

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 9, 2011 that relates to the Board's Concept Release on Auditor Independence and Audit Firm Rotation. The other topics discussed during the November 9, 2011 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

STANDING ADVISORY GROUP MEETING

Public Company Accounting Oversight Board

1666 K Street, N.W.

Suite 800

Washington, D.C. 20006

November 9, 2011

9:00 a.m.

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PARTICIPANTS

Moderators:

MARTIN BAUMANN

Participants:

JENNIFER RAND	KIKO HARVEY
BRIAN SIPES	STEVE RAFFERTY
JOE CARCELLO	ANTHONY KENDALL
STEPHEN HOMZA	MICHAEL AUERBACH
KURT SCHACHT	BOB DUCEY
ARCH ARCHAMBAULT	LARRY SMITH
JAY HANSON	
MARY HARTMAN MORRIS	BRIAN CROUTEAU
DOUG CARMICHAEL	JIM KROEKER
KEVIN REILLY	ARNOLD SCHILDER
BARBARA ROPER	MEGAN ZEITSMAN
WAYNE KOLINS	HARRISON GREENE
ARNOLD HANISH	GAIL HANSON
SUE HARRIS	LYNN TURNER
DAMON SILVERS	LIZ GANTNIER
BILL PLATT	LEW FERGUSON

1 Participants (continued):

2 SCOTT SHOWALTER

3 JOHN WHITE

4 JEFF MAHONEY

5 JIM DOTY

6 GAYLEN HANSEN

7 NERI BUCKSPAN

8 MIKE GALLAGHER

9 DAN SLACK

10 DAN GOELZER

11 DENNY BERESFORD

12 LISA LINDSLEY

13 SAM RANZILLA

14 MICHAEL GURBUTT

15 KEITH WILSON

16 BRIAN DEGANO

17 GREG SCATES

18 GREG FLETCHER

19 DMYTRO ANDRIYENKO

20 DOMINIKA TARASZKIEWICZ

21 KANNAS RAGHUNANDAN

22 LISA CALANDRIELLO

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4 [Whereupon, at 11:33 a.m., the meeting resumed.]

5 MR. BAUMANN: Thanks, everybody, for getting back.

6 And I appreciated the valuable input on our standards-

7 setting agenda and other matters that we should think

8 about in connection with standard-setting. So as

9 always, thanks for that very, very valuable input.

10 We're going to turn our attention now to the

11 concept release that the board issued in August on

12 auditor independence, objectivity, and professional

13 skepticism, including consideration of mandatory audit

14 firm rotation. The comment period on that concept

15 release ends on December 14th, and certainly comments

16 received here today will be part of an official

17 transcript in our comment period, so we look forward to

18 your input.

19 Steve Harris will give us some initial comments,

20 and then Michael Gurbutt here will lead the discussion

21 after that.

22 But I'll turn it over to Steve. Thanks.

1 MR. HARRIS: Well, thank you very much, Marty, for
2 the opportunity to introduce this extremely important
3 and clearly noncontroversial topic.

4 [Laughter.]

5 MR. HARRIS: Independence is clearly key to the
6 credibility of the audit and the viability of the
7 profession. The value of an auditor's opinion depends
8 on the extent to which he or she is an objective third-
9 party with no stake in the company's financial success,
10 and is recognized as such.

11 The importance of auditor independence has been
12 confirmed by the U.S. Supreme Court, which has said
13 that the auditor owes ultimate allegiance to the
14 corporation's creditors and stockholders as well as to
15 the investing public. Yet at the same time, the
16 accounting firm is a for-profit enterprise that is paid
17 by the company whose financial statements it audits.
18 As a consequence, auditors inevitably must struggle
19 against letting the day-to-day pressures of client
20 service interfere with their overriding obligation to
21 serve investors.

22 As we all know, the Sarbanes-Oxley Act included a

1 number of significant provisions designed to bolster
2 the auditor's independence from the company under
3 audit. Yet our inspections show us that there is still
4 significant room for improvement in this area. The
5 inspection reports of many of our international
6 regulatory counterparts show this as well.

7 In August, the board issued a concept release that
8 fostered broad debate about ways that auditor
9 independence, objectivity, and professional skepticism
10 could be enhanced.

11 One possible approach, which is explored in depth
12 in the concept release, is mandatory audit firm
13 rotation. As the concept release explains, the theory
14 is that mandatory audit rotation might bolster the
15 auditor's willingness to resist management pressure and
16 to bring a fresh look at the company's accounting.

17 We on the board have a responsibility to carefully
18 monitor all of the arguments in a transparent, open
19 process, and today we are here to seek the SAG's views
20 of how best to meaningfully enhance auditor's
21 independence.

22 So I think it's fair to say that we all look

1 forward to a lively discussion.

2 MR. GURBUTT: Thank you, Steve. And good morning,
3 everyone.

4 Just as a reminder, the concept release itself is
5 included in your package, so you can all make reference
6 to that. And as Steve indicated, before we open this
7 topic up for discussion, the concept release solicits
8 comments on ways that auditor independence,
9 objectivity, and professional skepticism can be
10 enhanced, including through mandatory audit firm
11 rotation.

12 In addition, the concept release also solicits
13 comments on other approaches as well. You'll see that
14 there are a number of general questions, which are
15 included on pages 18 and 19 of the concept release.
16 And on pages 20 through 24, there are a number of more
17 specific questions on various aspects of any potential
18 rotation requirements.

19 With that being said, what I would like to do at
20 this point is invite your comments on any aspect of any
21 issue that is raised in the concept release.

22 Thank you.

1 Denny?

2 MR. BERESFORD: Well, as board members and staff
3 know, I wrote a letter. And first of all, I'd like to
4 make one comment, as Steve pointed out, on the
5 important issue of independence. I just wanted to read
6 a couple of sentences from my letter:

7 I was somewhat surprised to see that the entire
8 release covered audit firm rotation and not the broader
9 topic of auditor independence. As Chairman Doty noted
10 in the press release that introduced the topic, one
11 cannot talk about audit quality without discussing
12 independence, skepticism, and objectivity. I fully
13 agreed, but would've expected that the board would
14 consider those important topics with a much broader
15 look, rather than what many may feel is a myopic focus
16 on audit firm rotation.

17 So I'm all in favor of independence, in other
18 words. But this really is, in my opinion, just a focus
19 on audit firm rotation and not a broader request for
20 comments on independence. And that was the intention
21 of my letter.

22 And to really briefly summarize, I wrote from the

1 perspective of an audit committee member, which is
2 obviously under attack from the comments in the last
3 session, which I would like to come back to in just a
4 minute.

5 But I believe, in general, and I'm going to keep
6 this very short, because you can read my letter, I
7 believe overall that the mandatory rotation would
8 lessen the quality of the audit procedures, and I think
9 it would also increase the cost.

10 And I think that, basically, the approach of
11 mandatory audit rotation takes away a lot of the --
12 doesn't really take into consideration the important
13 role that audit committee does play now in assessing
14 the annual performance of the auditor and the important
15 decision to reappoint the auditors on an annual basis.

16 I make two points in my letter, one that I think
17 is consistent with some of the comments that were made
18 earlier, perhaps Arnie's in particular, that I do
19 believe the existing SEC definition of an audit
20 committee financial expert is deficient. It sets way
21 too low of a standard, and it could be enhanced. I
22 know that's not the purview of the PCAOB, but I think

1 the bully pulpit, if you will, could be used to help
2 address that.

3 And a somewhat unrelated topic, but I think that
4 the PCAOB could require that the inspection results
5 that come through when you do inspect an individual
6 firm could be shared on a required basis with the audit
7 committee.

8 A couple of comments on the audit committee.
9 Comments that were made earlier, I have to disagree
10 with the comments that were made about audit committees
11 have been backsliding, per Scott. Joe Carcello: half
12 get it, half don't. Gaylen: management still making
13 the audit committee selection.

14 Those comments, I think, are very troubling. If
15 true, we have a big problem. And as I said, I think we
16 can and should readdress the question of audit
17 committee, the definition of audit committee financial
18 expert. But I hope that we don't jump to conclusions
19 based on these kinds of assertions that are being made
20 without some better evidence of the statements.

21 Joe, I suspect that if you made that comment in a
22 400-member PricewaterhouseCoopers audit committee

1 seminar that took place several weeks ago in New York
2 City, for example, that they would not agree, in
3 general. Or if you said it in a seminar with financial
4 executives sponsored in New York City a couple weeks
5 ago of leading experts from the FEI, they would
6 probably not agree in general. Perhaps when you get
7 down to the very small companies, that might be true.
8 And we would certainly like to see that audit
9 committees of all companies are brought up to snuff.

