U.S. DEPARTMENT OF TREASURY

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ADVISORY COMMITTEE ON THE AUDITING PROFESSION

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TELECONFERENCE

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TUESDAY
APRIL 1, 2008

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The Advisory Committee met by teleconference at 1:00 p.m., Eastern Daylight Time, Arthur Levitt, Co-Chair, presiding.

MEMBERS PRESENT:

ARTHUR LEVITT, JR., Co-Chair
DONALD T. NICOLAISEN, Co-Chair
AMY WOODS BRINKLEY
RODGE COHEN
TIMOTHY FLYNN
ROBERT GLAUBER
KENNETH A. GOLDMAN
GAYLEN R. HANSEN
JEFF MAHONEY
BARRY C. MELANCON
RICHARD H. MURRAY
GARY J. PREVITS
DAMON A. SILVERS
SARAH E. SMITH
WILLIAM D. TRAVIS
LYNN E. TURNER

OBSERVERS PRESENT:

ROBERT H. HERZ
CONRAD HEWITT

PHIL LASKAWY
MARK W. OLSON
ZOE-VONNA PALMROSE

TREASURY STAFF:

KELLY AYERS
GERRY HUGHES
TIMOTHY HUNT
KRISTEN JACONI

Whereupon, due to audio problems with the conference call, the actual transcript begins 26 minutes into the conference call. The first 26 minutes of the meeting are summed up in the following paragraphs below:

Mr. Levitt called the meeting to order and reminded members that the call is broadcasting live via the Internet. The purpose of this meeting was further discussion of and decision to use Preliminary Recommendations as basis for a draft report. Ms. Jaconi called roll.

Discussion ensued concerning the future meeting schedule. Mr. Levitt informed the Committee that the April 22 meeting would be pushed back to a date in early May and that Treasury staff will contact members concerning finding an appropriate time to meet in May.

Discussion ensued about the Human Capital Preliminary recommendations, and specifically about community colleges. Mr. Hansen stated that audit firms do not recruit at community colleges because these students typically will not have sufficient qualifications to sit for the CPA exam and that the Preliminary Recommendations should mention this fact.

Discussion ensued about the increased participation of professionally qualified faculty within colleges and universities. Discussion ensued about the recruitment of minorities in the profession. Mr. Melancon stated that the profession needs to continue to find ways to recruit minorities into the profession.

Discussion ensued about audit partner rotation. Mr. Flynn stated that the audit firms should study this issue. Discussion ensued about a professional school model. Mr. Previts discussed the history of this model and mentioned that Joseph V. Carcello’s written submission from the December 3, 2007 Full Committee meeting discusses this issue. Mr. Previts noted that this issue would have a long-term focus, while the Human Capital Subcommittee’s four other recommendations seem to take on a short-term focus. Mr. Flynn noted that this issue is worthy of a study.

P-R-O-C-E-E-D-I-N-G-S

1:26 p.m.

(Whereupon, due to audio problems with the conference call, the transcript begins 24 minutes into the conference call.)

MR. PREVITS: The question is, is anybody else having trouble hearing Arthur? I cannot hear him.

CHAIRMAN LEVITT: I'll try to speak louder but I'm on a land line. Can you, can everyone hear me?

PARTICIPANT: Yes. I hear you now.

CHAIRMAN LEVITT: You can now?

PARTICIPANT: Yes.

MR. PREVITS: Better. Thank you.

CHAIRMAN LEVITT: I'm sorry. I was, I assume then, that the notion of a professional school of accounting is something that the group, as a whole, wants Gary and the

Committee to carry a step further.

Unless I hear any voices to the contrary, I would like to now move onto Bob Glauber who will talk about work in the Firm Structure and Finances Subcommittee.

MR. TRAVIS: Arthur, this is Bill Travis. I have one question for Gary.

MR. PREVITS: Sure Bill.

MR. TRAVIS: Were you saying that the, that the quality of a life consideration is focused solely on the five to seven year rotation? Or were you also considering the adverse impact of busy season on retaining young professionals, especially women?

MR. PREVITS: At this point in time, we, you know, the topic is, how I understood it, was given to us as part of a discussion. I think it came out of Damon's Subcommittee. Where he -- if it was Damon's Subcommittee. Kristen maybe you can help us.

There was a reference to it because there were quality of life issues in the rotation. The seasonality of the business, per se, is implied. You know, the five year season as opposed to a busy season.

MR. GLAUBER: Arthur?

CHAIRMAN LEVITT: Yes.

MR. GLAUBER: It's Bob Glauber. I was so excited to be called on, I managed to disconnect myself.

MR. PREVITS: Okay.

CHAIRMAN LEVITT: Bob, just before we get to you, another question came up --

MR. GLAUBER: Oh good.

CHAIRMAN LEVITT: -- the quality of life.

MR. PREVITS: So we were, I would say, Bill, that if there is an equal interest in the quality of life issue over busy season, certainly, if you would care to frame that, I don't see why we wouldn't be willing to consider it.

It was not, however, part of what I saw as the five to seven year partner rotation issue.

MR. TRAVIS: Maybe what I could do Gary, after the meeting is, contact Barry Melancon and talk a little bit about whether this is a big enough issue across the profession. I certainly think it's a big issue from my experience.

MR. PREVITS: And I know there are seasonality issues, when I was a member of AICPA Council that that came up. But I think that might be the way to approach it, to see if we have data that suggests that it should be a priority.

