved heavily in providing advice and planning
 13 around all of these issues, then invariably they will
 14 be violating their -- the principle that they shouldn't
 15 audit their own work. Once the client begins to take
 16 the advice that the auditor gives that provides a
 17 particular financial-reporting effect, as well as a
 18 particular tax effect, the auditor will be in that
 19 position.
 20 Finally, I would like to reiterate one other
 21 thing that Barbara said. It would seem to me that
 22 independence always needs to trump these other issues.
 23 That's why we're around this table today. The
 24 integrity of the financial statements relies on the
 25 independence of the auditor. If there is any risk that

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1 that independence will be violated, then the best
 2 course of action is to not take that stance.
 3 I also think, finally, that we are putting
 4 audit committees in very difficult situations if we do
 5 not provide them with a lot of information about how to
 6 judge independence, in addition to these four
 7 principles. What kinds of questions should they ask a
 8 particular auditor who comes to them and is probably,
 9 at this point, the only one, in addition to management,
 10 arguing that they should be the firm who is given the
 11 tax-services contract? Other outside parties are not
 12 there at the table. It would seem to me audit
 13 committees are at a disadvantage in that respect in
 14 determining whether or not the independence of that
 15 auditor will be best served by providing them with
 16 those -- with that contract.
 17 MR. CARMICHAEL: Thank you. They're -- both
 18 of the questions on tax compliance and planning had a
 19 fee-structure element that we haven't touched on. So
 20 right after lunch, what I'd like to do is go to those
 21 questions for both services, see if we can get some
 22 information on whether there's commonality of fee
 23 structures, what are the differences between the two
 24 services.
 25 I'm going to ask you to come back at 1:00

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1 p.m., shorten your lunchtime a little bit, in the
 2 interest of staying on schedule and having time to
 3 cover those topics.
 4 Thank you.
 5 [Luncheon recess from 12:12 to 1:03 p.m.]
 6 MR. CARMICHAEL: I know everybody's not back
 7 yet, but in the interest of staying on schedule, if
 8 you'll take your seats.
 9 The first thing is that we do want to get
 10 some information on fee structures and what the fee
 11 structures typically are for tax-compliant services,
 12 and how they might differ, if at all, for tax planning
 13 and advice services. Any volunteers before I call on
 14 people?
 15 (Laughter.)
 16 MR. CARMICHAEL: Yes, Paul.
 17 MR. KOREN: Paul Koren, Goldstein Golub
 18 Kessler. Our answer is simple. We are a standard time
 19 charge firm and any services that we perform are billed
 20 at our standard time charges.
 21 MR. CARMICHAEL: Okay. Walter McNairy.
 22 MR. MCNAIRY: Walter McNairy with Dixon
 23 Hughes. I'll echo that comment with my firm. Rightly
 24 or wrongly, we have never really believed in value-
 25 added pricing. Maybe we left something on the table

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1 there, but our rate structure is just our standard
 2 hourly rates. We have one standard hourly rate for any
 3 service that we perform.
 4 MR. CARMICHAEL: Mark Weinberger.
 5 MR. WEINBERGER: For compliance, it's solely
 6 hourly or based on hours. Sometimes it's a fixed fee
 7 based on hours because they want to know when they sign
 8 up how much it's actually going to cost, so you
 9 estimate the amount of time and then you bill a fixed
 10 fee, but it's based on hours.
 11 And for consulting, any work that we provide
 12 for our audit clients is hours or based on hours as
 13 well.
 14 MR. CARMICHAEL: Scott Bayless.
 15 MR. BAYLESS: For Deloitte, it's fixed fee or
 16 time and expense.
 17 MR. CARMICHAEL: Bruce Webb.
 18 MR. WEBB: Bruce Webb, McGladrey. That would
 19 be true for our firm as well, hours at rates or fixed
 20 fees.
 21 MR. CARMICHAEL: Rich Angelone.
 22 MR. ANGELONE: My name's Rich Angelone. I'm
 23 here on behalf of the ABA. I'm also the tax chair of
 24 our tax committee. I can speak for my own company that
 25 what we saw in the past were contingency fees, and I

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1 think in recent times, and I'd say over the last two
 2 years, it's on a fixed-fee basis that we see tax
 3 services.
 4 MR. CARMICHAEL: Dean Uminski.
 5 MR. UMINSKI: Dean Uminski with Crowe Chizek.
 6 I would have to agree with Mark and Scott, primarily
 7 standard hourly rates, in some cases fixed fees.
 8 MR. CARMICHAEL: Any other information? Okay,
 9 then let's move to the next topic. Bella Rivshin is
 10 going to lead us through that starting with tax
 11 strategy services.
 12 MS. RIVSHIN: Good afternoon. Our next topic,
 13 tax strategy services, includes a development of tax-
 14 motivated, structured transactions, occasionally
 15 referred to as tax products. These tax products are
 16 designed to enable a company to reduce its tax
 17 liability or achieve a financial accounting result.
 18 Let's now turn to our first question. Does
 19 an accounting firm sale of tax strategies or tax
 20 products to audit clients affect the firm's
 21 independence from the audit client? Are there
 22 different independence considerations depending on
 23 whether the tax strategy or product is designed to
 24 reduce tax liability or to achieve a financial
 25 statement result?

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1 Okay, Mike Gagnon.
 2 MR. GAGNON: Silence is deafening. It
 3 obviously is a critically important topic. I think we
 4 did touch upon it a bit this morning. I do think it's
 5 important to differentiate here what I'll call tax
 6 advantage or inappropriate tax strategies, tax
 7 advantage transactions. I do think it impacts a firm's
 8 independence and not in a positive way. I think that
 9 kind of activity should not be performed by an audit
 10 firm, should not be provided to its audit clients. I
 11 think the current independence rules basically touch
 12 upon it in terms of the background, but point to the
 13 audit committee in its oversight to consider these.
 14 I would encourage a reconsideration of that,
 15 because I don't believe -- I think clarity in this area
 16 is better than, I'll call it flexibility, in terms of a
 17 discussion or a dialogue with the audit committee,
 18 because I don't believe from an integrity perspective,
 19 something we've talked about and at least believe that
 20 very, very important to the financial markets from that
 21 perspective, I do think it is inappropriate, and would
 22 urge a reconsideration of that.
 23 The second question really talks about, well,
 24 is there a difference here between that, and if there's
 25 a tax result or something to achieve a particular

<p style="text-align: right;">Page 102</p> <p>1 financial accounting result. Here, I don't think 2 that's appropriate either. I think certainly tax 3 advisers ought to be providing tax advice, they ought 4 to be looking at facts and circumstances, understanding 5 the organization, understanding its structure, and 6 providing appropriate and clear tax advice on the basis 7 of those findings.</p> <p>8 And I do not believe that providing that sort 9 of advice with a goal to achieve a particular financial 10 accounting conclusion is appropriate.</p> <p>11 MS. RIVSHIN: Colleen Sayther.</p> <p>12 MS. SAYTHER: I actually put my card down 13 because I just would reiterate everything that Mike 14 just said, so I would answer yes and no.</p> <p>15 MS. RIVSHIN: Okay. Jeff Steinhoff.</p> <p>16 MR. STEINHOFF: I will reiterate the same 17 thing, but to say that it seems to me fairly clear from 18 the current four overarching principles that these 19 things would be very problematic. And, as Mike, I 20 don't see any difference between the tax side or the 21 financial reporting side. You would have problems with 22 those overarching principles.</p> <p>23 MS. RIVSHIN: Jim Brasher.</p> <p>24 MR. BRASHER: Thank you. We believe that in 25 the spirit of good governance, the auditing firms</p>	<p style="text-align: right;">Page 104</p> <p>1 independent third-party opinion. 2 And finally, we do a post-implementation 3 review to ensure that the advice has been implemented 4 properly.</p> <p>5 MS. RIVSHIN: Scott Bayless.</p> <p>6 MR. BAYLESS: At Deloitte we follow a similar 7 procedure, have significant quality control risk 8 analysis of products to ensure that, one, they're not 9 provided to SEC audit clients, and two, that they go 10 through a very rigorous process as determined from 11 people that are not compensated as a result of those 12 products.</p> <p>13 MS. RIVSHIN: Nick Cyprus.</p> <p>14 MR. CYPRUS: I'm going to stay consistent to 15 where I was this morning, as unpopular as it might have 16 been. I think anything that puts the auditor in the 17 form of originating, so tax strategy, if they're 18 originating a tax strategy for a company, I think it's 19 a problem. And whether it's a tax strategy or some 20 other advice to get around an accounting thing, I think 21 that's a problem.</p> <p>22 MS. RIVSHIN: Pat Walters.</p> <p>23 MS. WALTERS: As I said before lunch, I think 24 it's almost impossible for a tax strategy or product to 25 not have a significant financial reporting result, and</p>
<p style="text-align: right;">Page 103</p> <p>1 should not sell tax strategies to an audit client that 2 lack business purpose and economic substance. We do 3 believe that we should be continuing to provide 4 traditional tax advice and compliance services, and of 5 course, all such services have to be approved by the 6 audit committee in any event, and that we think the 7 provision of such services is consistent with sound 8 public policy.</p> <p>9 However, in addition, at KPMG we've 10 instituted the following risk procedures when we bring 11 an idea, a planning idea, to a client, which is 12 material to the financial statements. First of all, 13 the tax planning, of course, must be technically sound 14 and customized to the client's facts. We're not 15 marketing any pre-shrink wrapped or ideas of that 16 nature. The idea must be approved by our partner in 17 charge of tax risk and regulatory affairs who is 18 totally independent of the tax function. That's an 19 oversight provision in our firm.</p> <p>20 The planning idea must have economic 21 substance and business purpose, and we tell the audit 22 committee of the audit client that they must obtain a 23 third-party opinion from an independent firm of their 24 choosing, not somebody that's lined up or recommended 25 by us, but they need to go out and obtain an</p>	<p style="text-align: right;">Page 105</p> <p>1 it's inconceivable to me that companies would not take 2 that into account as a joint decision-making situation. 3 And therefore, I would have significant difficult with 4 auditors who engage in either of these particular types 5 of advising to companies.</p> <p>6 MS. RIVSHIN: Barbara Roper.</p> <p>7 MS. ROPER: I agree, and I think -- earlier I 8 said I think there are certain areas where it is 9 incumbent upon the PCAOB to ban certain services in 10 certain areas where audit committees need to be given 11 guidance on how to evaluate them. I think this is an 12 area where we need a ban on -- and then the challenge 13 is where you draw the line between those types of tax 14 strategies or products that are banned and what is 15 permissible, and I think that is an appropriate area to 16 supplement the ban with guidance to audit committees on 17 how they make a distinction between what's appropriate 18 and what's inappropriate.</p> <p>19 MS. RIVSHIN: Damon Silvers.</p> <p>20 MR. SILVERS: I want to echo what Barbara said 21 and I want to remind people about something that 22 predates the latest round of -- the scandal around sort 23 of prepackaged, mass-marketed type strategies, and go 24 back to Enron. When Enron collapsed, in the initial 25 round of hearings, there were a series of statements by</p>

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1 Arthur Andersen in those hearings that Arthur Andersen
 2 was not involved in structuring the special purpose
 3 entities that were at the heart of what was wrong with
 4 Enron. These were entities that both could be
 5 characterized as tax planning structures and also
 6 obviously structures for affecting the shape of the
 7 GAAP financials of Enron.
 8 Andersen sought to deny that they were
 9 involved in structuring them in the initial hearings.
 10 Of course, it turned out that they were lying. Much of
 11 the AFL-CIO's concern about this issue of auditor
 12 independence and particularly around tax issues arose
 13 out of that experience, and our sense that our members
 14 as investors directly and through our pension plans
 15 were seriously endangered by the practice of audit
 16 firms structuring these off-balance sheet vehicles, and
 17 then auditing their own work.
 18 We believed that the combination of the
 19 statutory language in Sarbanes-Oxley plus the guidance
 20 that -- the principles that we were discussing earlier
 21 this morning would be a very strong signal to audit
 22 firms that they were not to do this. I just no longer
 23 have that belief and I believe that the PCAOB needs to
 24 provide exactly what Barbara said, clear -- that this
 25 sort of stuff needs to be banned and that there needs

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1 to be clear guidance given both to audit firms and to
 2 audit committees as to where the lines are. It is not
 3 acceptable, and again I think that Nick Cyprus'
 4 comments are completely correct. It is not acceptable
 5 to have an audit firm creating the structures they
 6 audit.
 7 MS. RIVSHIN: Mark Weinberger.
 8 MR. WEINBERGER: Thank you. I would say that
 9 certainly I would agree that the rule that's currently
 10 out there, which says that there should be careful
 11 scrutiny of these transactions where sole motivation is
 12 tax aid without business purpose, could go further and
 13 it should be banned frankly from audit firms providing
 14 it to their audit clients or others.
 15 I think that the audit committees are there,
 16 but clarity there would certainly not hurt. And I
 17 agree with Barbara's comment that once you go beyond
 18 that, it's a lot more difficult to define, and that's
 19 really I think where the other harder issues arise.
 20 MS. RIVSHIN: David Shedlarz.
 21 MR. SHEDLARZ: Yes, I would agree as well that
 22 this is inappropriate activity for the outside
 23 accounting firm. But at the same time, and just
 24 drawing back to this morning's conversation, I think it
 25 has to be done with a mind towards what is acceptable

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1 tax advice and tax service.
 2 A lot of discussion this morning surrounded
 3 auditor independence and the extent to which that may
 4 actually be advanced by distancing the accountant from
 5 this particular area. I would suggest to you, given
 6 the complexity of this particular area, and I draw upon
 7 the one I deal with day in and day out, operating in
 8 140 countries around the world, filing over 1,000 tax
 9 returns, that if the outside accounting firm in terms
 10 of its advice and planning posture gets too far afield
 11 of this, then you'll find that you're actually
 12 compromising their independence. There is a heavy
 13 utility to knowledge and understanding in this area.
 14 So I think there are a host of things that
 15 may have been sponsored in the past which are
 16 inappropriate, and this is an excellent example. But I
 17 encourage the committee to take a look at what is
 18 acceptable practice in this particular area, because I
 19 believe it is instrumental in terms of having effective
 20 independence of the accounting firms that they be
 21 knowledgeable about the transaction.
 22 MS. RIVSHIN: Lynn Turner.
 23 MR. TURNER: I think it's actually encouraging
 24 and a very positive sign to hear some of the firms talk
 25 about the fact they don't think some of the tax

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1 strategy stuff goes hand in hand with auditor
 2 independence, and especially on the comments I've heard
 3 today about tax opinion letters that people have been
 4 issuing in the past. Just as we've banned them on the
 5 financial reporting side, I think they ought to be
 6 banned on this side, on the tax side as well. I do
 7 think that causes a problem.
 8 But going back to what Barb said, I think
 9 this becomes more of a question of where you slice
 10 things and how you define things, because while people
 11 may say, we don't do tax strategy services, what they
 12 all do is they'll go in and help you with your
 13 international operations, they'll help you identify the
 14 right countries to be in, then with their foreign
 15 affiliates they'll help you identify how to structure
 16 that international operation in the right international
 17 company with the right type of royalty or other type of
 18 revenue arrangements to get those revenues outside the
 19 U.S. along with the income and get taxed offshore.
 20 To me, everyone's doing that and that's a
 21 pretty clear tax strategy. And so when people say, we
 22 aren't doing tax strategy, that's a misnomer, because
 23 there's every one of the firms are turning around and
 24 doing that. So I think it depends upon how you define
 25 it, whereas it sounds like everyone attempts to say we