10 But it troubles me when we hear those kinds of
11 comments. And I would hope that whether it's through
12 the SEC, whether it's through the PCAOB, whatever, that
13 we start having more hard evidence for these kinds of
14 comments, rather than just assertions that are thrown
15 out like that in public arenas.

16 My experience in dealing with a number of audit
17 committee members through various associations, through
18 seminars, and so forth, is that these people are
19 dedicated, they're hard-working, and they want very
20 much to do the very right thing.

21 Thank you.

22 MR. BAUMANN: Thanks, Denny.

1 Let me just make one or two comments on your
2 independence point, the points on the concept release.
3 I do hope that many more audit committee members
4 comment on the concept release. We're looking for
5 broad comment, and we appreciate the fact that you sent
6 a letter in early, well before the end of the comment
7 period. And I hope that other audit committee members,
8 members of the board, give us their views. We are
9 seeking broad input on this topic. So thanks for that.

10 And secondly, on the matter of focusing on
11 mandatory firm rotation, it's a complex subject that
12 needs to be explored with the pros and cons. And yes,
13 there's a lot in there in the concept release about
14 that, not taking a position one way or the another.
15 But certainly we are seeking comments and input from a
16 wide variety of parties, and certainly including the
17 profession on other ideas to improve independence,
18 objectivity, and professional skepticism.

19 So hopefully we made that clear in the release,
20 and I want to make that clear again today, that we are
21 looking for that.

22 MR. BERESFORD: If I could just follow up briefly,

1 and thank you for that comment.

2 I have, and other people have, tried much harder
3 to get audit committees more involved in the process.
4 I mean, thinking back to the communications between
5 audit committees and auditors, there are a total of
6 three letters that were sent in, which is frankly,
7 embarrassing on behalf of audit committees. And there
8 were only a handful of them that came in on the
9 auditor's report project.

10 I understand there are already about four or five
11 or so letters on this project, and I can promise you
12 there will be a lot more, because I know many, many are
13 in the process right now. And we're working very hard
14 to see that this happens.

15 This is one that particularly energizes companies,
16 but I know we're going to have a lot more input. I
17 have talked to Jim already about making sure the audit
18 committees are going to be more represented in the
19 PCAOB's process going forward.

20 MR. GURBUTT: Thanks, Denny.

21 Yes, we've received approximately 40 comment
22 letters already. And as you said, we have a number of

1 comment letters from audit committee chairs, which is
2 great. And people are commenting not only on rotation
3 but also on alternatives as well.

4 So hopefully that is a sign of things to come,
5 because we are still pretty early in the comment
6 process.

7 Barbara Roper?

8 MS. ROPER: First of all, I'm sorry that I stepped
9 out at a key point earlier to take a call, because I
10 missed a discussion on one of my favorite topics, which
11 is audit committees and their role in the oversight of
12 the audit. That's actually something in Sarbanes-Oxley
13 that CFA strongly supported, even while we thought we
14 were -- that the audit committees were a slender reed
15 on which to put our faith in the independence of the
16 audit, particularly in the absence of meaningful board
17 reform.

18 But that said, on this issue, I actually, I guess
19 from perhaps a slightly different perspective, agree
20 with Denny's point about the broader range of issues
21 that need to be considered in terms of improving
22 independence.

1 We come to this issue believing that auditor
2 independence is, as I think Damon said, the core value.
3 It is the characteristic without which the audit has
4 no value.

5 I don't need an auditor who thinks his job is to
6 get comfortable with management numbers. And I don't
7 need an auditor who is afraid of second-guessing
8 management. And I don't need auditor who is going to
9 be willing to find a way to go along with what is in
10 the financial statements, no matter what. I need a
11 skeptical auditor.

12 And we have a situation where the PCAOB and other
13 regulators are finding that there is a consistent,
14 serious problem in this fundamental, core value of the
15 auditor. So it's a problem that I think we have to
16 take very seriously.

17 And CFA has supported mandatory rotation in the
18 past as one of the tools that you can use to try to
19 bring greater independence to the audit. I think it's
20 a mistake to look at it as a silver bullet. And
21 particularly, if we go to long enough terms, as some
22 have proposed on the mandatory rotation, you're talking

1 10-plus years. I think you get the worst of both
2 worlds.

3 You have a stream of income that people are going
4 to be fearful of losing, so that you don't get the
5 independence of rotation, and you get the disruption of
6 the mandatory rotation. So I'd be very cautious about
7 looking at those kinds of proposals.

8 But my broader point is not a concern about the
9 way the board presented the options, but that there
10 needs to be a challenge. If you are against mandatory
11 rotation, if for whatever reason you think that
12 rotation is not the answer, then I want to know what
13 you are for to solve this serious problem with the
14 fundamental, core characteristic that the audit needs
15 to have and that the regulators throughout the world
16 say is not, at this point, consistently having. I
17 mean, that is the least that investors ought to be able
18 to ask of their auditors, is that they be independent.

19 So if you're not for mandatory rotation, and I get
20 there may be good reasons why people are not for
21 mandatory rotation, but tell me what you are for to
22 solve this problem, because we need a solution.

1 MR. GURBUTT: Damon Silvers?

2 MR. SILVERS: I'll make a sort of broader comment
3 that I think to some degree is in the vein of what Barb
4 said.

5 The concept of firm rotation has been debated now
6 since the founding of this board and before the
7 founding of this board as a possible response to the
8 problem of psychological independence of the auditor.

9 In the context of what some might think, who take
10 a look at this from a more sort of academic kind of
11 point of view, see as really this intractable problem
12 of the folks who are being overseen hiring and
13 supervising the overseers.

14 Strengthening audit committees was one approach to
15 dealing with that problem. And partner rotation, firm
16 rotation, these are all approaches for managing a
17 fundamental conflict in the nature of the auditing of
18 firms, in particular of public companies.

19 I think it's fair to say that in the years that
20 this debate has gone on, that, if anything, the
21 relevance of public company financial statements,
22 particularly -- and this reflects the bias of my work

1 in recent years -- particularly in the financial sector
2 has diminished. And I think the strongest, the most
3 obvious evidence of that diminishing relevance is in
4 the widening gap between market to market
5 capitalization of these firms and the GAAP value of
6 these firms.

7 Now, trying to strengthen these counteracting
8 mechanisms through, for example, firm rotation strikes
9 me as a very kind of modest and reasonable way to deal
10 with a really much sort of deeper, more profound
11 problem. And it seems to me, one, a solution that
12 doesn't upend fundamental -- that does not upend the
13 fundamental relationships that I think all the parties
14 around this table are familiar with, between
15 independent auditor, board, preparer, financial staff,
16 and the like.

17 I think people need to understand that looming in
18 the background is the possibility that at some point
19 policymakers will give up on trying to square the
20 circle, on trying to make these arrangements work in
21 their current form, and will look for more structural
22 remedies.

1 My view is, let's try this. We've spent years
2 discussing it, and I think the reality is that most
3 thoughtful observers thought that firm rotation at a
4 certain point was good policy 10 years ago, and it's
5 only politics that has blocked it.

6 So I see this as both a modest step in reality,
7 and one that is long overdue, and one where the need is
8 growing, and where the cost of not taking action in
9 relation to issues of independence is the growing
10 irrelevance of the entire process, the growing
11 irrelevance of GAAP financial statements, of the public
12 audit, of what this board does.

13 And so there are really significant stakes here,
14 and I think folks who see this as sort of disruptive
15 deeply misunderstand what the other possibilities are
16 here.

17 MR. GURBUTT: Arnie Hanish?

18 MR. HANISH: So preface these comments by saying
19 that obviously it's the views of a preparer
20 perspective. I agree with all the comments that are
21 made around the key focus of independence, that that is
22 paramount to audit of our financial statements.

1 Shouldn't be any disagreement on that point.

2 I just believe, without any hard data to prove it,
3 but having been in a role for over 25 years, that
4 auditor rotation is not the simple solution to a more
5 complex question.

6 As to the quality of an audit, it is a very
7 complex question, but I don't believe that auditor
8 rotation is the answer. There is so much to be gained
9 from an investor perspective to have an audit team that
10 has the depth of knowledge of your company, the
11 intricacies of your operations. A multinational
12 company is very complex.