MS. SMITH: If we, if you remember Gary, we, the service we saw did not point to it as being --

MR. PREVITS: Yes.

MS. SMITH: -- as that overwhelming an issue. And I think, certainly on our Subcommittee, there was not a particular interest, just assuming it as a women's issue.

MR. PREVITS: That seems to be a good way to phrase it Sarah.

MR. FLYNN: And I would think from -- this is Tim Flynn. I think from the profession’s standpoint, particularly in the audit side, the seasonality tends to spread more throughout the year. And it's not quite as big of a bubble as it might have been thought to have been. I think you get smaller tax practitioners and you get a very consolidated time frame from that.

So Barry's input might be interesting, from the CPA standpoint. But I don't believe it's a burning issue from the profession’s standpoint, at this point in time.

There's been a lot of effort on seasonal work programs, flex work schedules and other things to try and address that issue. And the profession's been very focused on it in the last three to five years.

MR. MELANCON: I guess it -- this

is Barry. I guess it depends on how you define "profession".

You're right Tim. I think that the smaller practitioner and those that have a significant tax practice in a small enterprise situation, the tax laws particularly driving it, which effects both accounting and tax, because the accounting flows from the tax year end requirements. That's been a major issue since the Tax Act of 1986.

And the larger the firm, the more opportunity there is, as you just said, to sort of manage through that. The smaller the firm, the more it creates the problem that Bill talked about.

I think if we just take a step back, and if this is focused on public company auditing, that, which is what this committee is about, I think that's sort of how we talked about it at the Subcommittee to the extent we talked about it. And Sarah's correct.

We didn't see it as a male versus

female issue. As much as, just there are a lot of contributors to the work/life balance things that's going on in society today. And companies, as well as firms, are, you know, having to deal with them. It clearly is skewed more appropriately to the smaller firm.

MS. BRINKLEY: This is Amy Brinkley. Just to follow-up. I think, not only with the testimony we heard, but I think some of us went and tried to interview groups of younger partners, etcetera, out in firms. And I would say the, any quality of life issue came up equally for male and female. At least in my discussions.

And that, in fact, when the rotation issue was discussed it was just as much a concern for males as females.

MR. HANSEN: This is Gaylen Hansen. I kind of wanted to follow-up on what both Barry and Tim were saying.

You know, and, from the perspective of small firms, they really do have a very heavy duty busy season, as it were.

The larger firms, I believe, and correct me if I'm wrong Tim, but, we have continuous audits on the larger companies, virtually all year round. So a lot of the seasonality has been taken out of that aspect of it.

That is not the case with small practitioners. Small practitioners have a very narrow time frame where a significant piece of their work really lands. Really starts during the fourth quarter in their planning. But, by the time smaller companies close their books and they get the audit completed, you're talking a very short time frame. And literally, a very significant time commitment.

And I do believe that that does impact quality of life.

MR. PREVITS: I would say, let us take it under advisement, Bill and Gaylen, I'm not sure, this is, this is the, you know, this is the compression issue. And a lot of other things. And as Sarah and others have commented, it's not necessarily, you know, something that may rise to the level of a recommendation. But let us take it under advisement. And see what kind of data we can get that might support some form of an observation or whatever may come from it.

MR. HANSEN: Gary, thank you. The reason I keep bringing this up is, first of all, my role is to represent the smaller and mid-size firms.

MR. PREVITS: Right.

MR. HANSEN: And a lot of the people that are involved in serving public clients also serve private companies. And a lot of the people that have been serving public clients, come from the broader pool of young resources.

And I think the mid-size and smaller firms do have significant issues in retaining people because of the compressed work load during the busy season.

But I appreciate your listening. Thank you.

CHAIRMAN LEVITT: Okay. Bob as you are reconnected, could you talk about the preliminary recommendations on the easiest of all Subcommittees, Firm Structure and Finances.

MR. GLAUBER: I am indeed reconnected. And will try very hard not to disconnect myself again.

Let me try and describe where we are with our Subcommittee. And first, in regards to the recommendations we put before the full Committee at it's face-to-face meeting, I would describe our edits as being not particularly substantive. But let me just lead you through them.

First on 1(b), we have, in responding to comments from the rest of the Committee, added a phrase at the end of the recommendation, and then in the text, as well, that puts an emphasis on a continuing update by the PCAOB of key areas auditors should consider. And the types and amounts of inputs that it should bring to bear on the issue of the prevention and detection of fraud. And that, as I say, is consistent with the discussion we had in the full Committee.

Second, in Recommendation 2, where we had proposed, that at some point, Congress consider preempting the states on the mobility provisions of the UAA. The date we had was December 31st of 2010. I think that had quite firm support from the Subcommittee. There was a discussion in the full Committee about pushing that back a year. We have not. Reflecting, I think, the view of the Subcommittee. This obviously, can be subject to greater discussion of the full Committee. But, as I say, as of now, we have not.

That really is the balance of what we have done of substance, or not substance, to the recommendations. I guess for completeness, I should say, if you go back to Recommendation 1(a), in the catalog of people who should participate in the development of and sharing of fraud detection and prevention practices and experiences, we've added forensic accounting firms and certified fraud examiners to that list.

So that's, those are the changes that we've made.

The other point I want to add is, as I did at the full Committee meeting in Washington, there are two sets of issues, yet, that are, do not appear in recommendations. And may -- are likely to in one form or another.