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1 shouldn't do tax opinion letters, maybe that's a
 2 starting point, but then it becomes how far down that
 3 path do you go?
 4 And that's where I come back to, if there
 5 isn't clear-cut support for what you're doing in the
 6 code, if the likelihood of prevailing starts to drop,
 7 then you put the auditor in the role of being an
 8 advocate, and I think that's where you need to turn
 9 around and start cutting it off, and as I heard someone
 10 say, provide some guidance to the audit committees.
 11 I can tell you the O'Malley Panel, who
 12 thoroughly researched this, did put out nine criteria,
 13 very good criteria, that the SEC has repeated for audit
 14 committees to look at, and I think if you applied those
 15 nine criteria to a number of these things, you'll find
 16 that they don't stand up against the test.
 17 MS. RIVSHIN: Mark Anson.
 18 MR. ANSON: Mark Anson from CALPERS. First,
 19 with regard to the first half of question 6, does the
 20 accounting firm's sale of tax products affect their
 21 independence? The answer is absolutely. Accounting
 22 firms' audit firms are supposed to audit the arm's-
 23 length transactions of the corporation, and in the
 24 first part of that question they go from auditing the
 25 arm's-length transactions to taking part in the arm's-

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1 length transaction with the public company. How can
 2 that be independent?
 3 Second, with regard to the second part of
 4 that question, I think it's particularly, the issue of
 5 independence is particularly acute when the tax
 6 strategy is sold to achieve a financial statement
 7 result. The whole point of the auditor is to audit the
 8 financial statements, but now they're affecting the
 9 financial statement of results and they're then going
 10 to audit that? How can that possibly be independent?
 11 MS. RIVSHIN: Mark Weinberger.
 12 MR. WEINBERGER: I just wanted to follow up
 13 on, I guess, Lynn's point, because it is -- obviously
 14 we're all giving our opinions and it's all being
 15 interpreted and the words up there on the page mean
 16 many different things to many different people. When
 17 you described, Lynn, the situation you're talking about
 18 where an auditor advises a business on business issues
 19 that are unique to that company and they have a
 20 knowledge of that business and they're going to go in
 21 and advise tax advice on how to pay the appropriate
 22 amount of tax, I did not mean to suggest that we would
 23 say that we don't think that auditors should provide
 24 that.
 25 What I was referring to, in my comments at

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1 least, was those situations where there is no business
 2 purpose, it's solely tax-motivated, and where it's mass
 3 marketed and it's not tailored to an individual client.
 4 I think those are very, very different situations.
 5 MS. RIVSHIN: Paul Koren.
 6 MR. KOREN: Well, I certainly think it's clear
 7 that the answer to number 6 is we shouldn't. But I'm a
 8 little -- I think I'd like to readdress something. If
 9 we say that the auditor should do nothing but audit,
 10 and that's certainly be eloquently expressed here
 11 today, then in giving our views to the Board, there
 12 really isn't much further discussion as to what are the
 13 gradations of what you could do.
 14 If the Board doesn't turn the light off and
 15 keeps the light on, then I think it's important that
 16 perhaps we should share some of the ideas which might
 17 be appropriate, again always recognizing that the
 18 investor community has its choice of doing what it
 19 wants.
 20 Our firm does provide tax planning. We don't
 21 do any of the tax strategy services. And I had one of
 22 our tax partners, who uses, I guess, complex phrases,
 23 kind of describe for me what we do and what we believe
 24 is, well, professional, and doesn't impact us. And his
 25 phrasing is, in discussing a service, which in his view

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1 and our view doesn't conflict for auditors, it's
 2 planning using methods of structuring business
 3 transactions, which are within the common knowledge of
 4 sophisticated tax practitioners, supported by the code
 5 regulations and case law with an absence of conflict
 6 that we would be sharing the benefit between us and the
 7 client, creating a partnership.
 8 That's the way we've approached it, and
 9 obviously we wait for whatever comes out of these
 10 particular hearings to see whether that still is
 11 appropriate.
 12 MS. RIVSHIN: Okay. Let's move on to the next
 13 question. If the IRS or other tax regulator challenges
 14 a tax strategy designed or marketed by the issuer's
 15 auditor, what, if any, should the auditor's role be in
 16 resolving the challenge?
 17 Sure, Lynn. Go ahead.
 18 MR. TURNER: Nothing. This gets into the
 19 defense and advocacy. If you bring in the auditor into
 20 trying to get involved with the defense or something, I
 21 just don't see how this could ever be viewed as being
 22 consistent with the auditor being unbiased. They've
 23 got to act as they aren't going to sit there and go to
 24 the IRS and say, yeah, we owe you the taxes, because
 25 it's just inconsistent that you could ever be in a

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1 position, and this is exactly one of the reasons we put
 2 the advocacy principle in the four principles.
 3 MS. RIVSHIN: Bruce Webb.
 4 MR. WEBB: If we're talking about strategies
 5 in terms of the mass marketed and everything else we
 6 just said shouldn't be permitted in the first place,
 7 then I have to absolutely agree with Lynn. On the
 8 other hand, if you're talking about an auditor
 9 assisting a client with an IRS examination or something
 10 regarding a position that was taken on the return, I
 11 don't see how that's any different than an auditor
 12 dealing with the Office of the Chief Accountant when a
 13 client's accounting position is being challenged.
 14 You've had to do the research, you've had to reach a
 15 conclusion, and you have an obligation to state the
 16 basis for your conclusions.
 17 MS. RIVSHIN: David Shedlarz.
 18 MR. SHEDLARZ: I hate to do this and I may
 19 regret it, but I'd have to agree with Lynn on this.
 20 (Laughter.)
 21 MR. SHEDLARZ: I don't think much of anything
 22 under these circumstances.
 23 MS. RIVSHIN: Anyone else?
 24 Barbara Roper.
 25 MS. ROPER: I just think this question takes

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1 us back to the point Lynn made earlier that part of how
 2 you draw the line between what's permissible and what's
 3 impermissible is how likely you're going to end up in
 4 this situation. If you're talking about a position
 5 you've taken that is supported by case law and
 6 supported by the regulations and not considered
 7 controversial, you're in a very different position for
 8 one that's likely to put you in the position of finding
 9 yourself before the IRS.
 10 And if I'm not mistaken, I think in his
 11 comment on the SEC rule proposal, Lynn drew a
 12 distinction between the role of being a fact witness
 13 and serving as an advocate. I don't know if that's
 14 relevant here, but I think there's a difference from
 15 being in a position of explaining the reasoning that
 16 went into a situation and actually trying to defend a
 17 client's position.
 18 MS. RIVSHIN: Jeff Steinhoff.
 19 MR. STEINHOFF: I think it's an extremely
 20 difficult issue. I think the auditor's already got
 21 some issues already, even before they get to this
 22 stage. So if the issue is, will they impair their
 23 independence, perhaps no more than it already has been
 24 already. And I guess from a fundamental gut feeling
 25 is, if the auditor has designed this and marketed it to

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1 the client, going really building in what Barbara said,
 2 I think they have a responsibility at least to explain
 3 to the IRS what they marketed. Otherwise, the client's
 4 kind of hung out to dry there.
 5 So maybe they don't go and fight it in their
 6 day of court, but at least they have some
 7 responsibility to explain it, because it's their
 8 strategy really. It's not so much the client if it's
 9 one they've developed for the client. I'm assuming
 10 this was a packaged or marketed strategy, and it's
 11 possible the auditor has sold that strategy many times.
 12 So I would think that they would be expected to defend
 13 that under some code of ethics or something.
 14 MS. RIVSHIN: Mark Weinberger.
 15 MR. WEINBERGER: Thank you. I would agree. I
 16 think we have the same issue. If you believe the
 17 underlying service that the auditor is providing is one
 18 that's legitimate for the auditor to provide, and it
 19 would seem to be very difficult to then say, they've
 20 already taken a position on it, they said it works from
 21 a tax standpoint, they're going to sign off on the
 22 financial statement that they believe it works from a
 23 financial statement standpoint the way it's treated, to
 24 suggest that there's something odd that they would be
 25 of the opinion to be able to help out the taxpayer to

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1 get it right, I'm not sure I would agree that that's a
 2 problem.
 3 Particularly, if you're talking about the
 4 aggressive mass-marketed, as we've just discussed, if
 5 you don't believe those should provide, it's easier to
 6 get there. But if you think about a tax return, for
 7 example, major companies, big companies are audited in
 8 the large-case audit every year. You often are
 9 involved in the audit helping that client work through
 10 the issues, and in that case you are explaining and
 11 advocating the positions on the return for the client.
 12 To say that the auditor couldn't do that, and
 13 somebody else would have to come in and understand and
 14 grasp all those issues and everything that went into
 15 them, if the auditor did the work, did the reporting, I
 16 think it would be extremely burdensome on the issuer.
 17 MS. RIVSHIN: Damon Silvers.
 18 MR. SILVERS: I think it's -- it may not be
 19 that well known, but this is one very unusual exception
 20 to the general iron grip that the legal profession has
 21 on the business of representing people in litigation
 22 environments. And so there really -- it's common for
 23 audit firms, for integrated accounting firms to play
 24 the role of the lawyer before the IRS in these matters,
 25 and the -- that puts a particular edge on this question

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1 in a way that not everyone may appreciate, because the
 2 question is not -- the question as posed is not
 3 actually the question of, should the audit firm be
 4 allowed to come and explain its thinking? It's, should
 5 the audit firm be the advocate for the issuer in front
 6 of the Commission? And it's very hard for me to see
 7 how that squares with the principles, and I think it's
 8 a particularly serious conflict with those principles.
 9 Secondly, I think that the discussion that
 10 we've just had around the kind of contradictions one
 11 gets into around this question shows that the real
 12 problem here is the notion of the audit -- of an audit
 13 firm simultaneously selling a management strategy to
 14 the audit client. That just doesn't work, and that you
 15 get into all kinds of problems, this one of advocacy
 16 being one of them, once you cross over that line.
 17 MS. RIVSHIN: Scott Bayless.
 18 MR. BAYLESS: I think it's important to
 19 remember in this context that taking the prepackaged
 20 offerings or strategies off the table, you're left with
 21 tax advice and whether that tax advice is provided by a
 22 third party, not the auditor, or the auditor, the
 23 auditor is going to have to reach a conclusion as to
 24 the appropriate tax treatment in that context. And the
 25 very difficulty at that juncture is whether, when

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1 challenged, the auditor is in the position of a fact
 2 witness or an expert witness or acting in an advocacy
 3 capacity when describing its own analysis, the audit
 4 firm's own analysis, as to the appropriateness of the
 5 tax treatment, even though it might not have been the
 6 firm that provided that strategy for that tax planning
 7 issue.
 8 It makes it very difficult in that context,
 9 and you have to keep that in mind. If an audit firm is
 10 permitted to go through its own analysis and provide
 11 its own conclusion, it ought to be able to do that
 12 whether or not it provided the tax planning advice.
 13 MS. RIVSHIN: Colleen Sayther.
 14 MS. SAYTHER: Colleen Sayther, Financial
 15 Executives International. And as a company, I would
 16 want an advocate sitting by my side discussing -- I'm
 17 sorry, sorry to interrupt that.
 18 MS. RIVSHIN: Can you repeat what you were
 19 saying?
 20 MS. SAYTHER: Yes, I was -- as a company I
 21 want to make sure I have an advocate by my side if I'm
 22 going to the IRS to defend a tax strategy. And I think
 23 that the operative words here are designed and marketed
 24 by the issuer's auditor, and I think if you look at the
 25 principle disallowing the auditor to be an advocate for

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1 you, you get there, and you basically would not -- it's
 2 not appropriate to use your auditor for designing and
 3 marketing with respect to tax strategies if they
 4 designed and marketed.
 5 MS. RIVSHIN: Pat Walters.
 6 MS. WALTERS: I actually think Colleen summed
 7 it up well, because I think Mark's arguments in favor
 8 of having the auditor appear before the IRS really
 9 taken in the opposite direction argues against them
 10 doing any of these activities, because if they have
 11 designed and marketed this tax strategy, if as the
 12 auditor they have opined that it's okay, then you're
 13 right, they should be standing there saying, we think
 14 this is a good idea.
 15 I think because I don't think that that's
 16 appropriate for them, working backwards, they shouldn't
 17 be auditing their own firm's work and they shouldn't be
 18 marketing the strategies to the companies that they
 19 audit. It just seems to me that if the final
 20 conclusion is they shouldn't be acting as an advocate
 21 for the company, which they would invariably be doing,
 22 they shouldn't have gotten themselves in the position
 23 where they had no alternative but to do that.
 24 MS. RIVSHIN: Okay. Mike Gagnon.
 25 MR. GAGNON: I think the discussion is a good

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1 one and it highlights the challenges that we're facing
 2 in terms of marketed strategies and advice to a client
 3 on tax matters driven by specific facts and
 4 circumstances, and then tax compliance services in
 5 preparing tax filings. And I do think it requires an
 6 in-depth discussion, and there are differences. I
 7 think we've all talked this afternoon about the notion
 8 of abusive tax shelters and mass-marketed programs are
 9 not appropriate, and certainly if that were to have
 10 been done, the answer to this question I think is clear
 11 to most in the room that it's not appropriate.
 12 Where I think there is some difficulty and
 13 maybe even some ambiguity is the notion of advice, tax
 14 advice, being provided by an auditor on some particular
 15 matter at the client, and a position then taken by the
 16 client with respect to that advice and a filing
 17 position made.
 18 And it does highlight in my mind the
 19 challenges that we face here in terms of the four
 20 overarching independence principles. Fundamentally, I
 21 believe our tax system is, if you will, an advocacy
 22 system. Lynn said it this morning that we would all
 23 prepare our tax returns in a manner that's consistent
 24 with the tax laws, but in a manner that would be
 25 designed consistent with those laws to minimize our

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1 taxes. That's the way the system works and I think, at
 2 least in the basic premise, we would all agree with
 3 that.
 4 In terms of filing positions and actions and
 5 thoughts and independent objective opinions taken by
 6 auditors, I do think under those circumstances it is
 7 appropriate to explain positions taken, bases for those
 8 positions, and authority for those positions to the IRS
 9 or other taxing authority. And here is where I think
 10 there are issues and the debate, or at least the
 11 discussion, ought to be explored, because given the
 12 inherent, at least as I would articulate it, advocacy
 13 inherent in the tax system, advocacy services are an
 14 independence issue, and it is certainly one of the four
 15 basic principles. And I think that topic is one that
 16 is difficult to reconcile, it ought to be explored,
 17 because it's a very difficult one, but under certain
 18 circumstances I think are appropriate.
 19 Just one last comment on there. I do think
 20 today in the context of audit committee oversight,
 21 review, and approval, there are in fact -- and
 22 assuming, as Lynn alluded to earlier, assuming -- and I
 23 think it's absolutely imperative that audit committees
 24 be given full disclosure of services being provided,
 25 which I think is a very good thing, certainly in the

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1 audit context a very good thing -- I do think that
 2 ought to bear on how we think about these things.
 3 MS. RIVSHIN: Nick Cyprus.
 4 MR. CYPRUS: Mike, I'm in agreement with a lot
 5 of what you said, but there is a thing Lynn brought up
 6 that probably is, at least for me, an age-old question
 7 that I deal with. Lynn, you said this morning that
 8 clients can put something they only had a 40 percent
 9 chance or less than 50 for sure on their tax return.
 10 And I get into the point is, when is it -- is that the
 11 right thing -- when is it the wrong thing to do? When
 12 you think you will not prevail with the service and
 13 it's less than a 50 percent chance, okay, that goes on
 14 your return, it just bugs me.
 15 And then, of course, what you'll see is
 16 they'll turn around on the other side and take 100
 17 percent provision for it, right? So we'll set up a
 18 reserve and in fact we'll accrue interest and penalties
 19 on that reserve.
 20 Somehow that issue just really -- and you see
 21 it a lot. To me, and this is simple, so if I believe
 22 that I have a valid deduction to take on the return
 23 then I'm not so sure I want to provide for it, because
 24 how could you -- which branch of the government are you
 25 lying to? I know it's simplistic thought, but if you