13 The move towards lead partner rotation, which has
14 occurred, by itself creates a check and balance, in my
15 view, from a independence perspective. You also see,
16 as I've seen, rotation of senior managers off of the
17 engagement from a periodic perspective. You have the
18 inherent rotation of staff auditors and other managers
19 on an engagement, just because of the natural attrition
20 that occurs within the auditing firms, as I've seen
21 over the last 25 years.

22 So I believe that at least with respect to the

1 auditor, that you are gaining, over time, just through
2 natural attrition and rotation that is occurring, some
3 independent thinking that occurs, and independent
4 challenge of our business and our processes, and the
5 accounting associated with those changes in the
6 business process that occur over time.

7 I don't believe that there is lesser quality
8 because you have consistency of auditors on an
9 engagement. I think that, as I said, it's a
10 multifaceted issue.

11 Part of it is the role that management plays, as
12 far as challenging issues, setting the right tone and
13 framework with the auditors, making sure that they are
14 not just "rubberstamping" issues. That's a role that
15 management plays in this whole puzzle of creating an
16 environment.

17 And I don't know how many controllers, chief
18 accounting officers, CFOs have the dialogue with their
19 auditors to reinforce the fact that, you know: What's
20 your role, what's our role, you know, the challenge
21 that you have, you are independent. We want to be
22 challenged. We want this pushback. We want to make

1 sure that if you surface things, I want to understand
2 if there are inherent systemic issues from a control
3 perspective throughout my organization.

4 You get there by having that appropriate dialogue
5 with your auditor. I just don't believe that the
6 simple solution, again, is auditor firm rotation. I
7 believe that you would have a situation ultimately
8 where you get less quality, that you have individuals
9 who, depending upon who they're speaking with in an
10 organization, will -- let me back up.

11 We talk about trust and verify all the time. The
12 verification is critical to the role of an auditor. We
13 have a lot at stake as preparers. We can't have our
14 tentacles everywhere throughout an organization to make
15 sure that we don't have a rogue affiliate CFO or a
16 rogue controller in an affiliate who is trying to do
17 things to hit targets and forecasts because of the
18 pressures that are brought to bear. We rely to a large
19 extent on the auditors to help us there as well,
20 because we can't be everywhere. And so they play a
21 critical role in helping us as management achieve our
22 desired goals and objectives to have financial

1 statements that are reliable and trustworthy, you know,
2 for the public.

3 That's what is most critical, is to be able to
4 publish for investors reliable and trustworthy
5 financial statements that are in accordance with GAAP.

6 And the auditors play a significant role in that
7 process.

8 But I believe that if we had auditor rotation that
9 the quality would deteriorate because of the lack of
10 knowledge of the industry, the business, our business
11 processes, and how we go about doing things. It takes
12 a long time to get an auditor up to speed on the
13 complexities of our business. And to find that you
14 would have to reeducate over a period of years would be
15 an incredible amount of work and effort, from my
16 perspective, with low value.

17 So maybe I'll stop there and reserve the right to
18 comment later.

19 MR. GURBUTT: Thanks, Arnie.

20 Neri Bukspan?

21 MR. BUKSPAN: Thank you.

22 A couple of observations. The first is clearly

1 the role of independence state of mind of an auditor is
2 clearly important.

3 But what I would suggest putting in context, and
4 reacting to what Barbara mentioned earlier, is what you
5 are for, if you are against it. I can tell you what
6 could be considered what I am for is -- and actually,
7 reading through the proposal and looking at some of the
8 comments and some of the articulation of what auditor
9 rotation could enhance, could enhance the process, I
10 would suggest that the board should consider it jointly
11 with other proposals that are advocating greater
12 process transparency, including communication with
13 audit committee and others.

14 Because my concern is that if you create a
15 process, and whether it is 10 years or 7 years or
16 others, there is pressure going on both ways, right,
17 because there's existing pressures on the existing
18 auditors. And if you think those pressures are
19 existing within the system, there could be some
20 pressure on an incoming auditor in order to earn a
21 place for the next 10 years to probably be advocating
22 raising not as many friction as well.

1 So I think you need to think about how you create
2 a systemic -- how you relieve some of the systemic
3 tension. And in my mind one of the ways to go there is
4 to introduce greater transparency into the system, so
5 integrate transparency with the audit committee, with
6 the auditor communication, allowing market to
7 discriminate, and say even if those rotations occur,
8 what are the circumstances pursuant to which they are
9 occurring rather than simply the technical musical
10 chairs that will be occurring.

11 So what I would suggest is, one is think about
12 some empirical information in the context of cost vs.
13 benefits. I do think that many good auditors can get
14 up to speed fairly quickly, as we have encountered in
15 the recent past. I'm not overly concerned with the
16 deterioration in quality. What I am concerned with is
17 how we use such a process to improve the quality. And
18 I think transparency in the process, and thinking about
19 the transparency first, would be key, before you go
20 into simply technical rotation.

21 MR. BAUMANN: Can I just follow up, Neri, in terms
22 of transparency, in what regard? I just want to make

1 sure that I understand.

2 You said to think about this in concert with other
3 projects. I guess the first one I thought of was some
4 of the types of things that the auditors communicate to
5 the audit committee, some have suggested in our concept
6 release on the auditor's report that the auditor share
7 more of that with investors on difficult, contentious
8 matters, and so on and so forth, sort of transparency
9 into the audit.

10 Was that what you were talking about?

11 MR. BUKSPAN: This is one thing, but in order to
12 try to ascribe a certain level of auditor independence
13 and skepticism, I think from an investor standpoint, a
14 lot of information can be gleaned by a summarization of
15 the communications. What are the key areas of the
16 communication occurring?

17 And also to Lynn's earlier comment about the
18 nature of 404 topics or the binary nature of an auditor
19 opinion, if you simply encapsulated within a binary
20 opinion, yes/no, there is very little information that
21 investors can glean from the process. Then they revert
22 to comfort in rotation. And it may be a false comfort

1 in a way, because you still don't know what happens
2 within the box.

3 So to Barbara's earlier point, what you are for, I
4 am for greater transparency that can be accomplished by
5 virtue of several of your projects taken together. And
6 this is a transparency of the report, this is a
7 transparency into the communication with the audit
8 committee, and transparency into, for example,
9 exception found and how they share it with external
10 constituents. So constituents are in better position
11 to get some assessment of, do I think this is really an
12 indication of independence, a challenge of management.
13 And this I think could be extremely useful.

14 MR. BAUMANN: Thanks for the clarification.

15 MR. GURBUTT: Scott Showalter?

16 MR. SHOWALTER: Thank you. I felt the need to
17 defend my honor with Denny on the audit committee, but
18 then I want to talk about the standard itself.

19 Denny, there's actually a paper out there Shyam
20 Sunder was on at Yale that actually talks about the
21 issue where management stepped into the role of audit
22 committees. I'll also tell you of my conversations --

1 one benefit, as you know, to being an academic is all
2 the firm's love to talk to you when they come on
3 campus. So you get all types of information from
4 partners who are willing to share with you that I never
5 got when I was with a firm.

6 So they share with you very clearly the struggles
7 they have with audit committees. And you have to be
8 careful that we don't mean all that audit committees.
9 It's not a personal attack upon you, Denny, which I
10 know you didn't take.

11 But as Joe said, there are some other committees
12 that work very effectively and some that do not. My
13 observation was the backsliding. It's more of a trend,
14 as opposed to an absolute number.

15 But let me talk a minute about that paper, Marty.

16 I think your papers are well done. I really enjoy
17 them. I think they have great backing. And I think
18 it's very helpful.

19 I guess my reading of it is you haven't built a
20 case for auditor rotation. What you built a case was
21 lack of auditor professional skepticism. So I'm
22 getting to your point. I think there may be a bigger

1 issue.

2 In other words, I think if you want to take on
3 auditor rotation, you have to take it on with all the
4 levers that impact of professional skepticism. And
5 there many in there. There's many in there on time
6 pressures.

7 Every time the time pressure gets moved up, you're
8 squeezing these audit firms to end their audits in a
9 shorter period of time and with less time to get
10 information about fair value, management intent, and
11 forward-looking information.

12 So we're driving this two different ways. We have
13 a financial reporting model that requires more
14 estimates, less time to get any information about those
15 estimates.

16 And so I would suggest there many levers out there
17 on professional skepticism other than auditor rotation.

18 I'm not saying it's not a part of that, but I think
19 you need to step back and look at professional
20 skepticism, look at the issues that are in there, and
21 this may be a contributing factor. I'm not sure that
22 this paper builds that. And if you move it forward, I

1 think you need to build that case more, how this is
2 going to solve professional skepticism.