One is, recommendations on transparency. And there I would just comment in light of what has been added to the Subcommittee, that Damon chairs, this issue of metrics of audit quality. I think it was the decision of the Chairs that that is first and foremost a competitive issue. And therefore, appears in the recommendations of that Subcommittee. And that, of course, is fine.

What I would say is, that I think in the transparency recommendations that we are likely to still bring forward, we probably will have some comments on that same issue of the disclosure of such metrics of audit quality.

And then finally, the other issue that we continue to discuss, is the issue of liability exposure of the firms and any mechanisms that might deal with that. The Committee, the Subcommittee rather, has a meeting scheduled for April 14th at which point I think we will more fully engage these two last topics.

So I think, Arthur, that that summarizes where we are. And I'm more than happy -- first I should ask the other members of the Subcommittee to extend or clarify my comments. And then open the floor to questions. If that's okay with you.

CHAIRMAN LEVITT: Sure.

MR. MURRAY: Bob, it's Rick. Just one item that I would describe as, perhaps clarification or request for it. Going back to 1(b) and the language that you mentioned had been added.

I could well have been inattentive when we addressed this but with the exception of the discussion on March 13, which I did not perceive as having reached this conclusion, that language seems new to me.

It is, obviously not particularly emotive but it does strike me, that the thought is complete at the point where the PCAOB is recommended to periodically review and update these standards.

The language which follows is either redundant to that thought or, given the fact that a report like this won't be read as allowing redundancies, it seems to imply that there needs to be an escalation of the standards for detecting fraud. And while that may be the result of PCAOB's reflections, it may not.

And I didn't think we had really crossed the Rubicon of pressing for the escalation of those standards. And I do read this language as, at least, implying that.

MR. GLAUBER: Well, I appreciate your point Rick. I should add, as one reads this carefully, and indeed reflecting the conversations at the Committee meeting, the emphasis here is on the type and amounts of inputs that they should bring to bear. And that was, of course, the emphasis of that discussion.

MR. MURRAY: But that is, of course, a description of our scope.

MR. GLAUBER: Yes. Distinguished from a discussion of the expectations of what would be found.

And I think the intent of making that distinction was, it was intentional.

MR. LASKAWY: But Bob -- Phil

Laskawy. I'm a little unclear what, I remember the conversation, but I'm still unclear about what we are trying to accomplish in this addition.

MR. GLAUBER: Well, I think, I'm not certain that the intent was to extend the nature of the recommendation. But I think to clarify it. And to clarify it that the expectations of these standards went along the lines of the amount of effort and type of effort that would be expended rather than in the direction of any expectations, specific expectations of what would be found.

MR. LASKAWY: Bob I -- without trying to wordsmith it in front of the full Committee, I would think that thought is complete, if the language were to stop after, "The inputs they should bring to bear," is the last phrase of, "To prevent and detect," that really seems to tilt the thought.

MR. GLAUBER: I understand.

Arthur or let me seek guidance --

but perhaps this is something that we ought to return to the Subcommittee for it to cover at its meeting on the 14th of April.

PARTICIPANT: Hello?

MR. SILVERS: Bob this is Damon.

MR. GLAUBER: Yes.

MR. SILVERS: Yes. I don't know if, you know, Lynn or Jeff Mahoney are on the call today. But it strikes me that your suggestion is what you ought to do. That this is, this is a matter of great -- of the Committee and the Subcommittee. And that it should not, we should not try to work it out here.

MR. GLAUBER: Yes.

MR. SILVERS: But in, but in Subcommittee.

MR. GLAUBER: Thank you. And I agree with you. And that's what I would propose, if that's all right with the Chairs.

CHAIRMAN LEVITT: That's fine.

MR. GLAUBER: Okay. Well then,

I'll add that to the agenda of what the Subcommittee treats and will be in a position to report back to the full Committee.

CHAIRMAN NICOLAISEN: Bob, it's Don. I -- that's really it. So, it sounds like you're on the right track.

MR. GLAUBER: Okay. Fine.

MR. LASKAWY: And Bob, I welcome that and agree it's the right step but I felt forced to raise it here. Because we hadn't had the Subcommittee discussion of this. And I didn't want to leave an apparent agreement in place without raising --

MR. GLAUBER: Good. No, no, no, I'm delighted you did. And we'll go back to work.

MR. TURNER: Bob this is Lynn --

MR. GLAUBER: Good.

MR. TURNER: -- and I'm happy to discuss it again. But I do think the language that you got there is, captures the essence of what you talked about earlier. And I'm fine with it.

MR. GLAUBER: Good. That's what makes the discussions of our Subcommittee so enlightening.

MR. MELANCON: Are we open for other topics now? Are you all finished with that topic?

MR. GLAUBER: I think we have. We just decided to return it to the Subcommittee discussion for fun.

MR. MELANCON: This is Barry. I raised the 2010 --

MR. GLAUBER: Yes.

MR. MELANCON: -- versus the 2011 --

MR. GLAUBER: You did indeed.

MR. MELANCON: -- last time. And I am as much of a supporter on getting it done as quickly as probably anyone in the country.

The facts are that, in 2007, we had something in the neighborhood of 12 states enact, or by the end of 2007, had 12 states.

We're on pace for a very good number this year. In fact, several states that have been not on the leading edge of legislation have enacted and some of which are waiting governor's signatures and things of that nature.