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1 take it, you believe you're going to prevail, reserving
 2 for it at the same time drives me crazy, and yet I know
 3 it's prevailing practice, so you see it out there quite
 4 a bit.
 5 But I had to comment on that, because that's
 6 an issue that I think somehow, and probably not at the
 7 PCAOB level, needs addressed.
 8 MS. RIVSHIN: Okay. Let's move on to our last
 9 question in this area. Is it appropriate for the
 10 auditor to audit the financial statement of facts of a
 11 tax strategy the auditor's firm sold to the company?
 12 If another firm sold the company the tax strategy, are
 13 there independence implications if the auditor's firm
 14 markets the same strategy to other companies?
 15 Barbara Roper.
 16 MS. ROPER: If you preclude them from selling
 17 these kinds of services to their audit clients so that
 18 they are not a potential competitor for the provision
 19 of those services, then you should, if not remove, at
 20 least ameliorate any possible conflicts that would
 21 result.
 22 MS. RIVSHIN: Pat Walters.
 23 MS. WALTERS: I just have a really dumb
 24 question here for the firms. If your tax department is
 25 designing strategies for your audit clients or others

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1 to implement, doesn't the audit part of the firm have
 2 any input to whether or not those would be legitimate
 3 strategies from an audit perspective? I mean, there's
 4 just some sort of disconnect here that is escaping me.
 5 So either the strategy is legitimate or it isn't, and
 6 if it's not legitimate, nobody should be selling it,
 7 and auditors should be out there saying, this, we're
 8 just not going to give clean opinions if you implement
 9 this strategy. So what am I missing?
 10 MS. RIVSHIN: Mark Weinberger.
 11 MR. WEINBERGER: Pat, I think you're
 12 brilliant. I don't think that was a stupid question.
 13 I think you hit the nail on the head frankly, which is,
 14 if a tax strategy works, then the only question is,
 15 what is the appropriate financial accounting treatment
 16 for it that the auditors determine, not the tax people?
 17 The tax people determine whether or not the transaction
 18 works under the tax law. The auditors then come in and
 19 determine what is the treatment from financial
 20 statement purposes with regard to that transaction.
 21 So looking at this question, if the
 22 transaction works and you -- it's a type of a service
 23 that you all conclude is one that auditors should
 24 provide, then I don't see any problem with the audit
 25 firm doing it, and then the audit firm obviously

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1 reviewing it, the audit site reviewing the financial
 2 statement consequences from it.
 3 The second question raises an issue I'm not
 4 sure I fully understand, but I guess if it goes to --
 5 if you provide a strategy to a non-audit client, is the
 6 -- I guess there's a suggestion somehow that could come
 7 back and impair your independence from a client that
 8 you don't even provide that strategy to. I think that
 9 would be very hard to effectuate. I don't really
 10 understand what that question goes to.
 11 MS. RIVSHIN: That part of the question goes
 12 to if two separate audit firms are providing the same
 13 types of tax strategy, and audit firm number A provides
 14 it to company X and audit firm number B provides it to
 15 company Y, and A is the auditor of Y, then is there,
 16 since it's the same strategy, is there any difference?
 17 MR. WEINBERGER: I think the answer is F.
 18 (Laughter.)
 19 MS. RIVSHIN: Okay.
 20 MR. WEINBERGER: I think obviously the issue
 21 there is, the one I would raise is, there's no -- I
 22 mean, we're talking about strategies. Again, this is
 23 hard because sometimes you know too much about the
 24 details of some of the tax laws, but there's really not
 25 one strategy per se that you come out with if you're

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1 not mass marketing, which we said we shouldn't be
 2 doing, and doing a transaction for a client, kind of as
 3 Lynn described before, you may have a similar fact
 4 pattern for a client who has operations in different
 5 parts of the world that you have a structure that helps
 6 them minimize their taxes. That is totally, absolutely
 7 legal, and we all agree that you shouldn't pay more tax
 8 than you owe under the law.
 9 If you have another taxpayer who happens to
 10 have similar facts and they have a similar, use similar
 11 parts of the tax code to reach that result, I think it
 12 would be hard to say that you would be not independent,
 13 so to speak, in either of those circumstances.
 14 MS. RIVSHIN: Damon Silvers.
 15 MR. SILVERS: I have two points about this.
 16 The first is that while it's true that the tax -- if
 17 you have an integrated firm that provides both tax and
 18 auditor services, the tax people do -- are responsible
 19 for determining whether, in their capacity as tax
 20 consultant, whether their tax treatment is correct. Is
 21 it not the case though that as the auditor, for GAAP
 22 purposes, you have to, you have a responsibility for
 23 reviewing the tax -- the tax line, so to speak, on the
 24 GAAP statement, and thus providing the audit side
 25 opinion that the way in which taxes figure into the

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1 company's GAAP financials is accurate?
 2 It seems to me this once again goes to the
 3 point that these are indeed separate functions, but
 4 they look at the same thing, and to say that -- for the
 5 audit side to defer to the tax side on the audit
 6 implications of the company's tax behavior seems
 7 problematic.
 8 Secondly, in relationship to the question
 9 asked, is there a conflict, I think the answer is yes,
 10 but how much the conflict, how big the conflict is
 11 depends completely, I think, on what Mark was talking
 12 about, which is how customized is this, or how mass-
 13 marketed is it? The more mass-marketed, the greater
 14 the conflict.
 15 What is very clear though is that when -- is
 16 that the greatest degree of conflict is, of course,
 17 when it's the same firm that is marketing to the --
 18 that is both marketing to and passing on for audit
 19 purposes the strategy. Then it doesn't matter whether
 20 it's mass-marketed or customized because then, right,
 21 you're actually looking at the real thing, not some
 22 comparable or similar thing or maybe similar thing.
 23 I think this is an example of the -- of
 24 something that's true in corporate governance in
 25 general, which is that there are conflicts and there

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1 are conflicts and there are conflicts, and that it's
 2 important to get to the big conflicts first and some
 3 conflicts you'll never get to, because they're sort of
 4 endemic to the nature of the way the corporate form
 5 works or the audit function works, and that as long as
 6 we have audit firms that also provide tax services to
 7 somebody, anybody, and it's worth noting where those
 8 conflicts are and reining them in as much as possible.
 9 But I think it would be a very grave mistake
 10 to say, oh well, you know, there are conflicts, no
 11 matter what we do there will be some conflicts left
 12 over, so then let's do nothing. That would be the
 13 wrong approach.
 14 MS. RIVSHIN: Jeff Steinhoff.
 15 MR. STEINHOFF: First, I want to put context
 16 to the way I read this question. I saw this as a
 17 follow-on to the previous question, so when you talk
 18 about tax strategy, you're not talking about routine
 19 tax advice, you're talking about something structured
 20 to really reduce tax liability or change the accounting
 21 treatment in some manner. And I think there was pretty
 22 much unanimity that people did not think that that was
 23 a proper role.
 24 I think in looking at the second part of your
 25 question, if someone else actually sold that strategy,

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1 but you were fully able to sell it yourself, because
 2 you were also marketing it, I think you have to look at
 3 substance over form. If one's going to be concerned
 4 about whether you're independent in auditing the
 5 transaction, the fact that you're marketing the same
 6 strategy, I think, would be the same thing. So I don't
 7 really see any difference in substance between those
 8 two. It really gets down to how one defines. I think
 9 it will be important for the PCAOB to properly define
 10 what these terms mean and take the 10, 15, 20 different
 11 types of tax services provided and be very clear as to
 12 what would be allowed and what wouldn't.

13 But if tax strategy structuring, that kind of
 14 thing would not be allowed, and your firm in fact was
 15 selling that same thing or it sold that same thing, I
 16 would think you would have some independence problems.

17 MS. RIVSHIN: Barbara Roper.

18 MS. ROPER: When I looked at this question
 19 initially, I was looking at it from one point of view,
 20 which is that if you're offering a competing product
 21 and you're an auditor, as we know has occurred in some
 22 instances, who is being strongly encouraged by your
 23 firm to market your firm's products, then you have an
 24 incentive to say, well, you know, this thing over here
 25 you're using is really inappropriate and we've got

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1 something comparable but superior that we think solves
 2 some of these problems.

3 So you have an independence problem, I think,
 4 there as a potential competitor. There's, of course,
 5 the conflict on the other side, which is if your firm
 6 is marketing something that's virtually identical, you
 7 are potentially put in a very difficult situation to
 8 say that this is somehow inappropriate. And so I think
 9 on either -- whichever way you look at the conflicts,
 10 they exist and they are a potential problem, which I
 11 think brings us back to the same thing, why we don't
 12 want audit firms marketing strategies to their audit
 13 clients.

14 MS. RIVSHIN: Pat Walters.

15 MS. WALTERS: I actually have like two things
 16 I want to say and then a question. I would like to
 17 echo what Mr. Steinhoff said about the difficulty in
 18 understanding the differences between tax advice, tax
 19 planning, tax strategy, and then tax products, and how
 20 -- where on this continuum of all of these things we
 21 might say there is some legitimacy to the audit firm
 22 being involved. I use that vague term specifically.

23 The second thing I would like to say is that
 24 no tax strategy only affects the taxes payable and
 25 deferred tax aspects of the financial statements.

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1 Every strategy designed to reduce your tax liability
 2 has other financial statement and disclosure effects.
 3 I was very -- I don't know whether the word is
 4 delighted or horrified -- to hear Nick explain about
 5 the provisions that I doubt are adequately disclosed
 6 anywhere in the footnotes about tax strategies that may
 7 be implemented but there's a less than 50 percent
 8 chance that they're going to be accepted by the IRS.
 9 I'll have to go back and look at a few financial
 10 statements when I get home.

11 So I think that we really have to keep in
 12 mind that all of these things have much wider effects
 13 on the financial statements than simply tax, and that
 14 the wider those effects, the more concern investors
 15 have over the integrity of the statements when the
 16 auditor is involved in the decision-making for those
 17 strategies, advice, however you want to characterize
 18 it.

19 And therefore, I want to go back and ask
 20 David from Pfizer a question based on his statement
 21 earlier in this session, and I hope I'm going to be
 22 able to restate it as he would have intended to be, and
 23 that the failure of the auditor to be involved in tax
 24 planning or strategies may actually compromise their
 25 independence. I still don't understand how that could

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1 be. I could understand how their failure to be
 2 knowledgeable about tax planning and strategies could
 3 compromise their ability to do an effective audit, but
 4 I don't understand how it would compromise their
 5 independence, and I would like to better understand
 6 that.

7 MS. RIVSHIN: David, would you like to
 8 respond?

9 MR. SHEDLARZ: I didn't even have to put my
 10 nameplate up. See what I get for agreeing with Lynn?

11 (Laughter.)

12 MR. SHEDLARZ: This in many respects may be a
 13 semantical issue. I think it is important to have some
 14 clear guidelines in terms of what's acceptable practice
 15 when it comes to tax planning, tax advice, and tax
 16 involvement on the part of the accounting firms. There
 17 are many things I would not be in favor of, and some of
 18 them have just been discussed, because I do think they
 19 do compromise the independence of the outside
 20 accounting firm.

21 We personally do not use our outside
 22 accounting firm for tax strategy. They're not involved
 23 in the bringing forward of any tax vehicle on behalf of
 24 the company and haven't been for some time.

25 On the other hand, it is critically important

<p style="text-align: right;">Page 134</p> <p>1 that the outside accounting firm have a viable vantage 2 point from which to exercise their independence. If 3 they are not involved on an ongoing basis in terms of 4 the planning and advice that goes on in a global 5 concern, and even a smaller concern, then that vantage 6 point is not maximized. I believe very strongly, 7 having practiced in this field for 28 years, that 8 independence has a lot of dimensions. One of the 9 critical ones is being knowledgeable enough to exercise 10 that independence, and not being involved in the 11 planning and advisory services in the tax arena clearly 12 compromises that in terms of the continuity of 13 understanding in this very, very complex and involved 14 area.</p> <p>15 So I think it's critically important in terms 16 of what we're all trying to achieve, which is the 17 independence of the outside accounting firms, the 18 integrity of the financial statements that the 19 accounting firms have that vantage point. In fact, 20 it's one I demand of the outside accounting firms so 21 they can exercise the independence and judgement which 22 is so critical in this complex area.</p> <p>23 MS. RIVSHIN: Mark Weinberger?</p> <p>24 MR. WEINBERGER: Thanks. I hate to go back to 25 this question, but it's interesting, it's fascinating,</p>	<p style="text-align: right;">Page 136</p> <p>1 was when relying on the use of an in-firm tax 2 specialist. And I think the response to that is that 3 an auditor who uses an in-firm tax specialist has the 4 same responsibility to supervise and review that work 5 as he does for any other assistant that the auditor 6 uses. So therefore, the partner with the final 7 responsibility for signing that audit report has an 8 obligation to supervise and review the tax specialist.</p> <p>9 MS. RIVSHIN: Lynn Turner.</p> <p>10 MR. TURNER: We had a similar question on the 11 auditing side that the profession has dealt with, and 12 that was, were we going to let the accounting firms 13 continue to issue these opinions on accounting matters, 14 including if you just issued an opinion to an 15 investment banking firm that they could then go sell to 16 others, and you might do it and you wouldn't be 17 necessarily issuing it to one of your audit clients, 18 but it could be out there and certainly run you in a 19 position where your audit client then picked it up and 20 what do you do with it then?</p> <p>21 And in those situations, and I think the 22 profession did it right, I think the profession came 23 back and said, consistent with what our current code 24 is, we have an obligation to the public. And the 25 public, especially after Enron, doesn't see the</p>
<p style="text-align: right;">Page 135</p> <p>1 every time you read it, when you hear the conversations 2 that go on here, I get a different interpretation. I 3 actually think this question is much broader than the 4 work you can provide to your audit firm. And again, 5 I'm still trying to understand the AF and ZY, but I 6 would -- if you answer no to one and yes to two, so 7 there are certain tax strategies that you cannot 8 provide to your audit client, whatever they are, and 9 then you assume if you provide those strategies, 10 however, to another firm, a non-audit client, that 11 could risk your independence with your audit client 12 that you never sold a strategy to, it would basically 13 make it impossible for you to sell tax strategies to 14 any other non-audit client because the mere fact that 15 somebody may bring that idea to your client and cause 16 an independence problem due to no fault of anything 17 you've done for them. I think there are pretty broad 18 ramifications of that. Am I reading that wrong?</p> <p>19 MS. RIVSHIN: You are reading that actually 20 correct.</p> <p>21 MR. WEINBERGER: Okay.</p> <p>22 MS. RIVSHIN: Bruce Webb.</p> <p>23 MR. WEBB: Bruce Webb, McGladrey & Pullen. 24 This is maybe a tangential issue, but the issue was 25 sort of raised as to what the auditor's responsibility</p>	<p style="text-align: right;">Page 137</p> <p>1 profession living up to its obligation to the public if 2 we're issuing those type opinions, regardless of 3 whether it's to one of our audit clients or to another 4 firm, so we banned them on the accounting side.</p> <p>5 And I think the answer here, just from common 6 sense and building upon what Nick said, gets you to the 7 same answer. If you're, as a professional certified 8 public accountant, going to go out and issue these type 9 of tax opinions or take these type of positions on tax 10 strategies, where it's less than likely that you're 11 going to prevail, certainly if you're going to start 12 reserving for it and saying one thing to the IRS and 13 another thing to your investors, if you're going to 14 take that position as a public accountant, then there's 15 a definite price that goes with it, and the price is, 16 if that shows up at the audit client, you're not going 17 to be able to do that audit.</p> <p>18 The public investors just don't buy that that 19 is an unbiased and rational position for a certified 20 public accountant to take and they don't accept it. 21 And when you look at it from that perspective, I think 22 it very well comes out that if you get yourself in 23 those positions, you just shouldn't be doing it and 24 it's going to cause you a problem. And so just like we 25 banned it on the financial reporting side, I think the</p>