3 The way I read it was, we have all these issues of
4 professional skepticism; don't disagree at all. I
5 think that's been an issue with the profession since
6 day one. And then we kind of leap toward a rotation.
7 I didn't see the connection.

8 So just passing that on.

9 MR. GURBUTT: Lisa Lindsley?

10 MS. LINDSLEY: Thanks.

11 As I said before, I applaud the board for
12 considering auditor rotation, and I agree that it's not
13 sufficient by itself. You need to have other things,
14 otherwise you do run the risk of luring investors into
15 thinking they can count on auditing opinions.

16 I want to respond to Arnie's comments, because I
17 think that if you keep tossing the hot potato of who is
18 responsible for independence between auditors and
19 management, well, eventually the people that get hurt
20 are neither one. They are the investors, the people
21 who count on those opinions.

22 And I think he answered his own question when he

1 talked about rogue CFOs and rogue treasurers who are
2 out to manipulate the numbers because their bonuses
3 depend on it.

4 So I think that independence is important and that
5 rotation is a key component in achieving that.

6 MR. GURBUTT: Thank you.

7 Gail Hanson?

8 MS. HANSON: As I read this report, I thought
9 auditor rotation is potentially very disruptive. And
10 I'm just going to give you one example.

11 During my last 10 years, I was employed by
12 WellPoint, and we had an audit firm that did the audit.
13 We had a second large firm do the -- we outsourced the
14 internal audit. And we had a third firm do the
15 Sarbanes-Oxley work.

16 And if you think about rotating auditors, the
17 question is, you take the audit firm out of financial
18 audit work, and what happens to the other two firms?
19 Do they then step-- are they then in line to do the
20 audit? Because of Sarbanes-Oxley, you have one audit
21 firm, and if you want to do any other non-audit-related
22 work, you have other firms.

1 And so just by the very nature of taking the one
2 firm out of the mix, if you rotate the audit firms,
3 what happens to the other firms? And who then is
4 independent to step into the shoes?

5 And so, from a preparer's standpoint, thinking
6 about having to rotate all of those firms one to the
7 right, or to pick up a fourth firm or a fifth firm to
8 bring into the mix and then put the others on abeyance
9 for the next several years, it just, logistically, it
10 gives me heartburn.

11 So I just wanted to bring that up as an example
12 of, just don't think of this as only the rotation of
13 the key firm. Think about what it's going to do for
14 the other non-audit-related services that that issuer
15 employs.

16 MR. GURBUTT: Thanks for that point. And it's
17 actually something that we acknowledge within the
18 concept release. There are certainly disadvantages to
19 firm rotation that have been proposed by various
20 individuals over time. And so one of the things that
21 the board is interested in is potential mitigating
22 steps that the board might be able take to minimize

1 some of those issues, for example, around auditor
2 choice.

3 So again, any comments on that type of thing
4 around potential mitigating actions that the board
5 might take would be appreciated.

6 Joe Carcello?

7 MR. CARCELLO: Following up on Scott -- Denny, I'm
8 going to try to defend my honor here a little bit too.

9 In addition to the paper that he said, which is
10 excellent. You should look at it. It's really quite
11 troubling. There's a paper by Jeff Cohen, Ganesh
12 Krishnamoorthy, and Arnie Wright that looks at the
13 engagement of audit committees pre- and post-SOX. And
14 they are more engaged now, significantly so. But in
15 too many instances they still defer to senior
16 management, and it's problematic. And I won't go
17 through the whole paper, but it's worth looking at.

18 As it relates to auditor rotation, I think before
19 we decide if rotation is the solution, let's decide if
20 there's a problem. And in the concept release, there's
21 a discussion from one firm, as I understand it, and
22 proposals that were delivered to prospective clients

1 with language like "the auditor should be a partner,
2 support the desired outcome".

3 And then in the public meeting when this concept
4 release was released, Jay Hanson, and I think I'm
5 quoting Jay accurately here, said: This is a troubling
6 finding, but our inspectors have not seen such
7 assertions by other firms, so potentially maybe it's
8 just isolated.

9 Well, I wouldn't want to disappoint you, so what's
10 coming around to each of you, redacted, because I
11 didn't want to embarrass the firm, is two pages from a
12 audit proposal that I have recently received as the
13 chairman of the audit committee of Knox County.

14 This is not a big multimillion-dollar engagement,
15 guys. This is relatively small potatoes.

16 And this firm, which is an annually inspected
17 firm, annually inspected, uses language like "helping
18 clients succeed." How do you do that on that audit,
19 exactly?

20 An exceptional client experience, become a trusted
21 advisor to our clients, earns us a position as a
22 trusted advisor.

1 This kind of language to me is problematic and
2 very troubling. And so we at least have two annually
3 inspected firms that at least at times use this kind of
4 language. So I think it's fair to say that there may
5 be an issue.

6 And I agree with Scott. The issue may be
7 skepticism, and whether or not rotation is the answer,
8 I think the jury is still out on that. What I would
9 like to encourage, obviously, the PCAOB has to move
10 forward on their own track, but I think the firms,
11 notwithstanding what Sam has said about me giving
12 compliments to the firms, I think the firms' proposal
13 via the CAQ on the auditors reporting model was very
14 responsible, and had a lot to be said for it.

15 So I hope the firms, either through the CAQ or on
16 their own take the issue of lack of professional
17 skepticism seriously, because I think it's a valid
18 issue.

19 And rotation may or may not be the right answer,
20 but the firms have a lot of very smart, talented people
21 working for them. And as Barbara Roper said, if
22 rotation isn't the answer, come up with alternatives.

1 But ignoring the issue doesn't make it go away.

2 MR. GURBUTT: Thank you, Joe.

3 Kiko Harvey?

4 MS. HARVEY: I will let others debate the merits
5 of the rotation. I think you were asking those as a
6 possible -- for other possible solutions.

7 And I heard Denny say something that I thought was
8 very important, and that is, you know, the inspection
9 reports that the PCAOB does of the different audit
10 clients that the firms have, I do believe that those
11 should be shared with the audit committee. I am one
12 who still trusts the audit committee and thinks that I
13 have worked with very good ones. So I'm fortunate in
14 that respect.

15 I think the decision for changing auditors should
16 be with the audit committee, but they need to have some
17 additional information. If there are significant
18 deficiencies, as we say in these inspection reports,
19 and they're significant enough to warrant an upheaval
20 of the current process, in that a mandatory rotation is
21 necessary for all firms, then I think that at least we
22 should start with saying, for those firms that -- where

1 the recommendation of the PCAOB is that a rotation
2 should -- is advised or should be considered by the
3 audit committee, I think the audit committee might want
4 to hear that.

5 I would support -- again that's just me
6 personally, not my company -- but if necessary, that
7 the PCAOB starts making those recommendations, and the
8 audit committee is responsible for listening to and
9 meeting with the firm and talking about what the audit
10 approach is and how strong it is and what area and what
11 was deficient. And they come to a decision independent
12 of management that says whether they retain the firm or
13 ask for rotation to occur.

14 MR. GURBUTT: Thanks, Kiko.

15 Arch?

16 MR. ARCHAMBAULT: Thank you, Mike.

17 A lot of concerns have been raised about mandatory
18 firm rotation. There are certainly very valid concerns
19 that have to be considered.

20 And Grant Thornton is currently in the process of
21 preparing our comment letter on this release. But I'd
22 like to share at least some of the discussion and

1 debate that we have had on this issue.

2 As we've debated this, we feel that audit firm
3 tenure can affect objectivity. No one wants to lose an
4 audit relationship, let alone one that you have had for
5 many, many, many years. A new partner coming in
6 doesn't want to have that burden.

7 But the extent to which your objectivity might be
8 affected, and when you may reach that point or under
9 what circumstances that point is reached, is really
10 uncertain.

11 So firm rotation could really be a viable
12 component in the efforts to protect objectivity, but I
13 think we've also talked about -- and it was mentioned
14 earlier -- the extent to which or the timing which
15 rotation might be taking place.

16 You can't have it too short, because that would be
17 extraordinarily disruptive. So you have to try and
18 come up with a reasonable period of time, if in fact
19 it's implemented.

20 You'd also probably want to build in something, if
21 you went ahead with this, that would allow for some
22 flexibility, probably as long as it's properly

1 explained to the investing community, because for
2 example, a company could be in the middle of a major
3 acquisition, and you certainly wouldn't want to have
4 the disruption of the rotation at that point in time.
5 There might also need to be considered the need to have
6 -- I'm not sure if this is the right word --but some
7 protection about dismissal without cause for the firms.