I would fully hope that we will be approaching halfway by the end of 2008, although the vagaries of legislative action come into play.

The reality is, is that 2010 is, we're not going to be at 50 states by the end of 2010. And I think that the reason why I raised the issue is that, we could be there, or very close to being there, in 2011.

There are a couple of things that you have to take into consideration in state legislative action. One, many states do not have annual legislative sessions. And to the extent that some states do have annual legislative sessions, they are restrictive as to the types of things that can be considered in certain years.

This is on the agenda of literally every state. There is, as Gaylen has probably communicated to you in the Subcommittee, something that the profession, the regulators and everyone is a hundred percent on board with.

The fine line that this report will take on this is, sort of the, the art of the doable versus the art of creating frustration. And I don't think that it is a good idea, with the momentum that is going forward, to create frustration in the mind's eyes of those people that do the heavy lifting in the states. Which is, basically, the state CPA societies and the state boards of accountancies.

That there is some threat, that is, in terms of a unrealistic goal. I think if you, if you just made that 2011, even if you wanted to put the age old standard setting, "As early as possible but not later than," or something, I think you put the context of not backing states off of the issue by, "Well, we're not going to get there by 2010 because we can't," you know, "our calendar doesn't work."

So, I would ask the Committee again to take it, well, since you're going back on the other topic, to consider the 2011 date, purely, not from an intent perspective, I'm more onboard with you with the intent. In fact, I would like to see it even sooner than 2010. But in the art of the doable and the validity of the report being reflective of the real world.

MR. GLAUBER: Okay. Well, Barry we'll take your comments as they were stated. And I'll make sure that that returns to the agenda of the April 14th Subcommittee discussion.

CHAIRMAN LEVITT: Damon. And you are with us now. So why don't you take off on your revised preliminary recommendations.

MR. PREVITS: Arthur, Arthur, I'm sorry. I -- could you get closer to your phone again?

CHAIRMAN LEVITT: Yes. I'm saying that, Damon should comment on his preliminary, revised preliminary recommendations.

MR. SILVERS: Fine. Thank you very much Arthur.

MR. HERZ: Can I can I -- this is Bob Herz. Before we go to Damon's Subcommittee, could I just ask Bob one point here? The --

MR. GLAUBER: Sure.

MR. HERZ: -- on Recommendation 1, you added the word "transnational".

MR. GLAUBER: Yes we did.

MR. HERZ: I think that that's good. But you've left, "Preferably under the sponsorship of COSO and/or CAQ."

And COSO is largely and CAQ is certainly a U.S. organization. And just the usual sensitivity -- although in your detailed recommendation you talk about liaising with international regulators, kind of this dilemma of, kind of, you know, start something in the U.S. and get other people involved. Or should there be, should it be sponsored in a way that at the outset it's more actually transnational.

MR. GLAUBER: Well, that's an interesting point. COSO, my understanding always was, was not particularly U.S. Is that --

MR. HERZ: Yes. I think a lot of my own experience, well, it's kind of migrated, the ideas have migrated, you got other parts of the world, they have their own versions, like JCOSO. And Cadbury Commission and things like that.

MR. MELANCON: There is some work, this is Barry, there is some work at the COSO level to broaden that. And to try to fix that a little bit, Bob.

MR. HERZ: Yes.

MR. MELANCON: Just -- there's some discussions. In fact, I think they're going on today.

MR. HERZ: Yes. I am aware of that. It's just the issue of whether or not, you know, right, nowadays, if something is perceived to be just American to begin with, it faces some challenges. If the, if the idea is really to make it more international.

MR. GLAUBER: Well, it is certainly, as, again, I -- we've tried to reflect the discussion in the full Committee level. And that was added. I'm not sure that the words here are likely to block international participation.

MR. HERZ: No, I don't think so. It's the issue of who, of who gets, who's involved in the original sponsorship and setup. And sometimes, there's certain organizations that are sponsored on more of a transnational basis to begin with and others that start in the U.S. and hope to have outreach.

MR. GLAUBER: As you say, the text makes pretty clear the interest in involving international bodies.

MR. TURNER: There are, there are those of us, Bob, who have concerns about whether or not the international group, at the end of the day, they'll preside at the auditors and the audits in the U.S. are under the oversight of our PCAOB here in the U.S.

MR. GLAUBER: Right.

MR. TURNER: There's -- I for one, would turn around and say, that's where the end of the day needs to begin and end.

And as I've told people on the Committee, I'm not a big fan of what we got here now, anyway. Because I'm not sure we got the right group together to really go figure out how to get this done right, anyway. And to throw it out to a group like the International Auditing Standards setter would not, certainly not make me any more comfortable or supportive of that.

MR. HERZ: I understand. It has, it just kind of, has a similar, setting it up that way, has similar connotations overseas to what we call big world series or world champions in certain sports.

MS. JACONI: Just for the court reporter's knowledge, that was Lynn Turner speaking then Bob Herz.

MR. HERZ: Yes.

PARTICIPANT: Thanks.

CHAIRMAN LEVITT: Are we ready to pass to Damon? So let's --

MR. SILVERS: Arthur are you ready?

CHAIRMAN LEVITT: Ready.

MR. SILVERS: Okay. Our Subcommittee's recommendations have been revised since the, since our last meeting. In response, I think almost in total, to comments that we received either from fellow committee members at the meeting or from the public before and after our full meeting.