<p style="text-align: right;">Page 138</p> <p>1 profession needs to come in and do the same thing on 2 the tax side and say, we're just not going to find 3 ourselves in that position anymore because it doesn't 4 work out, it just does nothing but terrible damage to 5 the profession. 6 MS. RIVSHIN: Nick Cyprus. 7 MR. CYPRUS: Actually, Pat, I wanted to just 8 follow on to what David was talking about. I really 9 believe if the auditor is not in the origination 10 stages, but rather you use the auditor as a consultant, 11 whether it's in tax planning, tax strategies, et 12 cetera, just like I would use the auditor when I do 13 accounting policy, I mean, I wouldn't think about 14 calling up the SEC without making sure my auditors 15 understood where I stood on accounting policy and made 16 sure the national office was with me. 17 It would be the same thing if I'm thinking 18 about a merger or acquisition and the tax implications 19 of that, you'd want to consult your auditor and 20 understand both the tax and accounting impacts of that. 21 And as long as the auditor is independent, in other 22 words, they didn't create the strategy, they didn't 23 create the tax planning itself, but they're consulting 24 on it, they're giving you advice on it the same way 25 you'd get accounting advice, I don't really see a</p>	<p style="text-align: right;">Page 140</p> <p>1 SEC audit clients. I think it's important to 2 understand that concept and the extent to which firms 3 go in order to ensure that that is not the case, that 4 you're not providing something indirectly that you 5 can't provide directly to your SEC audit clients. 6 In that scenario, if there's a tax opinion 7 that sits out there, certainly that would be an issue 8 that would say you can't do that, it's an indirect 9 provision of something you can't provide directly. In 10 addition, that has to go back to this whole process of 11 determining that we're not going to put ourselves in 12 the positions of taking something to the audit 13 committee that from a risk perspective we don't think 14 is appropriate to independence, doesn't match up to the 15 principles, and it puts the audit committee in the 16 fully formed position to protect the investors as we 17 are trying to do and ensure that those services don't 18 show up indirectly. 19 MS. RIVSHIN: Bruce Webb. 20 MR. WEBB: Bruce Webb, McGladrey. I just wanted to 21 follow up on Lynn's comment on the amendment to SAS 50. 22 I served on the Auditing Standards Board at the time 23 that amendment was passed and we certainly supported 24 it. And I think that SAS 50 might be a good place to 25 look for some guidance in this area because an</p>
<p style="text-align: right;">Page 139</p> <p>1 problem with it. In fact, I think it's really 2 necessary. 3 And I know we've said this a lot, but when 4 you're a major international player with many, many, 5 many locations, it takes a long time for someone to 6 really understand the quirks of your company. And if 7 you're just bringing a third party to do it sort of on 8 a part-time basis, even on a full-time basis, I think 9 the audit firm, because there's so much more resource 10 there, you have the audit resource and the tax 11 resource, and lots of members that talk about things, 12 there are nuances that come to the attention of your 13 auditors that I think sometimes an outsider may not get 14 until it's too late, you've already made a mistake of 15 some kind. And so that's what I was really trying to 16 get to. 17 I think it would kind of hurt us if we took 18 that resource away from the consulting side of the 19 equation. 20 MS. RIVSHIN: Scott Bayless. 21 MR. BAYLESS: Scott Bayless, Deloitte. Just 22 in terms of addressing the issue that I think Lynn 23 raised, and that is that in looking at independence 24 issues, certainly we don't believe that you can provide 25 indirectly something that you can't provide directly to</p>	<p style="text-align: right;">Page 141</p> <p>1 accountant or an auditor is permitted to issue and 2 sometimes in fact is required to issue a preferability 3 opinion on the application of accounting principles to 4 specify transactions, either completed or proposed, 5 involving facts and circumstances of a specific entity. 6 On the other hand, an auditor or accountant 7 is precluded from issuing an opinion on the application 8 of accounting principles to a hypothetical transaction, 9 that is, one that does not involve a specific 10 transaction and specific facts and circumstances. 11 MS. RIVSHIN: We're going to take our two last 12 comments. We'll start with Mike Gagnon. 13 MR. GAGNON: Just echoing the last comment and 14 picking up on what Lynn said, I agree and I think it's 15 a pretty good framework, SAS 50, in the context of tax 16 opinions on hypothetical transactions. Tax advice, tax 17 consulting should be driven by individual facts and 18 circumstances, and it's the former, that is, the 19 hypothetical tax opinions, that is an area that I don't 20 think is appropriate, and I think there's a framework 21 for consideration here. 22 To Pat's issue earlier of independence, it's 23 important for auditors and tax advisers -- it's 24 actually not important, it's critical for auditors and 25 tax advisers -- to develop and have an independent</p>

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1 viewpoint. In order to develop that independent
 2 viewpoint which is relevant to the particular facts and
 3 circumstances, you've got to understand the
 4 environment, you've got to know what's going on, and
 5 maybe that was the basis for your comment. I believe
 6 that enhances independence. You are advising a client
 7 on a variety of matters, some of which bear on
 8 accounting, some of which may bear on a particular tax
 9 issue. That advice does need to be developed or spring
 10 from an independent, objective perspective, but that
 11 has to be well informed, and the information that is
 12 gathered in that process is critical as a backdrop to
 13 providing it.

14 I think, going back to the discussion of the
 15 application of our tax code, there are benefits there
 16 as well, because clearly an auditor in an audit process
 17 in an organization that operates in 140 countries, an
 18 auditor who has the breadth and depth and capability of
 19 undertaking that assignment from an audit perspective
 20 has the expertise and develops a base of knowledge in
 21 that organization around the world, and will see
 22 things, will observe things, not just tax-driven, but
 23 other avenues as well, and clearly is in a position to
 24 provide that independent, objective advice to the
 25 client on these matters, some of which will properly

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1 bear on taxes, some of which will bear on other areas
 2 of the organization.

3 But the critical point, not only from the
 4 perspective of the auditor's responsibilities, but from
 5 an independence perspective, is the ability to be
 6 impartial and objective in rendering that advice.

7 MS. RIVSHIN: Jim Brown.

8 MR. BROWN: Jim Brown of Crowe Chizek. The
 9 last question, I was sort of trying to wrap things up
 10 or maybe return to an issue here for a moment, and that
 11 is I don't really relish the Board's mission ahead of
 12 them, which is to sort of try to figure out where to
 13 draw the line here, and that's sort of how I see this.

14 We've been talking about tax planning and tax
 15 strategies, and it all sort of blends together. Some
 16 of it's even, is it tax advice or is it accounting
 17 advice? And I just wanted to give you a couple of
 18 examples I had down here on some things that people
 19 don't really, I think don't see too much of a concern
 20 when you do talk to a company about this or give them a
 21 suggestion. I just say, you know, when you go to a
 22 party, somebody says, oh, you're an accountant? Well,
 23 I have a tax question for you. People expect that
 24 accountants can give tax advice.

25 And there are some matters, such as getting

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1 off the first-in, first-out, FIFO inventory method,
 2 going to LIFO, not too controversial. Another might be
 3 whether I file a consolidated tax return or a separate
 4 tax return. Forming a sub-S corporation to avoid
 5 double taxation. Hey, look at your interest income and
 6 you're paying a lot or you're having a lot of high-
 7 yield bonds but you're paying tax on it. Have you
 8 thought about buying municipal bonds that are tax free?
 9 So there's a lot of issues here where you
 10 look at things and you say, now is this a tax strategy?
 11 Maybe to form a sub-S corporation, you know, here's the
 12 structure you need to do. There are certain things you
 13 have to do to go from the FIFO to LIFO methods to meet
 14 IRS rules. I've got something that I can help you
 15 with.

16 The issue here is I think there's a lot of
 17 these plain vanilla things that nobody really has an
 18 objection to, and we also read about a lot of things in
 19 the newspapers where a lot of people may have
 20 objections to. I can't really comment on that. I
 21 don't know their validity, I don't know their facts.
 22 But someplace between these two is a line where you can
 23 say, this is allowed, I think these things I mentioned
 24 are okay, but you can't go any further. And I welcome
 25 the challenge that you folks face in figuring out where

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1 that line is. I think we have to allow some matters.
 2 The public does expect accountants to be able to give
 3 advice on audit and tax issues. We have to as part of
 4 our audit responsibility, but at some point we get too
 5 involved.

6 I'll remind you of those four overarching
 7 principles, and I think those are good points to
 8 consider.

9 MS. RIVSHIN: Okay, due to time constraints
 10 we're going to move on to our next area, which is
 11 executive and international assignment tax services.
 12 Accounting firms may provide services to executives of
 13 its audit clients, such as the preparation of personal
 14 income tax returns and tax planning. Accounting firms
 15 may also provide specialized tax services to employees
 16 of the company who participate in an international
 17 assignment program. These services include home and
 18 host country tax compliance assistance and estate
 19 planning for expatriates.

20 Starting with our first question, does
 21 providing tax services to audit client executives and
 22 other members of management affect the auditor's
 23 independence from the company? Does the answer depend
 24 on whether the executives are involved in the financial
 25 reporting process or otherwise making representations

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1 to the auditor?
 2 Mark Anson.
 3 MR. ANSON: Mark Anson from CALPERS. Big
 4 problem with this question. Boards of directors and
 5 audit committees rely on the input from executive
 6 management, just like CALPERS. CALPERS' board of
 7 administration relies on the input and recommendations
 8 and presentations I make to them in their decision-
 9 making process. When you have the audit firm providing
 10 tax advice, preparing tax returns for the senior
 11 management, you've now created a mutual interest
 12 between the executive management and that audit firm
 13 which could potentially taint the recommendation to
 14 that audit committee or the board of directors.
 15 I mean, my God, if the audit firm is going to
 16 prepare the tax returns for the chief executive, as a
 17 shareowner, I want him to come prepare mine also.
 18 MS. RIVSHIN: Elliot Schwartz.
 19 MR. SCHWARTZ: Yes, of course the answer is
 20 that providing tax services to audit clients
 21 compromises their independence or at least it
 22 compromises the perception of their independence, which
 23 is a lot of what's going on here. Just continuing a
 24 little bit from the last discussion, as we continue to
 25 try to draw lines, it becomes increasingly obvious that

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1 it's very, very difficult to do so, and again, as I've
 2 said before, that is why audit firms should not be
 3 providing non-audit services to their audit clients.
 4 We have no problem with audit firms, accounting firms,
 5 providing tax advice or providing advice to executives,
 6 but not to the same ones that are in the firm or not to
 7 the same firm where they're doing their audits.
 8 MS. RIVSHIN: Damon Silvers.
 9 MR. SILVERS: Not surprisingly, I agree with
 10 the last two comments. I'd like to detail a little bit
 11 more of what the problem is here with providing tax
 12 services to senior executives. I think it gets more --
 13 I think maybe later on in the second part 2, it's more
 14 complicated when you're talking about more middle
 15 managers in the international context.
 16 But when you're dealing with senior
 17 executives, I think there are two things going on here
 18 that are a little different than a lot of what we
 19 talked about earlier today. One is that, assuming that
 20 the firm is also providing tax services to the company,
 21 the interests of the company, the tax-related interests
 22 of the company and the tax-related interests of the
 23 senior executives are likely not to be in line with
 24 each other, and it's sort of an independence problem of
 25 a different kind. It's not the audit services, it's

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1 the tax services that are being compromised vis-a-vis
 2 the company. And obviously from our perspective as
 3 investors, that's what we care about.
 4 Secondly, there's this issue of the audit now
 5 -- the audit and others and the ability of the firm to
 6 gain other services from the issuer is potentially in
 7 play as the issuer -- as the audit firm interacts on
 8 tax matters with the CEO or CFO of the company. And
 9 that adds a second layer of conflict on top of the
 10 existing tension between the company's tax interest and
 11 the company's -- and the executive's tax interest.
 12 This is -- this, in our view, is just a hornet's nest
 13 of problems, and not all of them are ones -- not all of
 14 them are problems that are of the sort the PCAOB
 15 typically focuses on, but there of extreme concern to
 16 investors.
 17 MS. RIVSHIN: Jim Brasher.
 18 MR. BRASHER: I guess the question on the
 19 floor here is whether or not the investment community
 20 feels comfortable with letting the audit committee
 21 makes these types of decisions, because I can assure
 22 you that's what's happening in the real world, not only
 23 with respect to executives, but also with respect to
 24 the international executive program that all of the big
 25 firms -- we all have that capability. Those decisions

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1 are seemingly being made almost on a weekly basis where
 2 they decide whether or not they want the auditor to
 3 provide those services.
 4 So I guess the question is, what else are we
 5 trying to safeguard if the audit committee cannot be
 6 entrusted to make that decision?
 7 MS. RIVSHIN: Barbara Roper.
 8 MS. ROPER: I had a question about that. Does
 9 the audit committee -- the audit committee is obliged
 10 to preapprove non-audit services provided to the
 11 company. Is there anything that says they're required
 12 to preapprove or even know about non-audit services
 13 provided to executives of the company? Because I'm not
 14 assuming that the audit committee will be consulted or
 15 involved in that review process.
 16 MS. RIVSHIN: Lynn Turner.
 17 MR. TURNER: There is not a requirement under
 18 Sarbanes-Oxley that the audit committee preapprove the
 19 work done for the executives. I know, however, and I
 20 give them great kudos for this, in the case where I sit
 21 on the audit committee, the firm has adopted a policy,
 22 at least they told us they've adopted a policy and I
 23 assume they have, that before they do any work for
 24 Section 16B officers and directors it will have to be
 25 approved by the audit committee, so that's Ernst &