8 And also, if some measures aren't put in place,
9 mandatory firm rotation, I think there may be some
10 studies -- part of the problem here is that there are
11 not many countries that currently require mandatory
12 firm rotation, so the extent of knowledge about the
13 impact on companies, the impact on firms, and so forth,
14 and the impact on the profession, is certainly
15 debatable. It's not abundantly clear.

16 But the concern is that it could actually lead to
17 an increase in concentration, which we certainly don't
18 believe is good for investors.

19 So really, because so much is unknown about the
20 impact of mandatory firm rotation, we haven't settled,
21 I guess, on a final position. But we are leaning
22 toward a rational consideration of mandatory firm

1 rotation as one tool to help address the objectivity of
2 concerns.

3 As I say, the debate is ongoing, and you will
4 receive our letter.

5 MR. BAUMANN: You acknowledged many of the
6 challenges that -- and many of those, I think, we do
7 try to touch on in the concept release. I think the
8 concept release tries to be balanced. That was our
9 goal in laying out some of the benefits and some of the
10 challenges in doing that.

11 So I can see why you're struggling with your
12 position. And we look forward to receiving your
13 letter.

14 MR. ARCHAMBAULT: Let me add one thing, Marty.

15 It's not only in relation to this issue, but to
16 some of the things we were talking about earlier with
17 some of the other standard-setting efforts you have
18 underway.

19 This has an impact, obviously, not just in the
20 U.S. but on a global basis. Many of your other
21 projects also are being -- there are similar issues
22 being debated globally. The auditor reporting, for

1 example, is one.

2 To whatever extent you possibly can, and I know
3 that you do do this, but I think to avoid
4 inconsistency, which I think would lead to a lot of
5 confusion, coordination of all these efforts and the
6 timing of when these things might become effective, I
7 think is absolutely critical as well.

8 MR. GURBUTT: Thank you, Arch.

9 Some interesting points there. Interestingly, the
10 point you made about tenure protection is also
11 something that is included in the concept release. And
12 some people believe that may further bolster an
13 auditor's ability to be independent. So any comment on
14 that point is also appreciated.

15 Barbara Roper?

16 MS. ROPER: First of all, if you want to go to
17 some of the people who haven't spoken first, that's
18 fine with me.

19 MR. GURBUTT: Okay.

20 Wayne?

21 MR. KOLINS: Thank you, Barbara.

22 The concept release recognizes the benefits of a

1 root cause analysis and also recognizes the difficulty
2 sometimes of getting to the underlying root cause of an
3 audit deficiency, in that in the upcoming inspection
4 cycle, the current inspection cycle, it is looking into
5 a root cost analysis.

6 I think from the perspective of getting a better
7 understanding of what are the impediments to
8 objectivity, independence, professional skepticism, a
9 root cause analysis is really a critical element in the
10 process, and I would strongly recommend that this
11 approach be followed assiduously, so that things that
12 we haven't even identified as potential root causes can
13 be identified, and looking at the solution to the
14 problem in a holistic manner.

15 MR. GURBUTT: Thank you, Wayne.

16 Liz Gantnier?

17 MS. GANTNIER: Yes, thank you.

18 I currently work for a smaller CPA firm. There
19 are some spectacular examples of audit failures, but I
20 would also describe them as audit committee failures
21 and client failures, not just audit failures.

22 And if there is a less than stellar audit

1 committee in place, you can rotate the firm constantly,
2 and I think you're still going to continue to see
3 failure, because I think as an auditor, I try to find
4 clients -- I know some people don't like that term --
5 but I try to find clients with the audit committee
6 that's in sync with my thinking about independence and
7 skepticism and who we are serving. We're serving the
8 public trust. We're not serving management. And
9 if the audit committee doesn't share that, then
10 it's going to be a failure, regardless of how many
11 times you rotate the firm.

12 From a smaller firm perspective, I'd be very
13 interested in seeing statistics about how often this is
14 a big firm issue, as opposed to smaller firm issue.
15 Because quite frankly, I face rotation constantly.
16 There is a lot of fee pressure. There's a lot of
17 competition, and the competitive environment is
18 somewhat different at my level.

19 And so you might be in a situation where you're
20 going to want to rotate every 7 years. Well, heck,
21 they want to rotate every 4. And so there might be
22 sort of an unintended consequence as a result of this,

1 that they might keep a firm longer rather than rotate,
2 because of the term limit type of thing.

3 Lastly, I would also be concerned over time, not
4 immediately, but over time, about losing firms serving
5 this market, because the stress to a smaller firm of
6 rotation every so often and the loss of that income
7 might eventually force some firms like mine out of this
8 business. I'm not exactly sure that that is what we
9 want. I think we want to keep firms in. And I think
10 we want to have healthy competition. I'd be somewhat
11 concerned about, long term, would it affect our
12 presence in this market.

13 So thank you.

14 MR. BAUMANN: Liz, thanks for those comments. I
15 just wanted to add a couple thoughts to what you said.

16 I certainly appreciate that the financial
17 reporting process is improved with management that has
18 great integrity and good controls. And a company that
19 has a very strong audit committee can greatly improve
20 the financial reporting process.

21 But I am concerned with the comment that without
22 that, with a less than strong audit committee, we're

1 doomed to audit failure. I think the auditing
2 standards deal with the risk of material misstatement
3 and the fact that one has to assess the risk and the
4 environment, the risk of -- the quality of the
5 controls, the quality of the management, the quality of
6 the audit committee oversight. And that the auditor is
7 responsible for either not accepting a client in
8 certain circumstances or, if you accept that client and
9 you have worrisome controls, extending procedures until
10 one gets satisfied that they have limited the risk of
11 material misstatements.

12 So I just didn't want the thought to stay out
13 there that just that there's weak oversight, that will
14 lead to audit failure. We expect that the audits are
15 still performed in accordance with our standards, and
16 therefore, financial statements present fairly that the
17 auditor has done an audit in accordance with the
18 standards.

19 MS. GANTNIER: Absolutely. My point was intended
20 to say that, in my experience, the stress to
21 independence does not come from the audit firm. It
22 comes from the client. And it comes from an audit

1 committee that is not sharing the same ideals with
2 regard to who are we serving.

3 And from a root cause perspective, I would hope
4 that we concentrate on ways to improve the transparency
5 of the audit committee process, so that that sort of
6 three-legged stool of management, the audit committee,
7 and the auditor, we're not solving one leg but
8 ignoring, perhaps, another one.

9 Thank you.

10 MR. BAUMANN: Okay. Thank you very much.

11 MR. GURBUTT: Lynn Turner?

12 MR. TURNER: Thank you.

13 The issue at hand is not new. We have been
14 debating this in the profession for decades. The
15 reasoning around the table has not changed. The
16 arguments haven't changed one iota at all from what I'm
17 hearing.

18 But the problem doesn't go away. And so I think
19 Ms. Roper asked the right question. If you aren't
20 going to support rotation, then what would you do that
21 would actually solve the problem? I've heard no one
22 from the preparer community and no one from the

1 auditing community put forward a solution that would
2 really deal with the problem.

3 The real problem is that management is writing the
4 check to the auditor. It's a very simple fix. If you
5 want to fix it without rotation, and that is change
6 that. Have a fee collected at an exchange or at the
7 PCAOB and dole it out. It's very doable.

8 I actually don't think that's within the grasp of
9 this board though. But if you really want to fix the
10 problem, and until we fix it in that way, I don't think
11 you're going to solve the problem.

12 So mandatory rotation seems to be a reasonable
13 step in between as you move towards that path, because
14 I'm convinced eventually not solving the problem, we
15 are going to end up there. It's just how much pain,
16 how many root canals do we go through before we turn
17 around and end up there.

18 It's inevitable, because the system isn't working.

19 And you can't have someone paying you that you're
20 turning around and giving a report card on. It just
21 doesn't work.

22 It would help as you go through this process if,

1 Marty, in your actual standards, you would clarify who
2 the client is. In all of our auditing literature, we
3 turn around and tell the auditors that the client is
4 management. I mean, that's the way the very standards
5 of the profession are written. And yet, that obviously
6 doesn't work, but that's who the board says is the
7 client. That's who auditors think is the client.

8 So I would suggest that as you go through this
9 process, you think about redoing that language to make
10 it very clear that the client is the owners of the
11 business, the stockholders, not the people that they've
12 chosen to oversee or the people they've chosen to
13 manage the business for them, but the actual owners,
14 the share owners of the business.