I'll go -- there aren't very many changes. One of them is quite significant. The others, besides a significant addition, the others are really just sort of some clarifying points.

In our Recommendation 1, that -- hold on just a second. In our Recommendation 1, we have, as an example, of the sorts of things that should be done to encourage the growth of the smaller firms, a disclosure of contractual provisions of public companies that limit their choice of audit firms. We've added in the explanatory language there, just a little bit more detail, what we would want to see disclosed, which would include the existence of the agreement, the names of the parties to the agreement, and what the actual provisions were limiting, limiting auditor choice.

We've also added a recommendation that, which I think was sort of implicit all along, but we made explicit, that, there ought to be attention, by regulatory bodies, in formulating advisory committees and the like to, public forums and so forth, to include representatives of the smaller firms.

In -- and I'm going to come back in a moment to our new Recommendation 3 which has to do with audit quality metrics, which Bob Glauber alluded to a few moments ago.

And just cover the, the one other item that we have, that we added.

There is one other item. Maybe not. Anyway. I guess there isn't.

So I'll come to the major point here. We received a comment letter, from a member of the public, pointing out that really there's not that much information available to audit committees or to shareholders that would enable the purchasers of audit services to compare the quality of service providers other than their sort of own direct experience with those firms.

And that, and as such, the

Committee felt that it would be a good idea, to add as a recommendation, the recommendation that the PCAOB develop a a battery of key indicators of audit quality that could be the subject of disclosure by the audit firms.

And then with us informed, market decision makers, the concern we had was that in the absence of good quality, of good comparables, that other factors that are, that don't drive audit quality are probably driving the choice of audit firm decision.

We were aware in doing this that, a certain amount of thoughtfulness needs to be exercised around an initiative like this to ensure that you don't have a perverse outcome. And so that was why we really looked to the PCAOB to sort of implement this idea in detail.

The -- we did receive an initial comment from Dan Goelzer, the PCAOB representative on our Subcommittee, expressing concern that we not be too prescriptive in terms of the details of how to do this and that we have, we have written this recommendation in the form that it's being, that you have it in, to be responsive to that comment. We haven't heard from Dan since the, this latest draft was circulated. And, but we're hopeful that it will be responsive to his concerns. And we can move forward with this.

That, I think, pretty much covers the changes in our recommendations since our last in-person meeting.

MR. LASKAWY: This is Phil Laskawy. Can I comment on this one --

MS. JACONI: And before you do that, Phil, can I just say, Damon, there was one other significant change you might want to point out.

MR. SILVERS: Oh, I was sure I had missed something. Which one did I miss?

MS. JACONI: It's under Recommendation 5. It's the last sentence.

The last page. The last sentence.

MR. SILVERS: Ah, yes. Right. The -- I knew I'd miss something. And this is what I was looking for.

The Recommendation 5, is the shareholder ratification Recommendation. And there's a lot of points there. We did add a sentence stating that, and again, in order to make this a more or less transparent process, then in addition to disclosing the name of the audit firm, the proxy report should disclose the name of the senior audit partner or partners managing the engagement.

Sorry about that. Someone was -- we interrupted somebody.

MR. LASKAWY: Yes, Phil Laskawy was going to --

MR. SILVERS: Yes, Phil.

MR. LASKAWY: -- comment on item 3, Damon.

MR. SILVERS: Yes.

MR. LASKAWY: I'll start by taking

the most extreme view. I think this is an enormous mistake to even get into this area of key performance indicators. I'm not quite sure what they would be. But leaving all the descriptive and specifics of it, I mean, I think something like this would not be helpful. But also just continues to ratchet up the potential for liability.

And I thought one of the goals of this Committee was to improve quality and do things of that nature. But also to balance the issue of, how do we maintain a healthy audit profession.

And I just don't understand the firms -- and Mark Olson and I don't know if he's on the phone, the firms have lots of requirements to indicate, based upon their peer or their reviews, their quality, their proficiencies, etcetera, etcetera.

And specific indicators, to me, after spending 40 years in the profession, seem really not very valuable, not very doable. And also, would just be a field day after there was a problem on an audit for a plaintiff's bar.

So I strongly object to this recommendation.

MR. TURNER: Damon, if I can just jump in. I take the other extreme then. And I strongly support this. I thought the comment letters that we got in from the retired Big Four partner was superb.

And I think he laid out the type of quality indicators that, you know, are a natural. And they aren't particular to any one specific engagement that he talks about. But from, I think, I suspect that the, from McGladrey and Grant Thornton and BDO could show that, if anything, they're more competitive or just as competitive on those quality factors as the Big Four are, which I think would help a lot from the competitiveness issue that you talk about. I don't see them as liability type issues in any way, fashion, shape or form.

And if you go and read that comment letter, that guy was concerned about litigation, but obviously, didn't see that as a problem on these, as well, from his experience, which is the same as mine.

And you know, I pointed out those, plus a couple others, to you and members of our own Subcommittee. And I think it's always good to have transparency around. When I was running a manufacturing company, our customers wanted to know what our key quality things and how we were doing. And I think that's good information to get out there in a transparent fashion.

So I'm extremely supportive of it.

MR. GOLDMAN: Yes. This is, this is Ken. I just want to add one thing. I think, I mean, I think the devil in this one will be the details. And, in, relative to transparency, do we end up disclosing this, disclosing this publically? Is it something that's done by the PCAOB? And do they go through their reviews, and they summarize and keep it internal? And as you well know, some of their findings are public. Some are not public.