<p style="text-align: right;">Page 150</p> <p>1 Young, and I give them tremendous kudos for that. And 2 so they have brought it to us, and we, of course, 3 declined to preapprove, so it solved our problem. But 4 technically under Sarbanes-Oxley, no, that does not go 5 to a vote of the audit committee. 6 MS. RIVSHIN: Mark Anson. 7 MR. ANSON: Jim, just to follow up on your 8 question, from an investor perspective the key issue 9 here is how much does the audit committee rely upon the 10 input, recommendations, and information from senior 11 management? If it's a decision made totally in a 12 vacuum without any input from senior management, then 13 you have a good claim to objectivity. But I know most 14 boards of directors listen to their senior management, 15 whether it's formally at the actual committee meeting 16 or outside the committee meeting, and that's where the 17 independence breaks down. 18 MR. BRASHER: Mark, I guess I'm not in a 19 position to comment on what goes through their minds 20 and how they make their decisions, but to Lynn's 21 statement I would like to add that if the company were 22 paying for that service, certainly the audit committee 23 would be required to sign off on that service. 24 Secondly, I think we also have risk 25 procedures that are designed in our firm that whether</p>	<p style="text-align: right;">Page 152</p> <p>1 It's simply inappropriate. 2 MS. RIVSHIN: Scott Bayless. 3 MR. BAYLESS: With respect to the executive 4 compensation issue, I think that those are independence- 5 impairing services that we do not render. However, 6 just to follow up with Lynn's comments, Deloitte does 7 undertake to, one, ensure that services provided to 8 executives of the company are preapproved, and where 9 there other services that are not required because the 10 company does not pay for those services, that there is 11 a notification procedure to ensure that the audit 12 committee has the ability to take control of that 13 relationship if they so desire. 14 MS. RIVSHIN: David Shedlarz. 15 MR. SHEDLARZ: I guess I'm a believer that you 16 can parse what's acceptable and not acceptable. But in 17 this particular area, I don't think is appropriate. 18 This is not appropriate activity for the audit firm to 19 be carrying on on behalf of the board, the senior 20 management, or any employee of the company. 21 MS. RIVSHIN: Nick Cyprus. 22 MR. CYPRUS: This was just also getting back 23 to Barbara. At AT&T, any expenses that were to your 24 public accounting firm had to run by the audit 25 committee, and when this issue came to the audit</p>
<p style="text-align: right;">Page 151</p> <p>1 or not the company paid for it we would have a 2 disclosure requirement to go to the audit committee and 3 advise them that we were rendering these types of 4 services and also advise them of what policies and 5 procedures that we would follow with respect to the 6 provision of services to the executives. That would 7 include other covered persons, for example, people on 8 the audit committee that we may provide those tax 9 services, not in connection with that audit, but 10 certainly because they're an individual client of the 11 firm, although they could be on the audit committee and 12 we'd have to disclose that to the audit committee that 13 we were doing this even though this person is not an 14 executive of the registrant. 15 MS. RIVSHIN: Damon Silvers. 16 MR. SILVERS: I figure I better answer your 17 question quickly. In my view, there is no circumstance 18 under which a professional services firm that owes a 19 fiduciary or quasi-fiduciary duty to its client should 20 be on both sides of the executive compensation 21 relationship, and therefore, the AFL-CIO does not 22 believe there is any circumstance under which an audit 23 committee should approve an audit firm or a law firm or 24 a consulting firm representing both the executive and 25 the company in the context of executive compensation.</p>	<p style="text-align: right;">Page 153</p> <p>1 committee, it was basically taboo, you can't provide 2 those services. So the audit committee will exercise - 3 - I think the audit committees are exercising their 4 fiduciary duty. I think I just heard Lynn say the same 5 thing when it came to him. 6 MS. RIVSHIN: Lynn Turner. 7 MR. TURNER: I will just say you don't see a 8 whole lot of disclosure on this. I've never seen an 9 investor institution I've talked to, I don't think I've 10 ever talked to one that thought this was appropriate. 11 I think it's 100 percent on the investor side that they 12 just don't believe this one is appropriate, and what's 13 interesting is you do have, Jim points out, makes a 14 good point, you have those situations where in a lot of 15 cases the executives actually pay for it themselves, 16 and then you've got the situation where the companies 17 are actually paying for it as well. 18 Unfortunately, when the companies are 19 providing those perks, we don't see those type of perks 20 showing up in the disclosure and the compensation 21 tables in the proxy disclosures, so it's not 22 forthright, and quite honestly, investors don't see 23 that. But where investors have seen it, I think Sprint 24 was the classic case, they just come out of the 25 woodwork on this one and investors say just, we just</p>

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1 can't comprehend, I think very consistent with Mark,
 2 they can't comprehend how you could do this and be on
 3 both sides with the fiduciary responsibility to the
 4 executives that's very clear, including a legal
 5 obligation there, as well as fiduciary responsibility
 6 to the company.
 7 Early on, I was involved with the Sprint
 8 situation, and I personally think that turned into a
 9 terrible conflict and it really wasn't clearly laid out
 10 where those conflicts were on both sides, so after that
 11 situation I think it made a clear-cut case that you
 12 just shouldn't be there.
 13 MS. RIVSHIN: We'll let Barbara Roper have the
 14 last say in this and move on to the next question then.
 15 MS. ROPER: I was just going to say that based
 16 on this discussion it sounds like even those who
 17 advocate leaving this decision to the audit committees
 18 view that almost always or always the appropriate
 19 decision by the audit committee is to say no, in which
 20 case I think the appropriate position by the PCAOB is
 21 to say no for them and eliminate the lack of clarity.
 22 MS. RIVSHIN: Okay. With that, let's move on
 23 to the last question in this area, and that is, does
 24 providing tax services to employees who participate in
 25 long-term international assignments affect the

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1 auditors' independence?
 2 Okay, Lynn.
 3 MR. TURNER: I've had to deal with this one.
 4 This is an interesting one, because you start looking
 5 are you really being an advocate or whatever, and a lot
 6 of times you don't hit into those. One of the problems
 7 that you get into these though is as you get into the
 8 international affiliates, they're not only providing
 9 the tax service in the tax return, they're providing
 10 relocation and a number of other services that go with
 11 it. So the question is probably more simpler than what
 12 it is. It should be, does providing the tax services
 13 and all the other services that you provide to the
 14 expats compatible with being independent?
 15 And when you go back to those nine O'Malley
 16 criteria and you apply them in this situation, the nine
 17 O'Malley criteria turn around and say, no, the auditors
 18 shouldn't be doing this type service, so that would
 19 turn around and give you a no answer to this one. I
 20 will tell you I have seen credit rating agencies, one
 21 of the three large credit rating agencies, actually
 22 challenge companies who are doing this on their
 23 independence, so that's at least one source where
 24 people, users of financial statements, were concerned
 25 about that.

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1 MS. RIVSHIN: Mark Weinberger.
 2 MR. WEINBERGER: Lynn, I'm not sure all the
 3 services obviously encompassed in your comments, but a
 4 lot of the time these services are basically company-
 5 provided services to individuals to help them comply
 6 with the tax laws, they're expatriates who are in
 7 foreign jurisdictions, and to make sure they comply
 8 with all the jurisdictional laws, and since they're
 9 usually not there for a whole lot of time, the company
 10 usually takes responsibility for providing for them in
 11 their compliance.
 12 With regard to that, I guess I don't believe
 13 there's an independence issue, and frankly I think that
 14 because we are serving the client in all those
 15 jurisdictions, and because these people are there, it
 16 enhances their opportunity to get the compliance right,
 17 and they choose us when we match up right
 18 geographically with them and know the law in those
 19 jurisdictions and can help their employees comply.
 20 Now, that's the compliance aspect. The other
 21 services you're referencing I'm not tying them to,
 22 because I'm not sure what they are.
 23 MS. RIVSHIN: Damon Silvers.
 24 MR. SILVERS: This is an area where it
 25 certainly does feel like sensible for companies to be

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1 able to get the type of assistance that they get from -
 2 - for companies and their employees to get the type of
 3 assistance that integrated audit firms provide. The
 4 problem, I think, that at least in my mind is raised is
 5 again the question of who is the firm representing in
 6 that effort? And it seems pretty clear to me that
 7 they're not representing the employee, that in reality
 8 they're representing the company, the issuer, the
 9 employer in this arrangement, and that this, in many
 10 instances, an employer and employee have a common
 11 interest in compliance obviously. But in tax, where
 12 there's a fair amount of latitude as to what you do,
 13 there may indeed be areas where there are tensions
 14 between employer and employee interests here.
 15 And it seems that in that circumstance it
 16 ought to be crystal clear that the firm is representing
 17 the employer, is acting in the employer's interest, and
 18 that, A, there's no ambiguity on the firm's part on
 19 that matter, and thus protecting investors' interests,
 20 and, B, the employee needs to know that that's what's
 21 going on here. Again, maybe not the PCAOB's concern,
 22 but that is, I think, a genuine sort of independence
 23 issue, but it's not, it doesn't have the punch of
 24 independence issues relating to the CEO or the CFO
 25 typically. But nonetheless, I think it's -- this is

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1 not really dual representation. This is representing
 2 the employer's interest, the issuer's interest, and
 3 seeing to it that these matters are handled
 4 appropriately and that both the issuer and its employee
 5 complies, and it's not really a dual representation and
 6 should not be represented as such.
 7 MS. RIVSHIN: Mike Gagnon.
 8 MR. GAGNON: I don't know. I put my sign up
 9 and Lynn put his down. I guess I'm getting a little
 10 nervous here. A couple of points on the background of
 11 the service. I think the service itself evolved from
 12 organizations obviously sending their people around the
 13 world and the complex tax environment that people
 14 operate in who are from one jurisdiction and operate in
 15 other jurisdictions, and it does become very
 16 complicated, and our firms have the breadth and scope
 17 and capability to deal with these complex areas.
 18 I would agree that I do see a distinction
 19 between this type of service, which is by and large, I
 20 believe, a compliance service at its core, and I'm
 21 going to get to a point Lynn raised a second ago in
 22 terms of other services, which I think provides needed
 23 assistance not only to the individual employees who are
 24 in another jurisdiction with presumably little
 25 knowledge of the local tax requirements, but certainly

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1 a requirement that they must adhere to them. And
 2 therefore, it's very important that a competent service
 3 provider assist these individuals, and in organizations
 4 there are frequently quite a large number of them, to
 5 make sure that they do in fact, as an individual and as
 6 an organization, because there are obviously
 7 reputational and other implications to the organization
 8 as a whole with the absence of compliance, that they
 9 adhere to the local requirements and the requirements
 10 of obviously the host country.
 11 I do see a distinction in those types of
 12 compliance services from an independence perspective to
 13 other sorts of planning services, other sorts of
 14 relocation services, and so on and so forth, and we've
 15 got some policies that differentiate between the two,
 16 whether the service offering is to an audit client
 17 versus a non-audit client, and I think that's very
 18 important.
 19 I do think in terms of Lynn's point on the
 20 other attributes outlined in the O'Malley Panel, I do
 21 think that's very helpful. I'm not sure if you look at
 22 all of those criteria whether they stack up in terms of
 23 this type of service. I believe in my own judgement at
 24 least that they would not suggest that the compliance
 25 service aspects, because of its implications to

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1 individuals and the organization as a whole, that would
 2 suggest that this is a prohibitive service.
 3 I do think it comes back to a fundamental
 4 point that I made earlier, which is that this does
 5 still need to be approached from the perspective of
 6 being knowledgeable, impartial, and objective as to how
 7 the service is performed. But I do think there are
 8 benefits associated with organizations like ours in
 9 providing the service.
 10 MS. RIVSHIN: Mark Anson.
 11 MR. ANSON: First, I'll agree with Mike's
 12 comments. It's clear this is a valuable service, not
 13 only for our compliance issues but also for attracting
 14 and retaining qualified employees for the company.
 15 However, there is a secondary issue associated with
 16 question 10. Keep in mind that this tax service is
 17 just another service contract that is sold to the
 18 public company, which at some point in time must be
 19 audited by the auditing firm that has sold the contract
 20 to the company. So once again you will still call into
 21 question at some point in time the independence issue,
 22 because the audit firm will be auditing a service
 23 contract that they had sold to the public company.
 24 MS. RIVSHIN: Pat Walters.
 25 MS. WALTERS: And to just follow on to that,

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1 there doesn't seem to be -- none of the arguments that
 2 have been put forward earlier today about why the audit
 3 firm should be tax services for the issuer apply here.
 4 It doesn't seem to me as if one needs to be terribly
 5 familiar with the business operations of the firm in
 6 order to provide these services. All of the major
 7 firms can accomplish this globally, and therefore,
 8 there doesn't seem to me to be any legitimate reason
 9 for the audit firm to do this for its audit client.
 10 The audit client can very easily contract for these
 11 services from someone else without any of the
 12 efficiencies or synergies or familiarities that we have
 13 used as arguments for providing tax services to the
 14 firm itself.
 15 And I actually would like to disagree a
 16 little bit with Damon about some of this in that one
 17 would expect that there is some negotiation when one
 18 accepts an international assignment. You're probably a
 19 management person, you may not be an executive, and
 20 therefore, you may wish to negotiate certain aspects of
 21 your compensation based on the advice that you get from
 22 your tax professional with your firm.
 23 And so I think some of the same arguments
 24 that he made about executives and executive
 25 compensation apply here.

<p style="text-align: right;">Page 162</p> <p>1 MS. RIVSHIN: We have four people with their 2 tents up. We'll take their comments and then move on 3 to the next area. 4 Walter McNairy. 5 MR. MCNAIRY: Walter McNairy, Dixon Hughes. 6 If the Board goes down the path of putting some 7 restrictions on tax services to executives, I would 8 just encourage that they consider other perhaps more 9 far-reaching ramifications from an independence 10 standpoint with respect to related-party transactions. 11 Would the restrictions be just for executives? Would 12 it extend to middle-level management? Would it extend 13 to the board? What about situations where the audit 14 firm audits the acquiree and the acquirer, situations 15 where the audit firm audits significant customers, the 16 audit firm audits the parent company and audits the 17 ESOP or benefit plans? 18 I just think there is a whole lot of related- 19 party type relationships that could come into play as 20 you evaluate all the clients that an auditor of a 21 public company may have, and those clients may have 22 conflicting interests with the interest of that public 23 company. Just something to consider. 24 MS. RIVSHIN: David Shedlarz. 25 MR. SHEDLARZ: This may be in fact a</p>	<p style="text-align: right;">Page 164</p> <p>1 ultimately will pay as a practical matter. And 2 secondly is, I think, the point that Mark made earlier 3 is it's very important for the company to make certain 4 that these are properly prepared because otherwise they 5 could be even potentially precluded from doing business 6 in those various countries. So it's much more of a 7 compliance issue, I think, than it is an independence 8 issue. 9 MS. RIVSHIN: Mark Weinberger. 10 MR. WEINBERGER: Thanks. I just wanted to 11 address a practical issue, I guess. There was a 12 statement made that any of the firms could do it, so 13 why not just move it around? I don't think it's that 14 easy. Actually, many of the issuers could be 15 conflicted from, based on their affiliation through 16 either financial service firms or mutual fund complexes 17 or with subsidiaries in other countries from being able 18 to do work for two or three firms if we start limiting 19 who can -- whether an auditor can do work. 20 But importantly, there's only, for better or 21 worse, four big global firms left, and if you're 22 precluded from working with one or two, the other two 23 have to match up geographically almost exactly where 24 you are in order to be able to provide those services 25 on a global basis, and it doesn't work out that way for</p>
<p style="text-align: right;">Page 163</p> <p>1 historical moment in that I get the opportunity this 2 afternoon not only to agree with Lynn, but also Pat. 3 (Laughter.) 4 MR. SHEDLARZ: I agree. It lacks a lot of the 5 arguments and good ones in terms of the vantage point 6 and knowledge attendant to tax planning and tax 7 advisory activity, and for that reason, if nothing for 8 form but clearly for substance, it's not something that 9 we support. 10 MS. RIVSHIN: Tom Ochenschlager. 11 MR. OCHSENSCHLAGER: Tom Ochenschlager with 12 the AICPA. I think the argument here regarding 13 expatriate returns is very similar to the argument, the 14 issue involving whether or not auditors should be 15 permitted to prepare tax returns in general for the 16 company. The way the expatriate returns frequently 17 work is it's actually a tax liability of the company. 18 The company reimburses the employee for the difference 19 between whatever the U.S. taxes and what the foreign 20 taxes were plus some housing expenses and things of 21 that nature. 22 So, in effect, what we're doing is -- for two 23 reasons I guess, one, because of this reimbursement, in 24 effect the company is filing the foreign returns on its 25 own behalf, if you will, because it's money that it</p>	<p style="text-align: right;">Page 165</p> <p>1 all the companies. And so it's not as easy to say that 2 if one can't provide it, one of the other two or three 3 that are available can. It's in practice a little more 4 difficult. 5 MS. RIVSHIN: Okay. Two other people put up 6 their tents, so we'll let them say their remarks. 7 Damon Silvers. 8 MR. SILVERS: Well, A, I don't disagree with 9 the comments that Mark and Pat made. I think that 10 those issues are present in any non-audit service, and 11 I was trying to be soft-hearted. 12 (Laughter.) 13 MR. SILVERS: The issue of whether or not you 14 -- whether in looking at conflicts between an employer 15 and employee in the context of tax consulting, whether 16 that necessarily brings in the question of whether you 17 could ever -- whether an audit firm could ever be in 18 its role as auditor on both sides of a transaction, 19 those are different things actually. And the reason is 20 because of what we discussed earlier, which is the 21 elements of advocacy involved in tax consulting and tax 22 advisory services that is quite different than -- at 23 least I hope it's quite different -- than the role that 24 the audit firm plays as auditor. And I think it's 25 important to keep that in mind that there are bright</p>

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1 lines that can be drawn here.
 2 MS. RIVSHIN: Lynn Turner.
 3 MR. TURNER: Back to this service, first of
 4 all, there's nothing in this service that really does
 5 enhance the auditor or even ties into the audit, so
 6 that's where the O'Malley panel things start to kick it
 7 out. It's done by people, it's not associated with the
 8 audit, it's more of a compliance-type thing. So you
 9 can get other service providers, and it's not just the
 10 other three firms. In fact, having recently been
 11 associated with this process, we had to shut the door
 12 we had so many people wanting to come in and offer you
 13 the service. You could get the service -- and this is
 14 one where perhaps you can even get it at a lower rate
 15 when you go through this type of process, but there's
 16 many people out that provide this service other than
 17 just the big three, so there's not an issue with
 18 getting a service provider on this one as well.
 19 MS. RIVSHIN: Okay, let's move on to our next
 20 area for a few minutes and then we're going to take a
 21 short break. And this is really kind of the catch-all
 22 of other tax services. This is your opportunity to
 23 discuss any other types of tax services that have not
 24 been mentioned in these categories and how they could
 25 affect auditor independence.