15 As far as some of the arguments we've heard around
16 the table, we heard that it's important to have depth
17 of knowledge on the audit. And yet we have phenomenal
18 depth of knowledge on the audits of the Enrons, the
19 Tycoos, the AIGs, the FANNIEs. They've been there for a
20 long time. And that depth of knowledge didn't serve to
21 improve the audit quality. In fact, it served to
22 create a situation where they were so beholden to

1 keeping that client, because of who paid them, that it
2 resulted in a degradation of the audit quality.

3 So the notion that you have to have that is crazy.

4 In the last decade, we saw about half of the public
5 companies change auditors. You had 3,000-plus, not
6 even including the Andersen, that changed auditors, out
7 of 8,000 public companies.

8 When management chose to make the change, we never
9 heard management stand up and say, oh, they aren't
10 going to have enough knowledge, or, it's going to cost
11 us too much. And this is thousands of companies where
12 management -- in that case, it was okay. But when all
13 of the sudden, for the sake of investors and confidence
14 in that financials, you say there's got to be a change,
15 all the sudden it's, oh, we can't do it. They won't
16 know what they're doing. It costs us too much. It
17 will lower audit quality.

18 The reality is we went through that change and
19 after we've gone through that series of changes in
20 public companies, restatements actually dropped in this
21 country. So the evidence supports that rather than
22 lowering audit quality, it actually increased audit

1 quality, if you actually look at the evidence and the
2 data.

3 We change auditors all the time in the
4 governmental sector. Governmental audits go through
5 this on a periodic basis. And those thousands of
6 public companies that were audited and the thousands of
7 governmental audits where we've rotated auditors, I
8 have never seen, never heard from a big firm or a small
9 firm that they go out and say we can't rotate, because
10 we won't have enough knowledge to do your audit the
11 first year.

12 And I've never seen an audit report in the first
13 year qualified to say: Here is our audit report. It's
14 a clean opinion, but we're not sure if we have enough
15 knowledge to do this audit.

16 This knowledge thing, it's unbelievable that you'd
17 put that argument out there.

18 As far as the audit committees, and certainly my
19 experience has been the same as what Scott and Joe
20 commented in terms of the quality of the audit
21 committee. In fact, I spoke to a CFO symposium in the
22 West last fall, 300 or 400 CFOs, and we talked about

1 the audit fees and who was retaining the auditor.

2 And there was general consensus that the CFOs are
3 still driving that process, contrary to Sarbanes-Oxley.

4 And I would hope that as part of your inspections
5 going forward, you will start to inspect and look at
6 the process by which auditor is actually hired by the
7 audit committee, because I have talked to many an audit
8 committee chair who when I started to ask about
9 specifically what was in the audit engagement letter,
10 their comment is, I'm not sure, the CFO gave it to me
11 and asked me to sign it. I asked him if it was all
12 okay, and he said it was, and we hired him.

13 And that is not compliance with Sarbanes-Oxley on
14 the behalf of audit committees. And when we see that,
15 we quite frankly ought to be referring it over to the
16 SEC for enforcement action, but because the audit
17 committees aren't complying with the law.

18 I think rotation will help increase competition.
19 I think one of the problems here amongst the firms is
20 they are actually scared to death to compete with one
21 another. They're afraid to lose a client. And I don't
22 blame them for that. No one likes to lose business.

1 But I think there needs to be more competition. I
2 think a reasonable rotation period is something like 10
3 years. I don't think it needs to be every 5 years.
4 Some people like 5, some people like 7. I think if
5 you'd did it within every 10 years, I'd never go out
6 beyond that, because I think it defeats the notion of
7 rotation. But I would do it in 10 years and maybe you
8 want to put it up for bid after 5. But something like
9 10 years, I think that would be sufficient.

10 There other options, also, that I think you ought
11 to seriously consider. Paul Volker for a long time has
12 supported and publicly advocated for an audit-only
13 firm. That is certainly another option that you can go
14 to.

15 But I think if people are going to say this
16 doesn't work, then as Barb says, they need to come up
17 with something that will work, and they can demonstrate
18 that it will work. And the notion of expanded auditor
19 reports, who quite frankly the firms haven't been real
20 supportive of, they're very limited on what they'd
21 expand, other things that are talked about that
22 ultimately don't get to the basic issue of

1 independence, which is what this is all about.

2 MR. DOTY: Lynn, you need to take a deep breath.

3 There are other cards up. I'm concerned about time.

4 MR. TURNER: I'll leave it at that.

5 MR. GURBUTT: Thank you, Lynn.

6 Mike Gallagher?

7 MR. GALLAGHER: Thanks.

8 I think Barb's challenge is a good one. I think
9 it's consistent with what Chairman Doty mentioned at
10 the concept release, that coming up with alternatives
11 is the right thing to do.

12 I think there's a broader issue. I think the
13 notion that we've got competent, capable people, yet
14 there are still issues, therefore it must be
15 skepticism, I do think it's broader. I think
16 skepticism is not an on-off switch. It's not binary.
17 I think it's a continuum. And I think looking at
18 things that can move us up the continuum is a good
19 thing. I think that's something we need to be ever
20 vigilant about.

21 But I also think there other things that we need
22 to be suggesting as well that will focus and improve on

1 audit quality. So I think that's what we're going to
2 be doing as a firm and that's what we're going to be
3 doing as a CAQ.

4 I do think mandatory firm rotation is little bit
5 of a blunt instrument, a one-size-fits-all rather than
6 relying on the audit committee to carry out their
7 responsibility. And so I have concerns that from a
8 quality perspective, taking that discretion away from
9 the audit committee does not support quality.

10 So we're clearly not for it, neither my firm and
11 certainly my position is I don't think mandatory firm
12 rotation is the answer.

13 If we did, hopefully as a firm and as an
14 individual, I wouldn't be waiting for standard to tell
15 me to do the right thing. If we didn't believe we
16 could deliver the highest quality to our long-tenured
17 clients, I wouldn't be waiting for a standard to
18 execute on rotation.

19 And by the way, audit committees have that
20 ability, I think as somebody mentioned earlier today,
21 to drive that rotation either as a matter of process or
22 to do it when they see that the skepticism is not at a

1 level that they would hope to see to drive the right
2 kind of quality.

3 I'll leave it there.

4 MR. GURBUTT: Thanks, Mike.

5 Dan Slack?

6 MR. SLACK: Thank you. I waited too long to put
7 my card up and Lynn made all of my points but much more
8 eloquently than I can. But I'll try and just make a
9 couple of short elaborations on them.

10 I just think it's important that, as the saying
11 goes, not to let the perfect be the enemy of the good.

12 The preparer or issuer pays model has inherent
13 conflict of interest in it, and so if we wanted to sort
14 of sit and theoretically talk about this, the best way
15 is going to be eliminate that or go to audit-only firms
16 or other ways to remove that inherent tension.

17 And I think other solutions -- but I think that's
18 beyond the purview of what we're talking about today,
19 although other comment is invited in the concept
20 release.

21 But other solutions are necessarily going to be a
22 compromise of some sort, and bearing that in mind, and

1 that sort of guiding my thinking, I think that
2 mandatory rotation is appropriate to address the issues
3 of independence, objectivity, et cetera.

4 There's a lot of concerns that were noted in the
5 concept release. I think those are legitimate
6 concerns, and the standard may be needed to be nuanced
7 to deal with that, perhaps with some of the exceptions
8 that Arch mentioned in his remarks, et cetera.

9 But I think it's an appropriate response to the
10 issue. Thank you.

11 MR. BAUMANN: This is a very, very lively
12 discussion, and many points on all sides of the
13 equation. I see, I think, six cards up.

14 We'll start with Gaylen.

15 Lisa, is your card still up or did it go up again?

16 Starting with Gaylen, going around the table to
17 Barbara. If we can get those comments in, I'd
18 appreciate it.

19 MR. HANSEN: I'll be brief because I think a lot
20 of the points have already been made that I would
21 otherwise make.

22 Everyone has anecdotal experience with this. I

1 know when I first started out in the profession, I went
2 -- I was with a very large firm and went to one of
3 their very largest clients and they had had that client
4 as a client for decades upon decades. And one of the
5 first messages that I got as a new staff person was,
6 Don't screw it up.

7 And you know, that stuck with me, and I obviously
8 still remember it. So I think mandatory rotation
9 should be on the table. And I don't think 2 years is
10 too long a period to think about.

11 On the knowledge question that a number have
12 spoken to it, you know, it's interesting. When I was
13 with that large firm, I had a lot of knowledge, and it
14 was really interesting when I went to a small firm
15 years later, all of a sudden, I guess that knowledge
16 just went away, which was sort of interesting.