And I think we want to leave that a little bit up in the air at this point, but I think the idea of having metrics of quality, it's just hard for me to understand why, in general, if we can do it right, why people would be against it.

MR. OLSON: This is Mark Olson. Let me just a, remind another point. We were emphasizing, I think, the fact that we were, one of the wording changes that we wanted was that, we would look at the feasibility of moving forward in this.

I think there's a real question. I think Phil's points are right. That we ought to look at all the aspects of the implications of taking on an exercise like this. And so I think that that was one point we wanted to emphasize.

Another point was that there, was that there was, of course, always the possibility that there could be some confusion between, what is a regulatory requirement and what is essentially, best practices. And I think if there is, that raises an entirely different set of points.

And of course, Phil's point about the implications for litigation exposure is another issue entirely.

But if this is an exercise, initially, to look at the feasibility, that was the point that we wanted to emphasize and I think Dan wanted to emphasize.

MR. MURRAY: This is Rick Murray. Recognizing that this is, very carefully set out as a feasibility recommendation, and admitting that there is no question that the goal involved is as legitimate as implied, I do think there are feasibility issues that need to be tested along the lines that Phil mentioned.

And considering that the illustrations, Damon, that are in the second paragraph here, are matters that I don't think we have any empirical evidence, are tied to an absence or an insufficiency of audit quality. In fact, the evidence we've received as a Committee is that, the problem lies not with staff experience but with audit partner judgment.

And I do believe there are a lot of potential developments in how this would be applied, both for liability purposes and for career enhancing purposes. And career stabilizing.

I would ask if maybe this might be added to the Structure and Finance Committee agenda for additional comment on this when we next meet.

MR. GLAUBER: Well -- this is Bob Glauber. Certainly, we intend to discuss this issue in the context of transparency. I --

and so, I'm sure we will return to this Rick as you request.

MR. SILVERS: Could -- this is Damon. I, as I said at the beginning of this discussion, I think it's important that this language give sufficient flexibility to the PCAOB to look at the complexity that's involved in trying to develop, you know, what the appropriate measures, what appropriate quality metrics would be, that would be usable by audit committees and investors.

I think that the Subcommittee's view is that, which under, which underlay this recommendation, is that, there really isn't that much information available to people who are in good faith trying to make the decision as to which audit firm to hire and whether to retain an existing firm and what the other options are. That there simply isn't the comparative data available that one might have in many other circumstances in making a judgment of this type.

What I'm sort of puzzled by and perhaps there's someone who can explain it, is why, I think to Ken Goldman's point, I mean, the point that this is complicated and that one has to really watch out for, sort of perverse consequences and this kind of thing, that that all makes sense to me. But what I'm not, what I have a hard time following is, the argument that there's something about audit services that means that there are no meaningful metrics in quality. Or that or that somehow it's dangerous to make those metrics known to the purchasers of the services.

MR. MURRAY: Damon, and this and this --I think, a quick answer, I think there are a multitude of metrics perhaps too many of them. But the literature on generally accepted auditing standards encompasses virtually hundreds of things that could be called, "key performance indicators". They're not organized that way. Not labeled that way.

And admittedly, not useful in brochure presentation to shareholders.

But the -- it's not as though there's no guidance to quality standards.

MR. SILVERS: Well, I wasn't making the point about what constitute quality standards. I'm talking about outcomes. I'm talking about measures of outcomes. Right. Which is typically I think how one does things in business. And if, if it's true that there's lots of them, I accept that. And I accept that the notion that sorting out what the right ones to make available to purchasers of audit services is not a simple job. And those all seem to be that, those distinctions are, I'm with you Rick.

But what I'm, what I'm sort of puzzled by, is the assertion, and I'm not sure Rick it's your assertion, but the assertion that there's something about this line of work that means that customers shouldn't have access to the information.

MR. LASKAWY: Damon, let me respond --

MR. SILVERS: Yes.

MR. LASKAWY: -- let me respond to that. Phil Laskawy. Obviously, any argument one makes in any of these areas --

MR. SILVERS: Right.

MR. LASKAWY: -- are subject to disagreement, contradiction, and different reasoning.

MR. SILVERS: Right.

MR. LASKAWY: But if the goal is to enable smaller firms to show that they have the same quality issues, your term, indicated at the large firms, I'm -- that will be an interesting conversation.

But if the bigger goal is to compare among the Big Four, who do control an enormous portion of the public company business, I don't know what would be learned or would be new, since all the firms, as Rick said, follow the required, if you will, quality indicators.

The performance fails for an accounting firm, whether they be big or small, in poor judgment, assuming there's no intentional malfeasance but assume, but it generally it’s poor judgment, either in auditing decisions or accounting decisions. And judgment of an individual person, when you are talking about firms of thousands of people, be they the big firms or the next group, is not something that can be measured.

And even though mutual funds and other investment companies give you all kinds of performance indicators, many of which turned out not to be exactly accurate, but that's a different discussion, that's not relevant to us, the traditional professional firms, I've never heard law firms giving out key performance indicators. I've never heard actuarial firms.

So, the tradition of professional firms is that they adhere to the guidelines and, in some cases, maybe go beyond them, but adhere to the guidelines with respect to their professions. Or by regulatory requirement. And that is -- should be the baseline. And if firms aren't doing that they're punished appropriately by the regulators who regulate them, whether they be at the state or federal levels.