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1 (No response.)
 2 MS. RIVSHIN: Did we do a really good job and
 3 categorize everything? Or do people want to break?
 4 (Laughter.)
 5 MS. RIVSHIN: Pat Walters.
 6 MS. WALTERS: Well, I think we're still not
 7 really sure what tax advice planning and strategies
 8 are, so anything else must be in one of those three
 9 categories.
 10 MS. RIVSHIN: Mike Gagnon.
 11 MR. GAGNON: I do think it's important,
 12 because I think embedded in some of the questions we've
 13 talked about this morning and this afternoon have I
 14 think other related services that at least I would not
 15 consider to be tax services per se. And I think it's
 16 clear in the independence rules today that calling a
 17 service a tax service, or the fact that the service
 18 itself may be performed by a tax professional doesn't
 19 mean it's a tax service.
 20 And I guess a couple of examples that I saw
 21 in some of the text of the questions would be some
 22 executive compensation consulting I wouldn't consider a
 23 direct tax service. There may be some unclaimed
 24 property type services that I don't believe are tax
 25 services. And so even under the rules as they

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1 currently exist today, I wouldn't want there to be
 2 confusion that sort of all of them would be grouped
 3 together, either because perhaps a tax professional
 4 might be providing them, or because they're sort of
 5 lumped in tax services per se. It may be a minor
 6 point, but an important distinction.
 7 MS. RIVSHIN: David Shedlarz. Anyone else?
 8 Okay, why don't we then take a 15-minute break. That
 9 means we will be back at 3:00. Thank you.
 10 MR. CARMICHAEL: Okay. We are going to resume
 11 our discussion on the relationship between audit and
 12 tax practices. I'd like to remind you at this point
 13 that we're inviting audience members to pose a question
 14 to the whole roundtable group potentially. If you'd
 15 like to ask a question, we'd ask that you please fill
 16 out a notecard that we've provided and return a
 17 completed card just to any member of the staff.
 18 Bella, if you would continue with our next
 19 topic.
 20 MS. RIVSHIN: Great. In some small firms,
 21 such as sole practitioner firms, audit personnel have
 22 expertise in both auditing and tax. In many other
 23 firms, especially large firms, there are separate tax
 24 and audit practices. The question is, is it
 25 appropriate to have tax specialists on engagement teams

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1 to examine tax accruals, structured transactions, and
 2 other tax-related accounting matters? If the firm uses
 3 a specialist from its tax practice to audit tax
 4 accounts, how should that engagement team supervise and
 5 otherwise relate to the specialist? And finally,
 6 should such a specialist's advancement, compensation,
 7 and other rewards be tied to the quality of his or her
 8 audit work?
 9 And it looks like Lynn would like to comment
 10 on that one.
 11 MR. TURNER: Actually, this is where I come
 12 back and totally agree with David and Nick on the issue
 13 of the tax people involved with the audit. Having been
 14 a CFO out there, I think it's critically important as
 15 you go through some of these transactions that their
 16 involvement is there right on at the front end advising
 17 you, because you got the attorneys sitting around the
 18 table, you're trying to put together either capital
 19 transactions or merger-type transactions, where we're
 20 doing financial statements now on a quarterly basis and
 21 each one is equally important. The Qs aren't any
 22 different than the Ks now. You don't have a chance to
 23 wait until the end of the year to get it done right.
 24 The audits have become -- and rightfully so -- have
 25 become continuous audit, so you absolutely, if you're

<p style="text-align: right;">Page 170</p> <p>1 going to sleep at night as a CFO, have to have the 2 ability to have that type of tax expertise sitting 3 there next to you telling you that if there going to be 4 something that's going to have a financial impact on 5 the business and on those financial statements, it 6 absolutely has to be done right. 7 And for an auditor to show up at the end of 8 the Q or end of the K and only then start to look at it 9 and then tell you that something is wrong is one of the 10 reasons we've gotten some of the restatements that 11 we've had that have done investors damage and not good. 12 So there has to be some interplay between the tax 13 expertise and the auditors when it comes to those items 14 in doing these deals, and there are many items in these 15 deals that can have financial statement applications. 16 And as David absolutely was correct on, it has to be 17 done early on rather than later. 18 MS. RIVSHIN: Jeff Steinhoff. 19 MR. STEINHOFF: In the course of conducting an 20 audit, you're going to use many specialists if it's a 21 complex entity. I don't really see that the tax 22 specialist is any different than the actuarial 23 specialist, if you might have a computer security 24 specialist, so you would manage that person in the same 25 way. Certainly if this is what this specialist does</p>	<p style="text-align: right;">Page 172</p> <p>1 oversee that work and review that work. That would not 2 mean they would need to have the same technical 3 knowledge as the specialist. 4 Clearly, to the extent that a specialist is 5 involved, a tax specialist is involved in performing 6 audit procedures, the quality and effectiveness of that 7 work should be evaluated. If that's all they do, that 8 should essentially be all they're evaluated on. On the 9 other hand, I would expect that most tax specialists 10 are not solely confined to audit, otherwise they 11 probably couldn't keep their tax skills up where you 12 would need them to be, so rather than being the sole 13 basis for their evaluation, I think it would normally 14 be one element of their evaluation. 15 MS. RIVSHIN: Colleen Sayther. 16 MS. SAYTHER: Colleen Sayther, Financial 17 Executives International. I'm not sure how you can 18 audit some complex organizations that enter into tax 19 strategies that may be fairly complicated without 20 having a tax specialist. I also think that this is the 21 area, you know, the key area where using your auditor 22 for certain tax services is clearly beneficial with 23 respect to the knowledge spill-over that you can get, 24 particularly when you're talking about due diligence of 25 potential acquisition candidates and the like.</p>
<p style="text-align: right;">Page 171</p> <p>1 for most of their professional life, they should be 2 evaluated on the quality of their audit work. That's 3 what they're doing. If they have a wide range of 4 duties, you would evaluate them on some kind of pro 5 rata basis. 6 But I don't really see a tax specialist, 7 which I agree with Lynn would be the type of person you 8 would want on the audit team, being any different than 9 any other specialist that the audit team would use on 10 an audit. 11 MS. RIVSHIN: Bruce Webb. 12 MR. WEBB: Bruce Webb, McGladrey & Pullen. I 13 think Jeff summed up things pretty well. I agree that 14 you should certainly use a tax specialist as a member 15 of the audit engagement team whenever such specialist 16 skills are required. I think AU 311 would require you 17 to do that. And I also agree that a tax specialist is 18 probably no different than any other specialist or 19 specialized skills that might need to be brought to 20 bear in an audit engagement. 21 The auditor's responsibility for supervising 22 the specialist is, as I've previously mentioned, 23 equivalent to any other assistant. That would mean 24 that the auditor would need to have a sufficient 25 understanding of what the specialist is doing to</p>	<p style="text-align: right;">Page 173</p> <p>1 MS. RIVSHIN: Paul Koren. 2 MR. KOREN: Paul Koren, Goldstein Golub 3 Kessler. Well, we're neither a sole practitioner firm 4 or a large firm, so we fall in between. However, we do 5 have -- our audit people are not tax specialists and 6 our tax people are not audit specialists. However, 7 they -- are tax people are conversant with the 8 standards regarding tax accrual process, and they 9 become part of our audit team. They're actually 10 reported to the PCAOB as associated persons of those 11 who practice in that area, and they have powers in 12 regard to the accrual, the accrual in the financial 13 statements, and they have to approve of that so that we 14 can go forward. 15 I think certainly in our firm our tax 16 specialists who do that work are evaluated on that 17 basis. 18 MS. RIVSHIN: Barbara Roper. 19 MS. ROPER: I think there's a fundamental 20 difference reflected in this discussion between having 21 a tax specialist who's working for the auditor and 22 under the auditor's direction, and having a tax 23 specialist who is working for the audit client, and 24 that as far as auditor independence issues are 25 concerned, that is a fundamental, basic difference in</p>

<p style="text-align: right;">Page 174</p> <p>1 terms of the concerns raised. 2 I think there's obvious -- I don't think 3 anyone would contest that there's obvious benefits to 4 having that kind of expertise where appropriate 5 represented on the audit team under the supervision of 6 the audit partner. If it is true, as has been 7 indicated, that those tax specialists are rarely going 8 to be confined to working on audit teams, then I think 9 it becomes very important to look at what other 10 services they perform and how they're compensated and 11 evaluated for those other services to ensure that they 12 do not conflict with the audit or compromise the 13 audit's independence. 14 MS. RIVSHIN: Michael Gagnon. 15 MR. GAGNON: I certainly -- Lynn actually 16 passed me a note and said, should anybody be nervous if 17 I were to sign a set of accounts or report on a set of 18 financial statements without some tax advice? And the 19 answer was, yes, they really should be nervous. 20 Certainly having tax expertise assisting an auditor in 21 carrying out an exam is vital to that examination, and 22 it goes back to, I believe, some of our dialogue this 23 morning. 24 There was, I think, a fair dialogue on audit 25 quality, audit effectiveness, audit efficiency, and I</p>	<p style="text-align: right;">Page 176</p> <p>1 bifurcated, there are two possible ramifications to 2 that. I think one ramification could be that the tax 3 experts -- they're still experts, that doesn't change 4 their expertise -- the knowledge though has the 5 potential for changing. And effective audits, more 6 effective audits, are influenced by not only having 7 auditor and accounting expertise, but by having 8 knowledge, and to some degree there is an impact there. 9 I think a second possible ramification is 10 having the requisite cadre of experts and people who 11 are dealing in this area on an ongoing basis within the 12 audit firm. I think it's vital because it's not simply 13 income taxes that we're talking about today. We're 14 talking about a complex array of various areas of 15 taxation, whether it be federal income taxes or state 16 and local in the U.S. or foreign taxes, and 17 particularly the interplay of foreign taxes to U.S. 18 taxation in various jurisdictions around the world, it 19 is indeed a complex area. And the knowledge of 20 organizations like ours is critical in order to 21 properly carry out the audit function. 22 So while I think there is broad agreement 23 that it's very important, indeed vital, to have proper 24 specialists in this area advise the audit team in 25 conducting the audit, I think there are at least</p>
<p style="text-align: right;">Page 175</p> <p>1 would bring us back at least for a minute or two to 2 that topic as it relates to tax advice to the audit 3 process. I think it's important to have, and while I 4 echo the comments of the critical need for 5 independence, what I think the Board ought to be 6 considering in this complex area is the implications to 7 audit quality of various levels of restrictions to tax 8 services. 9 And while I think there was some unanimity 10 this afternoon amongst this group on certain abusive 11 tax shelter arrangements, I think there is still 12 confusion as to definitional issues of other types of 13 services, and some comments I made earlier about not 14 only tax expertise, but knowledgeable tax expertise, 15 knowledgeable about the client's facts and 16 circumstances, the situation, particularly in complex 17 environments of operating in 140 countries around the 18 world. It's important not only to have the tax experts 19 certainly at the corporate headquarters knowledgeable 20 about how it's all coming together, but also to have 21 the knowledge spread around the world to advise the 22 auditors as the auditors carry out their 23 responsibilities, but also to advise the client as 24 well. 25 And to the extent services become more</p>	<p style="text-align: right;">Page 177</p> <p>1 potential areas that the Board needs to consider in 2 terms of audit quality, in terms of knowledge, in terms 3 of breadth of expertise as they consider this complex 4 area. 5 MS. RIVSHIN: Scott Bayless. 6 MR. BAYLESS: Scott Bayless with Deloitte. 7 Just to echo some of Mike's comments, I think it is 8 extremely important in the conduct of the audit, and 9 we've talked about the quality of the audit and the 10 importance of the tax function to the quality of the 11 audit going forward, that the persons that are brought 12 to bear in the conduct of the audit are also those 13 persons that have been the advisors along the way 14 throughout the year that have provided insight when the 15 client seeks an understanding, a better understanding 16 of how the tax laws applied, that that person that's 17 been involved in those consultations during the year or 18 that group of persons is brought to bear in that final 19 audit function, because they are, having been consulted 20 during the year, more aware of the issues that could 21 arise or affect that determination, either at the end 22 of the quarter or at the end of the year, whichever 23 period they're brought in to review. 24 Importantly, the compensation should be 25 geared to their contribution to the quality of the</p>