17 I don't understand it, but it seems to me that
18 there are some interrelationships and linkages here,
19 and one of which is competition. And being able to
20 link this to competition, I think is important and
21 would be healthy for the profession.

22 It was addressed by the treasury committee. As a

1 member of that committee, we really grappled with this.

2 And I think that rotation is an opportunity for us to
3 consider. I think Liz raised it in her remarks as
4 well. Smaller firms are not as impacted by this,
5 because we're constantly competing.

6 Thank you.

7 MR. GURBUTT: Thanks, Gaylen.

8 Jeff?

9 MR. MAHONEY: Thank you. I'll be brief.

10 The Council of Institutional Investors has some
11 membership-approved policies relating to auditor
12 independence. Those policies indicate that
13 independence may be enhanced if there is regular
14 consideration given both by the audit committee as well
15 as by shareholders with respect to changing auditors.

16 For example, our policies include a provision that
17 says that there should be an annual shareholder vote on
18 the retention of the auditor. Since we put that policy
19 in place, most public companies now have that
20 provision.

21 In addition, our policies provide that the audit
22 committee should seek competitive bids for the external

1 engagement every 5 years. In light of the PCAOB's
2 concept release, and the other work that is being done
3 in Europe and elsewhere, in light of the fact that our
4 policies with respect to auditor independence are more
5 than 10 years old, our policy committee is currently
6 reviewing this area. And we expect to either change
7 our policies or not change our policies, but make some
8 decisions sometime next year.

9 Thank you.

10 MR. GURBUTT: Thanks so much, Jeff.

11 And actually, one of the questions in the concept
12 release is to solicit comments on audit committees'
13 experiences as to whether or not they would consider
14 implementing a policy of mandatory rotation. So we're
15 definitely interested in the views of audit committees
16 on that matter.

17 John?

18 MR. WHITE: First, Marty, I'm very pleased that
19 the board has taken up this topic. It's obviously a
20 very challenging one.

21 And I don't often agree with Damon but I do agree
22 with Damon's statement that independence is -- I think

1 to use your words, Damon --the core theme that gives
2 auditing its legitimacy.

3 And I think on balance, I accept that auditor
4 rotation could, at least at the margins, enhance
5 professional skepticism. But I guess as I keep
6 balancing and I hear the costs and I listen to Gail and
7 Arnie about various issues related to audit quality and
8 so on, it got me thinking about whether there are any
9 analogies in the legal world to this.

10 And I'm not sure this analogy is perfect, but it
11 seemed to work for me in part. It's not common to
12 rotate your law firm, if you think about it. But there
13 are situations where corporations bring in a new law
14 firm, basically independent counsel. And they're
15 actually in the most challenging situations that
16 corporations face, usually M&A transactions and so on.

17 And I said independent, and that means generally
18 independent from management. And the key when you
19 bring in an independent law firm is they're reporting -
20 - it's who they're reporting to, and it's usually the
21 audit committee or a special board committee. And
22 they're hiring and supervising them. They're still

1 being paid by the company, but they're being hired and
2 supervised by that special committee.

3 And I guess it just seems to me that in those most
4 important situations for corporations, where the legal
5 world at least, you rely on a board committee to do the
6 job of supervising at least one set of professionals, I
7 guess on balance I think we should keep trying to have
8 the audit committee do that job with respect to the
9 auditors.

10 It's not a perfect analogy, but at least from the
11 legal perspective, it seemed to me to get part of the
12 way there.

13 MR. GURBUTT: Thank you, John.

14 Damon?

15 MR. SILVERS: It's been a long conversation, but I
16 wanted to return to the basic mechanisms here, that got
17 a little clouded. The notion -- why has auditor
18 rotation been a staple of debate about how to enhance
19 auditor independence for a long time? The reason is
20 because it's an effort at self-policing. The
21 alternatives -- I think we've heard from a number of
22 different people from different perspectives as to why

1 there is a continuing problem here, in terms of both
2 independence and the resulting quality of audits and
3 the financial statements.

4 The alternatives are not self-policing. They are
5 external policing. This is self-policing, meaning it
6 creates a mechanism by which one audit firm looks at
7 the work of another, and takes a fresh look at the
8 financial statements of the preparer and the internal
9 controls of the preparer and so forth.

10 Several people have talked about the question of
11 quality of audit firms, the quality of audit committees
12 and the like. It's certainly true that if you have
13 really high quality audit committees that the need for
14 all kinds of formal things are lessened. If you have
15 really high quality preparers, the need for an
16 independent audit is lessened.

17 It's not entirely clear to me that we actually
18 need financial statements. If you had really exemplary
19 human beings giving a narrative description of the
20 business, they could probably cover most of what
21 investors would want to know. But we don't make the
22 rules for exemplary human beings. We make them in

1 recognition that all the links in the chain I just went
2 through -- not everyone's above average. In fact, the
3 average is not above average.

4 And so this initiative is an initiative to create,
5 A, competition and, B, self-policing. Those seem to me
6 to be things that are not -- that shouldn't be
7 controversial. And, B, obviously there are costs
8 involved in everything. There are costs involved in
9 competition. If you didn't put stuff out for bid,
10 there would be no bidding costs.

11 The alternatives here, and there are alternatives,
12 are far more unpleasant, I think, from the perspective
13 of those are unhappy with this idea. And I people
14 ought to be mindful of that.

15 MR. GURBUTT: Thank you, Damon.

16 Steve?

17 MR. HARRIS: John, I just wanted to follow-up on
18 your idea of bringing in an independent accountant.
19 Both former SEC Chairman Harvey Pitt and Judge Stanley
20 Sporkin have talked about the role of a forensic
21 accountant and bringing in -- mandating bringing in
22 forensic accountants. At what point would you bring in

1 a forensic accountant, or for that matter, an
2 independent accountant?

3 MR. WHITE: I'm not sure that is what I was
4 suggesting. I think I was more going to the analogy
5 that we look to the response -- we look to a board
6 committee to their supervisory powers over special
7 counsel or auditors as the right standard, I mean as
8 the right people to do that.

9 I mean, I wasn't going to the idea that you would
10 bring in a forensic auditor.

11 MR. GURBUTT: Arnie?

12 MR. HARRIS: I wish you would take that under
13 advisement given the fact that you have had a former
14 chairman and a former head of the division of
15 enforcement of the SEC recommending it as one of many
16 alternatives.

17 I associate myself as well with Barbara and Lynn's
18 comments.

19 And, Neri, you said what are we for in increasing
20 transparency, and I think we ought to flesh out a
21 little bit more what increasing transparency means,
22 because -- and we'll get to that with respect to the

1 audit report.

2 But if we're not for audit rotation, I agree with
3 the comments made so far. I haven't heard any
4 alternatives, really, to it, in terms of increasing
5 professional skepticism, independence, and objectivity,
6 which are discrete topics.

7 But since these issues, as I raised in my
8 introductory remarks, are common globally with respect
9 to what all regulators are finding across the board, I
10 think it's absolutely incumbent upon us to figure out
11 what are other alternatives to skinning the cat.

12 MR. GURBUTT: Thank you, Steve.

13 Arnie?

14 MR. HANISH: I don't know where to start.

15 So first of all, John, maybe to build upon your
16 point. You raised an interesting point. And I'm
17 thinking about the situation that occurred actually at
18 our company a few years ago, where as a result of some
19 issues, the auditing firm brought in truly somebody who
20 was an independent. When I say independent, they were
21 part of their firm, but had nothing to do with our
22 audit engagement. It was an industry expert. He did

1 come in and do a very thorough review of our financial
2 accounting policies that we have in place and
3 practices. And concluded after discussions with us,
4 that they really didn't see anything that was
5 inappropriate as far as application and interpretation
6 of GAAP and principles.

7 But I actually thought it was a healthy review
8 that took place of our published internal policies and
9 practices that we have. And you know, would I be
10 offended or concerned if an independent person, an
11 industry expert, came in from another firm periodically
12 and took a look at our practices and stated policies?
13 I don't think I would. It certainly would not offend
14 me.

15 So it's an interesting comment or perspective, as
16 offering up again, and in the spirit of offering up
17 alternative solutions, that might be a reasonable
18 alternative solution.

19 I think also, if there's concerns -- and some of
20 the documents I've read, you know, concerns around the
21 firms having targets and goals of trying to enhance the
22 revenue from a particular audit client, one simple

1 solution there is to clearly limit nonaudit services
2 totally, which is not in the cards right now. I mean,
3 the firms are able to provide limited nonaudit services
4 as long as they don't feel like it impugns their
5 independence.