So I do have, I think it's a little misleading to compare them with manufacturing quality or even investment company indicators, which again, turn out in many cases to be, depending on how you make the calculation, you get different results. So I just think when it comes to service firms, we're all adhering or supposed to be adhering to the professional requirements. And why do we need to go beyond that?

MR. SILVERS: Phil can I just say, two things in response to what you just said? One is, I think that this issue of the impact of quality metrics of small firms, it's an important one. And that, certainly, this recommendation should be read in light of Recommendation 1. Right. And that may need to be made more explicit. All right.

And part of the reason to give the PCAOB, I think great latitude in this area, is precisely to avoid, you know, it's precisely so that the indicators are ones that are a level playing field. Right. And aren't sort of tilted around size.

The second point you made, I think is a very thoughtful one. Which is the question of, as you put it, the difference between professional service firms and other types of businesses. And I would suggest though, that the, that audit services are an unusual sort of professional service. And that, there's certainly been many advances whether you, which is to characterize them, people may have different views as to whether they really are advances, but there's certainly been many developments in the area of a sort of performance metrics for professional service firms, whether doctors or lawyers or others. There ought -- the performance of a public company audit seems a much more sort of, defined sort of service than the breadth of things that may be asked by clients of, say a law firm or a management consultant or others.

And I think there is a distinction here between the question of, are firms complying with minimum standards, as set forth, say by the PCAOB? And do we, and the question of, do we want to encourage it, the provision of information to people who are purchasing these services, so that there's a competitive dynamic here?

I think that the, there's sort of a supposition, the starting point of our Subcommittee was that, we were being asked to think about ways to encourage competitive dynamics.

Now one could take the other view.

Which is, which would be that, effectively, this is not a competitive market. Right. That we have a handful of firms that are, basically, all doing more or less the same thing. At more or less the same level of quality.

And then what we're going to do is, basically, to lease that to the regulatory process. And that, and that we're not, we're not really, we're not really interested in what, in what information the actual purchasers of these services or the vetters of that purchase, the shareholders, have in making those decision because they're really not important.

MR. MURRAY: Damon, you, you are, as always, articulate. And I, and I'm appreciating better what you intend.

My sense is, yes, there is one major key performance indicator that is the only relevant one here. And that is, how many frauds are detected and prevented?

MR. SILVERS: Hm-hmm.

MR. MURRAY: How many are not? And what is your firm's record? The difficulty, the feasibility difficulty with that is the undetected ones --

(Laughter.)

MR. SILVER: Hard to detect the undetected ones sometimes.

MR. MURRAY: -- all, almost universally, show up in litigation, regulatory investigation or PCAOB reports.

MR. SILVERS: Right.

MR. MURRAY: Vastly more numerous successful preventions and detections.

MR. SILVERS: Hm-hmm.

MR. MURRAY: And my experience, vastly more numerous, means well up in the more than 95 percent of the cases --

MR. SILVERS: Hm-hmm.

MR. MURRAY: -- are impossible to identify and confidential if you could.

So it's the feasibility of what

conclusions you draw from that, that is the problem.

You then go to a secondary surrogate set of well --

MR. SILVERS: Hm-hmm.

MR. MURRAY: -- you can't get at the real KPI, let's choose a bunch of other things we think may be relevant. If we don't have good empirical evidence that the surrogates are --

MR. SILVERS: Are good surrogates. Then you are going to perhaps do something destructive.

MR. MURRAY: -- right.

MR. SILVERS: Yes.

MR. FLYNN: This is, this is Tim Flynn. I think this is an interesting and healthy discussion. And I think, if we sit back and look at what we're trying to talk about here is audit quality. Which I think everybody on this phone call is in favor of.

MR. SILVERS: Hm-hmm.

MR. FLYNN: And I understand Phil's point. I understand Lynn's point. Rick's and Damon's point.

It just seems to me that what this recommendation is to do, is to bring a group together to look at, how do we determine key indicators of quality in this profession? It's been talked about at a variety of our different Subcommittee and at the full Committee meetings. It's a critical issue for the sustainability of the profession, going forward. It's not, it's not making a demand. It's simply stating, "Let's look at the feasibility of how we might look at this."

And I think we can't design it on this phone here today.

MR. SILVERS: Right.

MR. FLYNN: But it seems to me, worthy of a goal, to a feasibility standpoint, to go look at what would be things for audit quality. There are many metrics that might be worked out. You might look at the number of partner hours, total staff hour time engagements. You might look at partner/staff ratio. You might look at a large variety of things that go beyond just looking at, did they catch a fraud or not?

And so -- and I know as a profession, there's been a lot of, a lot of discussion around, how do we measure audit quality? And at audit Committee level.

So, you know, this might be one that allows us to do some work around some more research that the academic community's been talking about. And I would think that we want to look at this, embrace this recommendation for what on its face is more audit quality than competitiveness. I think it's all about audit quality.

And with the PCAOB leading this charge and looking at feasibility and bringing the right people to the table, I think it's worthy of a discussion.

MR. MELANCON: And -- this is

Barry. Just to add to that, Damon, in the second sentence, I understand the feasibility part in the first part.

MR. SILVERS: Hm-hmm.