<p style="text-align: right;">Page 178</p> <p>1 audit and should be considered in the total 2 compensation during their annual reviews. 3 MS. RIVSHIN: Damon Silvers. 4 MR. SILVERS: I can't see how anyone could 5 disagree with the notion that there ought to be some 6 tax experts involved in auditing tax matters. I think 7 what that tells you though is that because of the very 8 nature of the expertise involved, it's then vital that 9 that tax expert, to the extent that they're doing 10 anything other than auditing, is not doing anything 11 other than auditing that would compromise the audit. 12 And it comes back around -- this question is 13 really a very deftly hidden loop back to much of this 14 morning's discussion for that reason, that because you 15 have to have tax expertise involved in the audit, and 16 then the real question is, what else are these tax 17 experts doing for the rest of their time? 18 I'm not satisfied, I don't think, with the 19 notion that the tax expert is subordinate to the audit 20 partner, because I think much of what the audit 21 community has said today suggests that the audit 22 partner, if they themselves are not a tax expert, may 23 be unable to figure out when the tax expert -- if the 24 tax expert is compromised, they may not really have the 25 ability to oversee and correct that compromise because</p>	<p style="text-align: right;">Page 180</p> <p>1 MS. RIVSHIN: Okay, there aren't any other 2 commenters. We will move on to the next section, and 3 I'm going to turn it over to my colleague, Greg Scates, 4 to tee it off. 5 MR. SCATES: The last series of questions has 6 to do with independence and auditor ethics. Regardless 7 of how well the auditor performs the audit, investors 8 will not have confidence in the quality of the audit if 9 they do not believe the auditor is independent. 10 Investors may also question whether it is ethical for 11 the auditor to provide a particular service, even if a 12 service does not impair the auditor's independence. 13 That brings us to our next question. Do any 14 of the services discussed today raise specific concerns 15 about the auditor's appearance of independence? And do 16 any of the services discussed today raise specific 17 concerns about auditors' business ethics? 18 Pat Walters. 19 MS. WALTERS: I mean, how could we answer 20 anything other than yes? I think that certainly the 21 investor representatives around the table have been 22 pretty consistent across most of the questions that 23 have been raised today that everything really raises 24 concerns for us in terms of appearance as well as fact, 25 and it's sort of difficult to know what to say after</p>
<p style="text-align: right;">Page 179</p> <p>1 of the nature of the expertise involved. 2 MS. RIVSHIN: Bruce Webb. 3 MR. WEBB: Bruce Webb, McGladrey. I think 4 it's just important that we recognize that issuers 5 often come to their auditors, at least if their 6 auditors are their tax preparers, or if they're not, 7 they probably come to both their auditor and their tax 8 preparer in the course of contemplating a transaction 9 or in the course of completing a transaction, to ask 10 their advice regarding how that transaction will be 11 accounted for from both a tax and a GAAP perspective. 12 And I think it would be a mistake to preclude an 13 auditor from writing that advice. As I said this 14 morning, I don't think auditing is something you come 15 in and do at the end of the year after the client's 16 fully completed their financial statements. I believe 17 it's more of a continuous process. 18 I think it is the line between providing 19 advice and performing audit procedures can get blurred 20 at times, but I think auditors can be independent and 21 objective in discharging their responsibilities. As a 22 matter of fact, under our code of conduct auditors are 23 required -- or tax preparers for that matter -- any CPA 24 is required to be objective in the performance of any 25 services, including tax services.</p>	<p style="text-align: right;">Page 181</p> <p>1 that. 2 I guess the question about auditors' business 3 ethics is perhaps more problematic, because it's 4 difficult for me as an investor to listen to the 5 arguments that I've listened to today that attempt to 6 brush away the concerns that investors have. And I 7 guess to go as far as to say I have concerns about 8 their ethics is probably too far, but I'm puzzled that 9 the concerns that we have expressed on this wide 10 variety of issues related to providing these particular 11 kinds of services to issuers haven't really been heard. 12 With that, I'll let the other guys have their chance. 13 MR. SCATES: Barbara Roper. 14 MS. ROPER: Rather than reiterate what I've 15 said earlier, because I haven't exactly sat here 16 quietly, I'd just like to add one area that we haven't 17 discussed or haven't discussed much, which is how you 18 look at the question of audit and non-audit fees. And 19 in at least one instance we've seen an audit firm 20 advising its audit clients to lump the audit services, 21 the fees for audit services, audit-related service, and 22 tax services on one side of the equation, except for 23 tax shelter services, and then leave just the little 24 bit that's left on the other side when they're 25 balancing whether the fees for non-audit services</p>

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1 create a potential independence problem.
 2 And so in addition to questions about method
 3 of compensation, which we touched on briefly, I think
 4 this issue of how you balance the auditor's financial
 5 dependence on that client needs to be measured very
 6 differently, and it needs to be measured with only
 7 those services that are directly related to the audit
 8 on one side of the equation, and everything else on the
 9 other side of the equation, when you decide whether the
 10 audit firm has too much at stake in other services to
 11 risk losing this audit client.
 12 MR. SCATES: Elliot Schwartz.
 13 MR. SCHWARTZ: Well, of course I agree with
 14 Pat that the answer here is, of course, all of these
 15 services raise questions. And one thing I wish I had
 16 raised at the very beginning when we were talking about
 17 the four principles was the first one, which is the
 18 principle of whether a relationship creates a mutual or
 19 conflicting interest, and I would have added the
 20 appearance of a conflicting interest, because I think
 21 the appearance is one that is also important, it's one
 22 that we've talked about. And I don't want to impugn
 23 anybody's ethics, but it's very difficult for investors
 24 to know with certainty that an audit is independent,
 25 that it is done consistent with integrity of the

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1 auditor, and I think actually toughening up the initial
 2 standards would help some.
 3 MR. SCATES: Colleen Sayther.
 4 MS. SAYTHER: Colleen Sayther, Financial
 5 Executives International. I think we have to keep in
 6 mind we all have the same goal, and that's to enhance
 7 the quality and integrity of the financial statements
 8 and the audit. And I think that having the audit firm
 9 perform certain tax services enhances the quality of
 10 the audit, as we've stated several times today. It
 11 enables the knowledge spill-over and enhanced
 12 communication between the tax side and the audit side,
 13 and in most cases -- I won't use the term always --
 14 it's more efficient.
 15 I'm also familiar with the study that Jim
 16 Brown mentioned earlier by three well-respected
 17 academics, which correlated the provision of tax
 18 services with less audit restatements, and I encourage
 19 the Board to take a look at that study as they
 20 determine what route to take going forward on this,
 21 keeping the goal of enhanced quality and integrity of
 22 the audit in mind.
 23 I think some of the issues that came up today
 24 relate also to the ambiguity in what's compliance,
 25 what's planning, and what's tax strategy in consulting,

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1 and I think some guidance around, definitional guidance
 2 around that, would also be helpful to companies.
 3 And I think lastly we can't forget that the
 4 audit committee, that that sort of stopgap of having
 5 all of this go to the audit committee is a relevant and
 6 important piece of the puzzle here.
 7 MR. SCATES: Pat Walters.
 8 MS. WALTERS: There is something I would like
 9 to add and it does have to do with a conversation I had
 10 with David during the break. I think that, well, at
 11 least I have been persuaded that there are activities
 12 that occur in decision-making about tax and other
 13 strategies that happen during the year that the auditor
 14 needs to be -- and I'm going to use this term again,
 15 even though it's fuzzy -- involved in, so that they
 16 have the requisite knowledge in order to perform an
 17 effective audit, and an effective audit would be an
 18 independent audit.
 19 Part of that obviously would be to have a tax
 20 specialist as part of the audit team. To me, all of
 21 those activities are audit services, they are not tax
 22 services. And it's important to get to the fee
 23 question that Barbara raised that those kinds of
 24 services be included in the audit fee and not in a tax
 25 services or some other fee, so that it is clear that

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1 when the tax professionals are engaged in these
 2 activities, that they are engaged to the benefit of the
 3 auditor and the audit, and not to the benefit of the
 4 company necessarily and its decision-making as
 5 managers, and that those particular aspects of the
 6 discussion today I think is the important aspect for
 7 the Board to define and describe so that there's a
 8 clear understanding, not only by issuers and auditors,
 9 but by investors, as to what particular tax activities
 10 is appropriate for an auditor to engage in in order to
 11 enhance their independence and objectivity and to
 12 enhance the effectiveness in the audit, and what kinds
 13 of activities are inappropriate because they compromise
 14 the independence and objectivity of the audit.
 15 MR. SCATES: Mike Gagnon.
 16 MR. GAGNON: I think that the discussion now
 17 about appearance or appearances related to auditor
 18 independence is an important one, and would go back
 19 actually, Pat, to some of the comments you made before
 20 the break at lunch in the context of -- as well as this
 21 afternoon -- in that some of the appearance concerns
 22 appear to be downplayed or brushed aside. And I would
 23 tell you, at least from my own perspective, that
 24 couldn't be further from the truth in the sense that
 25 these are very serious issues. I think they're

<p style="text-align: right;">Page 186</p> <p>1 acknowledged by virtue of the fact of the people in the 2 room this afternoon that we all consider them very 3 serious issues, but nonetheless, very complex issues, 4 and complex in the sense of the intertwine between some 5 of the independence issues that we've talked about 6 today, which are very difficult to sort of get your 7 arms around in the context of tax services broadly, but 8 more specifically, the interplay between those services 9 and what is also critical to investor confidence and 10 protection and integrity, that is, the basic audit 11 itself and the integrity of the audit and the quality 12 of the audit. And the interplay between those two -- 13 they're not separate concepts, they're intertwined -- 14 are very important.</p> <p>15 If I have it correctly, I think that part of 16 the -- perhaps it's an impression that sort of audit 17 firms are here this afternoon wanting to do this work, 18 I think was some of the commentary -- and there's no 19 question that firms like ours do possess and have 20 deeply credentialed expertise to provide the service. 21 Providing that service though in all instances to all 22 audit clients, at least for my firm, is not the driving 23 force here. The marketplace is certainly shifting 24 these services, and it is important, as Colleen just 25 mentioned, that audit committee oversight here and</p>	<p style="text-align: right;">Page 188</p> <p>1 on fee disclosures that I think today there is very 2 clear guidance provided, requirements provided, in 3 terms of the categories of fee disclosures. I 4 personally believe that those disclosures are very 5 informative in the manner that they are now presented 6 today. I certainly believe they ought to be full 7 disclosures, and to the extent that there's an 8 ambiguity or an interplay there, that ought to be 9 corrected. But I do think the disclosures today in 10 terms of the categories are fairly clear and fairly 11 uniformly applies.</p> <p>12 MR. SCATES: Scott Bayless.</p> <p>13 MR. BAYLESS: Scott Bayless, Deloitte. In 14 terms of just responding to some of the comments that 15 have been made, certainly the firms are here today, 16 particularly Deloitte, because of the importance of 17 independence, because of the importance of audit 18 quality, and the importance of tax services in 19 connection with audit quality. We believe that they're 20 integrally tied together and that we want to protect 21 the integrity of our audits, protect the importance of 22 investors of these audits.</p> <p>23 Certainly the firms have undertaken and 24 continue to expend millions of dollars in funds and 25 resources to ensure independence and to maintain</p>
<p style="text-align: right;">Page 187</p> <p>1 consideration of the very important independence 2 matters we've talked about this afternoon is changing 3 the way businesses operate.</p> <p>4 In my judgement at least, some of those 5 considerations are -- need to also encompass the basic 6 principles of independence we've talked about as well 7 as the O'Malley principles that we've also alluded to 8 earlier. I am concerned about what I would guess I 9 would call unintended consequences in the sense of we 10 want to make sure that to serve the public interest in 11 this market, that we continue to preserve the required 12 and knowledgeable expertise in our firms to make sure 13 that we can get the job done and get the job done 14 properly and correctly. And that's a balancing factor 15 in my mind that complicates this question, complicates 16 it significantly.</p> <p>17 But I wouldn't want the impression provided 18 that this is sort of all about business. It's not. 19 Audit quality if of paramount importance here. 20 Independence goes hand in hand with audit quality. But 21 it is a very complex and a very difficult discussion 22 that at least in my mind wouldn't lend itself 23 necessarily to sort of bright line tests.</p> <p>24 One last point. In terms of fee disclosures, 25 I would certainly echo and agree with the comments made</p>	<p style="text-align: right;">Page 189</p> <p>1 independence with respect to SEC audit clients, and we 2 would encourage the Board to consider, as it reviews 3 these issues, certainly that there are scenarios in 4 which services, we believe, are strictly out of bounds. 5 I think we've talked about various provisions today, 6 transactions that would include no business purpose, or 7 that were purely tax motivated with no basis in the 8 code, as criteria that would clearly place services out 9 of bounds, but that the Board be measured in terms of 10 looking at those services that are tax compliance, tax 11 advice oriented, because those are integral, we feel, 12 to the conduct of audits.</p> <p>13 MR. SCATES: Lynn Turner.</p> <p>14 MR. TURNER: There's been a number of business 15 ethics raised on the front page of the newspapers in 16 recent years because of some of the auditors' 17 involvement with compensation or tax shelter-type 18 issues, and I don't think any of those have played out 19 well for the profession in the public eyes. And I 20 think there are some very significant business ethic 21 issues here that go beyond even where you decide, if 22 you decide to make a cut, that are very important. 23 I've heard people, Chairman McDonough, give a speech 24 more than once about getting it done right, and I think 25 that ties into the ethics side of things.</p>

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1 But you're also asking an awful lot of people
 2 here, because you've got a very regulated entity on the
 3 audit side now underneath the same corporation and
 4 within the same -- under the same roof as you do a non-
 5 regulated entity, and that's the tax people. And
 6 you're now asking -- talking about asking the tax
 7 people to switch that hat from time to time between
 8 when they are advocating the interest of a particular
 9 tax client vis-a-vis advocating the interest for an
 10 investor. That is not an easy switch to make as they
 11 go about their business day to day. That's a difficult
 12 thing to ask of very good people.
 13 And so I think part of what you need to think
 14 about as you decide what to do here is not only where
 15 you might make some cuts on tax services that are not
 16 okay, but how do you also provide the support for some
 17 of the tax people to make sure that they are able to
 18 switch that hat back and forth in an appropriate
 19 fashion. Give them the right environment in which to
 20 do it and I think they will do it right. But if you
 21 don't create the right environment for them, I think
 22 that will also have some negative ramifications. So I
 23 think quality controls and ethics go with this, and
 24 that's an important part of it.
 25 MR. SCATES: Jeff Steinhoff.

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1 MR. STEINHOFF: I think the issue you're
 2 really addressing today, independence, is really part
 3 of a broader issue, and that ties back to greed,
 4 morality, I think gave rise to this body was much
 5 broader than whether people were independent to do
 6 their work or not. I think there were large grey areas
 7 in terms of what was allowed and what wasn't. People
 8 continued to push the grey areas out and if there
 9 wasn't some rule that said I can't do it, then I'm
 10 permitted to do it. And I think the profession has
 11 paid a big price for that and saw the rule as being the
 12 floor and the ceiling at the same time.
 13 I think you're talking about cultural change,
 14 and I think some of the people participating today
 15 spoke about some of the things their firms are engaged
 16 in doing now. But it will be very, very important to
 17 push forward in a permanent basis that kind of cultural
 18 change.
 19 At the same time, all this has got to be
 20 balanced out, and it struck me that we were speaking
 21 today about types of services that were very, very
 22 broad. We were talking about structured transactions,
 23 we were talking about cases where auditing firms pulled
 24 together themselves very aggressive, questionable, if
 25 not illegal structures, and sold them to the clients.