6 I wouldn't necessarily be in favor of limiting tax
7 services, because I think there is a clear integration
8 between audit and tax services, as far as the knowledge
9 of the company. But if there were other services,
10 certainly a number of companies have stated policies
11 around not utilizing their auditors for non-audit
12 related services, other than tax.

13 I think it's important also to conduct a root
14 cause analysis. The things that Lynn talks about, the
15 examples, the Enrons, the Tycos, the AIGs, to a large
16 extent those are, I believe, if my dating is correct,
17 all pre-Sarbanes-Oxley, to a large extent. It would be
18 interesting to see what the data shows on a post-
19 Sarbanes-Oxley environment. I'm not sure. I don't
20 know. I don't have the data, but it's hard for me to
21 believe that the 3,000 audit changes is a direct cause
22 of reduction of restatements.

1 I believe that the reduction of restatements in
2 the post-Sarbanes-Oxley world is because the law
3 enabled companies like ours to go out and hire more
4 capable and competent people on our staff. To me that
5 was one of the significant benefits of Sarbanes-Oxley,
6 that no longer did I have to debate with my financial
7 colleagues and my CFO and others about the ability to
8 go out and hire competent specialists and additional
9 staff because of the complexities and to deal with the
10 complexities that we have to deal with today because of
11 the FASB's rules and practices that we all have to deal
12 with.

13 And the accounting rules have become greatly
14 enhanced and more complex in the last 8 to 10 years
15 than they were in the previous 20.

16 So I don't know if in fact the reduction in
17 restatements is because of auditor rotation. I
18 attribute it, quite frankly, to having had the ability
19 to hire more competent staff, which I think was an
20 offshoot of SOX and the law.

21 MR. BAUMANN: In the interest of time, this is
22 probably a great debate on what is causing the

1 decreasing of restatements.

2 MR. HANISH: If I could just give a couple more
3 points?

4 MR. BAUMANN: Thank you.

5 MR. HANISH: So, yes, I think that one solution
6 could be to have the firms audit at a lower materiality
7 level. They establish a materiality level based upon
8 whatever firm guidance that they put out. It tends to
9 be a big black box for many of us. But one solution is
10 that maybe you lower the thresholds as far as
11 definition of materiality and whether there's material
12 statement potential.

13 That has an added cost to us, but quite frankly
14 I'm willing to pay that added cost if I can get a
15 greater degree of comfort that they're auditing at a
16 lower level of materiality.

17 Another solution would be to require training for
18 board members. We talked a lot about board members.
19 While I recognize that the NACD and other organizations
20 put on training for board members, it's not consistent.

21 And maybe there ought to be some sort of, I'll call it
22 CPE requirement to requirements for board members, if

1 they're going to be members of audit committees, to go
2 through required training.

3 And I think that's -- I'll stop there. Thank you.

4 MR. GURBUTT: Okay, thanks, Arnie.

5 I think we'll take the three cards on the right-
6 hand side here and then we will break for lunch.

7 So, Barbara Roper, please?

8 MS. ROPER: So quickly, and I did not coordinate
9 with Damon first. I also always feel like I come to
10 Lake Woebegone when I come to these SAG meetings.

11 If I could have Arnie as my chief accounting
12 officer, and Lynn and Denny on my audit committee, and
13 there are too many auditors in the room for me to pick
14 one, but one of the many fine auditors in this room to
15 pick one, I'm sure we would have perfect financial
16 statements. And it perhaps speaks very well for the
17 modesty of the people in this room that they seem to
18 think of themselves as representative. And I don't
19 think that's the case.

20 And I think as we make policy in this area, we
21 need to recognize that that is not the case.

22 But one of the points that I just wanted to make

1 quickly is that we've gotten a lot -- we've heard a lot
2 in different contexts in recent years about the need to
3 go more toward professional judgment. We have more
4 fair value, respect for professional judgment, both by
5 issuers and by auditors. And all I can say is, anybody
6 can audit 2+2 equals 4. Well, maybe not my son, but
7 most people could audit 2+2 equals 4.

8 But if we want to go into the world of auditing
9 the financial equivalent of theoretical physics, one,
10 you better be awfully competent but, two, you sure
11 better be independent, because the value of
12 independence goes up as the complexity and lack of
13 clarity of the financial statements goes up.

14 MR. GURBUTT: Thanks, Barbara.

15 Doug?

16 MR. CARMICHAEL: The Cohen Commission concluded
17 that auditing at the time and the problems were that
18 auditing was suffering from too little -- well, it was
19 really suffering from too much competition. And I can
20 recall making a presentation at the University of
21 Chicago, where on behalf of the Cohen Commission, where
22 it was drilled into us that there was no such thing as

1 too much competition. And I think auditor rotation
2 would increase competition as a positive effect.

3 The Cohen Commission was the first that I know of
4 that came up with idea that one of the risks of auditor
5 rotation was that the auditor would be unfamiliar with
6 the client and there was increase audit failure risk.
7 And I think, in hindsight, the sample they used was
8 much too small. I know there have been some other
9 research studies, but they're too many confounding
10 events, and maybe too few observations to give any
11 credence to that.

12 Finally, I know John White didn't intend it that
13 way, I think he identified a viable alternative to
14 auditor rotation, and that is to have specialist firms
15 that would come in periodically and evaluate the
16 quality of the company's accounting and the quality of
17 the auditing and how they public report on it. And
18 that could be done every several years, 3 years, 5
19 years.

20 If what is said about the increased cost of
21 auditor rotation is true, it would not really add to
22 the costs significantly. And it would open up the

1 opportunity for increased competition for firms that
2 are perhaps too small to take on the audit of a large
3 global company. They wouldn't be too small to make
4 this kind of evaluation.

5 MR. GURBUTT: Thank you.

6 Mary?

7 MS. HARTMAN MORRIS: Thank you. I think timing is
8 everything. I think I'm the last card, right?

9 I just wanted to point out, thank you so much, and
10 I agree with all the different speakers on many
11 different points, but from an investor's perspective
12 from CalPERS, independence is key to investors
13 confidence. And as the largest institutional investors
14 in our allocations, we have to look at some of those
15 factors, and the independence of auditors is really key
16 to us.

17 The second point I wanted to make was what Jeff
18 had said, was CalPERS has had principles around this.
19 We're part of the Council of Institutional Investors,
20 the CFA Institute, the International Corporate
21 Governance Network, that have principles around this
22 policy about mandatory auditor rotation, or at least

1 looking at the enhancement of the auditors in
2 themselves.

3 I think it's really key though that we also look
4 at that time frame. And I don't know necessarily that
5 we have the right key on what the timeframe should be,
6 but I think it should be vetted. It should be provided
7 that the audit committee does have a perspective on
8 that. But even if the auditor -- annual auditor
9 ratification is really important to CalPERS.

10 And the last point I really wanted to make was
11 what was what Gaylen mentioned and also what Doug just
12 sort of mentioned as well, and I think also, Arnie, you
13 did as well.

14 Gaylen didn't lose his knowledge when we went from
15 a big firm to a smaller firm. And part of our
16 testimony in ACAP was that with auditor rotation and
17 mandatory auditor rotation, it might provide some great
18 benefits. It might increase audit choice, ability to
19 have different auditors, to have that choice of
20 auditors, improve audit quality.

21 So I think from that perspective, and I think
22 others mentioned it as well, I think Liz you said from

1 a smaller firm's perspective, regional firms should be
2 considered. And I think, Doug, that you mentioned that
3 there might be another opportunity about bringing them
4 in on special cases.

5 But I think this is a good point that mandatory
6 auditor rotation would increase that benefit of audit
7 choice.

8 So thank you.

9 MR. BAUMANN: Thanks, Mary.

10 Thanks to everybody for a very valuable input to
11 us as we consider this very, very important question
12 about enhancing, improving auditor independence,
13 objectivity, and professional skepticism for the
14 benefit of investors and improved financial statements.

15 I'll just echo a thought that was expressed by
16 many that was to the extent -- we want to hear comments
17 across the board, of course, and as much information as
18 we can get. But to the extent that one doesn't support
19 audit firm rotation, we look forward to comments on
20 other ways that the board can go about improving
21 auditor professional skepticism. We look forward to
22 those comments very much and letters we may receive.

1 So thank you very much for this discussion.

2 We're a little bit behind schedule. We're due to
3 get back here at 1:30, which won't happen, but let's
4 see if we can make it to one close to 1:45.

5 Thank you.

6 [Whereupon, at 1:01 p.m., the meeting recessed.]

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