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1 We didn't talk about the fee structures for those, but
 2 some of them weren't based on an hourly rate, it was
 3 based on you're getting so much back, so I share in
 4 that largess. And there's something frankly
 5 fundamentally wrong with that.
 6 On the other side of the spectrum today, we
 7 were speaking about preparing a tax return for an
 8 expatriate, which I guess I view somewhat as a
 9 ministerial duty. We've asked this employee to go
 10 abroad, you know, there's a lot of complex issues, they
 11 already have enough on their plate, so we'll provide
 12 this service to the employee. It's not quite like day
 13 care, but it's like providing a fringe benefit or a
 14 benefit to the employee.
 15 I think the Board is going to have to kind of
 16 focus in on what are the more important areas, what are
 17 those things that really drive behavior. One thing the
 18 Board has that was never really in play before is a
 19 process where one can be disciplined, and through the
 20 inspections and the work you all are doing, you can
 21 look at the range of issues that affect audit quality,
 22 including this one, and you can act when you see that
 23 type of behavior that in its totality is not
 24 acceptable.
 25 But I certainly think ethics are a big part

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1 of this and I think changing the cultural focus on,
 2 let's say, a firm or an entity's bottom line to more of
 3 the public interest focus is probably what's needed.
 4 MR. SCATES: Bruce Webb.
 5 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 6 There's been a lot of statements today that imply that
 7 when an auditor prepares a tax return, he's being a
 8 client advocate, when he signs an audit return he's
 9 being an investor advocate. I'm just not sure I buy
 10 that. My firm hasn't let me sign tax returns other
 11 than my own in 15 years, but I can assure you that when
 12 I sign tax returns on behalf of a client, I read that
 13 statement that I was signing and I took my
 14 responsibility very seriously.
 15 I think that what I said, to the best of my
 16 knowledge and belief, the representations contained in
 17 that tax return were true and correct. And I will tell
 18 you that if I was the auditor of that client, I had a
 19 much better knowledge and belief on which to base that
 20 representation.
 21 MR. SCATES: Tom Ochenschlager.
 22 MR. OCHSENSCHLAGER: Tom Ochenschlager with
 23 AICPA. I think much of the impetus that we are here
 24 today actually probably relates to some of the abusive
 25 tax shelters that we had. We've talked a lot about

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1 mass marketing of products and abusive tax shelters and
 2 things of that nature. I think had it not been for
 3 that unfortunate occurrence over a period of a few
 4 years we probably wouldn't be having this meeting
 5 today.
 6 And so I think we need to look at it from the
 7 perspective of is that still an issue or is it an
 8 ongoing issue and what is being done about it that
 9 might correct those problems so that we wouldn't
 10 necessarily need a draconian measure to eliminate all
 11 tax services that could be provided by a CPA firm?
 12 In that regard, the world has really changed.
 13 I mean, we now have audit committees that I can't
 14 imagine would approve any of these transactions going
 15 forward. The audit committees have only been in
 16 existence for about a year and a half now, and they're
 17 still on a learning curve as to some of the more
 18 technical tax issues, but based on anecdotal evidence,
 19 I think it's starting to take hold and we're starting
 20 to see the turnaround and them to be more effective.
 21 Secondly, there was an allusion earlier that
 22 there were different standards for CPAs in the audit
 23 function and relatively few standards for CPAs in the
 24 tax function, and that probably was true up until very
 25 recent -- relatively recently. But our friends at the

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1 Internal Revenue Service are strengthening up --
 2 dramatically strengthening the circular 230
 3 regulations, which will make it much more difficult for
 4 tax preparers or tax specialists to perform any of the
 5 sorts of activities that we think of in the more
 6 negative sense.
 7 Additionally, the AICPA, you may not be
 8 aware, has recently made its standards of tax practice
 9 to be mandatory, they're enforceable now, so that
 10 anyone violating, found to violate those standards,
 11 would be expelled from the AICPA. To take even a step
 12 further, we recently made those not only enforceable,
 13 but automatically enforceable in circumstances where
 14 any member of the AICPA has been sanctioned by either
 15 the SEC, the IRS, or the PCAOB. So we have standards
 16 now, and I might add that we've done a second
 17 interpretation to those standards that is very
 18 specifically related to tax opinions and taking tax
 19 return positions, so we've -- in a question and answer
 20 format and also a monologue format.
 21 So there's been a lot of changes that have
 22 happened that have yet -- that are starting to take
 23 effect and I think are having positive effects, and I
 24 see these changes being more dramatic going forward in
 25 the future, having more effect as we go forward. And I

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1 would think that that should temper any major change
 2 now in a policy as to whether or not auditing firms
 3 should be permitted to do tax work for their -- various
 4 types of tax work for their clients.
 5 MR. SCATES: Mark Weinberger.
 6 MR. WEINBERGER: Thanks. I guess I'd just
 7 maybe -- Tom stole some of what I was going to talk
 8 about, but I do believe it's all of our
 9 responsibilities, us as audit firms, certainly
 10 investors, to keep us focused on what the investors
 11 care about, regulators to write the right rules, to
 12 stay focused on these issues. These issues aren't
 13 brand new. They were around before Sarbanes-Oxley,
 14 they were around during the debate, they were around
 15 during the rulemaking, and they're still here today.
 16 I think there has been a lot that has changed
 17 though, and as you decide where to go next, I think you
 18 do have to view it with that filter, at least I would
 19 hope we all would. The world operates differently, and
 20 as we decide in our firms what to do to try and make
 21 ourselves from an ethics standpoint more aligned with
 22 where we should be, we put in numerable changes in our
 23 processes, and I'm sure the other firms have as well.
 24 In addition, you can't ignore -- I mean, one
 25 of the issues that was put on the table was the abusive

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1 tax transactions, which we all wish never happened and
 2 which we hope will not happen again, and that's not to
 3 say that there won't be differences of opinion on tax
 4 transactions as companies enter into them and they're
 5 reviewed by the IRS. But the mass marketing of these
 6 transactions that are tax motivated without business
 7 purpose, what is out there now to prevent them from
 8 happening again? It's something we all care about.
 9 Well, Cono and the IRS have taken a lot of
 10 steps that we need to be cognizant of if you all think
 11 through the rulemaking. Not only are there brand new
 12 regulations out there that require a whole web of
 13 transparency that didn't exist before, whereby now the
 14 issuers and all the way down to the individuals have
 15 to, if they meet certain requirements, file additional
 16 information with the IRS that they never had to before
 17 so they can better identify and target these
 18 transactions early on.
 19 Most recently, and something very pertinent
 20 to our discussion, is a new form that's going to be
 21 required to be filed with the 1120, with the corporate
 22 tax return. It's called an M-3, and the purpose of
 23 that is to highlight very specifically, not en banc but
 24 in transaction by transaction, book and tax differences
 25 between all aspects of the accounts on an issuer. That

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1 will allow the IRS obviously to go in more quickly,
 2 identify where there are problem areas, and try to
 3 address it either through rulemaking, through
 4 challenging it through audit, or going to try to get
 5 the law changed if they find problems.
 6 The audit committee involvement is clearly a
 7 new element. Sarbanes-Oxley and now the regulation of
 8 the profession is something that we're all grappling
 9 with and trying to understand day in and day out and
 10 getting better and better at trying to effectuate is
 11 brand new, and it's taking hold, and we saw that the
 12 audit committees are speaking loudly, significant
 13 reduction in the type of services, the amount of
 14 services we're providing to auditors.
 15 I think the real question is, over just a
 16 year after we have the new rules in effect, what is the
 17 next step? Do we come in and decide to do rulemaking?
 18 Do we see how these IRS rules, how the audit committees
 19 take their charge, how the audit firms frankly respond
 20 and step up to where we need to step up to to do the
 21 right things? Or do we come up with new rules, which
 22 will undoubtedly raise new issues? Because these
 23 issues, every time we write rules, create new issues.
 24 I think it's a tough issue that we're going to have to
 25 grapple with as we all move through this process, and I

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1 think we all want to be constructive and appreciate the
 2 opportunity to be here today to talk through the
 3 issues.
 4 MR. SCATES: Barbara Roper.
 5 MS. ROPER: On this issue of the world's
 6 changed, I see it somewhat differently. I hope audit
 7 committees are being more responsible in making these
 8 decisions and I hope firms are abandoning practices
 9 that have created problems in the past, and I believe
 10 that that's likely to be the case. But I also believe
 11 that memories fade and that you have a window of
 12 opportunity while memories are fresh to
 13 institutionalize the changes you would like to see as
 14 permanent changes.
 15 And if we have identified changes where there
 16 are clear independence problems with tax services, I
 17 think the opportunity is now to write those rules. And
 18 if we have identified areas where there are sort of
 19 questions about independence problems, the opportunity
 20 is now to clarify those issues for audit committees so
 21 there's something that they can look to going forward
 22 that will direct the decisions that they make and hold
 23 them accountable for making good decisions, even when
 24 memories of the recent pain in terms of the audit
 25 scandals have faded.

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1 MR. SCATES: Let's now take a look at the last
 2 two remaining questions. Are there any special factors
 3 that an audit committee should take into consideration
 4 before approving an engagement of an auditor to perform
 5 any of the services discussed today? Are there other
 6 ethical issues an audit firm should consider before
 7 providing tax planning advice, strategy, and other tax
 8 services?
 9 MR. CARMICHAEL: It looks as if all souls have
 10 been saved.
 11 (Laughter.)
 12 MR. SCATES: Tom Ochenschlager.
 13 MR. OCHSENSCHLAGER: I'm not quite ready to
 14 respond here. I'm asking Sue here -- Tom
 15 Ochenschlager with the AICPA. The AICPA does have a
 16 practice guide that we've published, an audit committee
 17 -- I'm sorry, late in the day, I guess -- an audit
 18 committee tool kit, which provides very specific bullet
 19 points that audit committees should consider before
 20 engaging an auditor to do services that are outside the
 21 scope of the audit. So there is such an item out
 22 there, which I'd be glad to supply anyone that wants to
 23 get in contact with me.
 24 MR. SCATES: Bruce Webb.
 25 MR. WEBB: Bruce Webb, McGladrey & Pullen. I

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1 just simply want to state that I believe it's incumbent
 2 upon both audit committees and auditors to consider the
 3 overriding principles and the spirit of the rules, not
 4 just the letter of the rules, before agreeing to engage
 5 the auditor for any non-audit services.
 6 MR. SCATES: Any other comments on audit
 7 committees or these two remaining questions? I've got
 8 one question here. Mark Weinberger, you alluded to the
 9 M-3, new schedule M-3. I have a question on this, not
 10 directed to you, but anyone. With the new schedule M-3
 11 requiring certain reconciliations to financial
 12 statements and characterization of book to tax
 13 differences as either permanent or temporary based on
 14 financial accounting principles, is there enhanced
 15 efficiencies by having the audit firm prepare the
 16 issuer's income tax returns, including the new schedule
 17 M-3?
 18 MR. WEINBERGER: Oh, wow. It's a tough
 19 question, and without my independence person here
 20 telling me what we can and cannot do, I'm a little
 21 leery to answer it. I certainly think -- I think the
 22 M-3 generally, and again, for those who aren't familiar
 23 with it, it is a brand new schedule that I think goes
 24 into effect -- I don't know, Cono, if you know the
 25 answer as to when -- but next year, not this year.

<p style="text-align: right;">Page 202</p> <p>1 It's a limited effect for the first year and then it 2 will be fully in effect the year after, but it really 3 is going to highlight the -- all the book tax 4 differences that -- per account. And obviously, to the 5 extent that the auditor is working with the books and 6 records and the work papers, they would have efficiency 7 to work on the M-3 schedule for sure. I just don't 8 know when you come to a situation where we can't 9 prepare it because it's somehow used in a financial 10 statement and where that issue arises, so I'm going to 11 leave the independence issue to somebody else. But at 12 first blush, it certainly seems like the information 13 would be at the auditor's fingertips. 14 MR. SCATES: Pat Walters. 15 MS. WALTERS: I'm certainly not talking about 16 the M-3. I would like to go back for a minute to the 17 audit committee issue and sort of throw something out 18 on the table which I'm not sure falls within the 19 purview of the PCAOB or not, and that is, what would be 20 the minimum level of due diligence that an audit 21 committee should go through in determining whether to 22 award a tax services contract to their auditor? For 23 example, should they be required to do an RFP, a 24 request for proposals, from others? Should they be 25 required to consider some of the issues that we have</p>	<p style="text-align: right;">Page 204</p> <p>1 on, I think investors need more confidence that the 2 audit committees are going to do extensive due 3 diligence around these issues. And to say we're going 4 to just leave it to the audit committee means that 5 audit committees who don't do requisite due diligence 6 will become lazier and lazier, and those audit 7 committees who see that others don't have to do that, 8 because I would expect that a lot of these people are 9 on at least one other audit committee in life, they 10 will get lazier and lazier, and I'm really not 11 encouraged by let's leave it to the audit committee. I 12 would like there to be some document, documented best 13 practices issued by some authoritative body that says, 14 we think that these are the minimum steps that an audit 15 committee should take on issues that reflect on the 16 independence of their auditor. 17 And I think that the simple fact that we've 18 had a day-long discussion around this particular topic, 19 and there's pretty much unanimity on the part of the 20 investor advocates in these rooms that tax services is 21 an issue for them, that someone, if it's not the PCAOB 22 maybe it's the SEC, or someone should come out and say, 23 we think these are minimum best practices in this area. 24 MR. SCATES: Scott Bayless. 25 MR. BAYLESS: Just to address the M-3</p>
<p style="text-align: right;">Page 203</p> <p>1 placed out on the table today with respect to concerns 2 about providing tax services and document their 3 discussions and decision-making surrounding those 4 issues? 5 Those are just some thoughts that I've had in 6 terms of what a reasonable investor would expect the 7 audit committee to have done before they award such a 8 service to their auditor. And certainly I would be 9 interested in hearing what others around the table 10 might say about that. 11 MR. SCATES: Mark Weinberger. 12 MR. WEINBERGER: I just don't want you to have 13 an unanswered question, Pat. I guess my view would be 14 we certainly have all circumstances in our firm, some 15 do issue RFPs regularly routinely and some don't. And 16 again I think this, because of the diversity of clients 17 and the diversity of taxpayers and the issues they 18 face, that I would suggest that that's probably best 19 left to the audit committee as under current processes. 20 MR. SCATES: Scott Bayless. 21 MS. WALTERS: Can I? 22 MR. SCATES: I'm sorry. Pat Walters. 23 MS. WALTERS: Going back to everything that 24 Barbara said, and I really wish I had said that, your 25 last series of comments were absolutely perfectly right</p>	<p style="text-align: right;">Page 205</p> <p>1 question, in terms of the process, of course, the 2 process is typically that the client has gone through 3 and prepared books and records that incorporate its tax 4 position that's weaved into the financial statements. 5 The auditor then comes in with the assistance of a tax 6 expert that works for the firm to assess whether the 7 positions laid out by the client in their books and 8 records with respect to taxes are accurate and reflect 9 the auditors through the tax eyes, tax expert's eyes, 10 views of what is appropriate in the financial statement 11 disclosures. 12 We heard Lynn Turner describe that the tax 13 return typically is not done at that time, that the tax 14 return is typically done months later, and it's the 15 ministerial act of filling out the form, putting 16 numbers that the client has generated into a reporting 17 format, that then is filed with the SEC -- or excuse 18 me, filed with the IRS. 19 The significant intervening event is that 20 management is ensuring that the numbers that are placed 21 in that form are consistent with what they're reported 22 in their books and records to ensure that they can then 23 sign the return, that it reflects the information that 24 they believe is correct and accurate. So significant 25 management involvement in both the process of</p>

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1 generating the books and records that are then placed
 2 into that format, it's a form. The auditors are not
 3 responsible for maintaining that information that is
 4 set forth in the M-3. That is the management's
 5 responsibility and they keep the books and records to
 6 ensure that those -- that information is reflected in
 7 their books and records.

8 MR. SCATES: Bruce Webb.

9 MR. WEBB: The Board may wish to consider an
 10 amendment to ethics interpretation 101-3 that was
 11 adopted last June, became effective last fall, so
 12 therefore is not included in the interim independence
 13 standards. But I think it represents a significant
 14 strengthening of the overall non-audit service
 15 requirements in that it requires a number of things
 16 that the old interpretation didn't. Perhaps first and
 17 most importantly is a documented understanding
 18 regarding several aspects of the engagement, the
 19 members' responsibilities, the client's
 20 responsibilities, the objectives of the engagements,
 21 some of the things that I believe Pat was getting at
 22 that the audit committee should want to understand as
 23 they approve those activities.

24 Secondly, it requires that management
 25 designate a competent employee to oversee those

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1 services so that -- make all management decisions in
 2 connection with those services. So that might be
 3 useful to the Board.

4 MR. SCATES: Any other comments?

5 MR. CARMICHAEL: Okay, we're ahead of
 6 schedule. That's fine. We would like to thank you all
 7 very much for the information that you've provided to
 8 us today. Many of you have traveled a long way to get
 9 here and we appreciate your willingness to do that and
 10 wish you safe travels as you return home. Thank you.

11 (Whereupon, at 3:58 p.m., the meeting was
 12 adjourned.)

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