MR. MELANCON: And the last sentence, basically, it says, "If it is feasible then require it," the PCAOB, "to be the monitor of this." And maybe that gets to Phil Laskawy's point, as well. I mean, depending on what the answer is, that may not be the answer. Did the Committee discuss that? As to why it got to the word "require" on there --

MR. SILVERS: Yes. Well, in fact, I think you may be identifying a drastic defect here. We were looking to kind of move the word -- the word "require" appeared in a number of places in an earlier draft of this. And my view was, is that, that word probably didn't really, didn't really capture where we were at, so to speak. And so, I think that that may just be a slip up.

My view of this based on, Barry, based on this discussion and people speaking prior to you, is that, I think that what we need to do here is to do a little further work on the drafting with the Subcommittee. It seems to me as though the, that there is, you know, with something such as "require" in mind, to get the right tone here.

But as I, as I indicated, this is a some, this is a, this is a significant recommendation that came out of a public comment. That the Committee has not, has not processed as extensively as our other recommendations. And this conversation today is a good, you know, is a good substitute for that in certain respects. But I think we need to go do this a little more. And we'll have input from the PCAOB itself. And we can fine tune this language a little bit. I think with, you know, with Tim's comment and Rick's comments in mind.

MR. SIMONSON: Damon, this is, this

is Rick Simonson. I wanted to add here, I think that's exactly right. As we struggle with this one. And we need to emphasize what you brought up before. That, no, it's not a comparison amongst the Big Four.

MR. SILVERS: Right.

MR. SIMONSON: It's looking at quality so that there might be a little bit more of a of a scorecard that's relevant to compare firms that aren't the Big Four with those.

And I very much support the idea that quality is about a number of different measures. We need to define those a bit more. And as an issue or, and an investor, quality is not limited to the detection of fraud, in my opinion. That's absolutely wrong.

MR. MAHONEY: This is Jeff Mahoney. Just two quick points. First, from an investor perspective, I support this recommendation.

And second, I'd just like to point

out that, with respect to the Big Four UK Annual Reports, they do provide a number of different key performance indicators. And there is language in those reports, I have one right in front of me now, that suggests that some of the indicators they do provide are focused on audit quality. So it might be useful to either, for the Subcommittee or the PCAOB, if this recommendation goes through, to look at some of the key performance indicators that the Big Four firms are already disclosing in the UK. And in which, they seem to think at least some of them relate to audit quality.

CHAIRMAN NICOLAISEN: It's Don Nicolaisen. And I'm going to have to sign-off here. And catch a plane.

But on this topic, I do think that the dialogue has been helpful. I do think it's two Committees that need to address the issue. Perhaps the word is not, "key performance indicator", but it's something else.

But to me, the concept, the firms compete, primarily, on the basis of cost. And that's been the history of the profession. And it has been disastrous for investors and for the firms.

I think, if we can elevate this, somehow, it is in the best interest of everyone to identify some of those things that would be, that would provide audit committees and investors an opportunity to better understand how firms compare amongst themselves. And what are some of those things that that would lead you to engage an audit firm, other than price.

CHAIRMAN LEVITT: I think that's a very important point. And mindful of some of the objections that have been voiced. I think that we would do a great disservice to this report, to step away from recommendations. Words are as precise as we want them to be. Or giving an impression other than what we want to create.

I completely agree with Don that this is a very important issue.

MR. MELANCON: Damon, I have a question. This is Barry.

MR. SILVERS: Yes.

MR. MELANCON: I have a question on something else.

MR. SILVERS: Sure.

MR. MELANCON: If we're moving off of this topic.

MR. SILVERS: Yes, I mean, just Barry, just hopefully we can just put the closure on this topic and then I can take your question.

MR. MELANCON: All right.

MR. SILVERS: I mean, just for process wise, I think, our Subcommittee will work with the treasury staff and PCAOB around the wording in our report. And then, maybe we should liaison with Bob and to make sure that we're in touch with what this Subcommittee is thinking in this area. Is that, is that what

I hear is the, Arthur is that the mandate?

MR. GLAUBER: Damon it's Bob. I think that's, of course, very sensible. And we will talk. Yes.

MR. SILVERS: Yes.

MR. SILVERS: I think we can get done on this.

Barry I'm sorry.

MR. MELANCON: No. That was fine, thanks. My question is, you've referred to in some of these things about, you know, understanding sometimes the unintended consequences of certain things. I'm certainly not opposed to the required disclosure by public companies in the proxy reports of any provisions and material agreements with third party limiting auditor choice.

My -- I'm not concerned with the concept. My concern with the recommendation per se is that, it's my experience that these limitations are not formal. Although they are certainly some examples of that.

MR. SILVERS: Right.

MR. MELANCON: But they tend to be more, I want to say, discussions over a conference room table.

MR. SILVERS: Right.

MR. MELANCON: Which obviously would not be disclosed in this. In my -- what I would not want to have happen, and I'm just curious if the Committee, you know, maybe talked about this at all, I would not want someone to do a study five years after this report, and say that, "Well, there's been," you know, "no disclosures or," you know, "only a handful of disclosures along these lines."

MR. SILVERS: So it's not a problem.

MR. MELANCON: "So it's not a problem." Exactly. Exactly. Was there any thought on that?

MR. SILVERS: You know, it's funny Barry, I don't think so. I don't think we, I don't think we considered that potential downside. I'll tell you that from, my other members of the Subcommittee may wish to put their two cents worth in here, but my own take on this, is this, that, when you put a disclosure requirement like this in place, it acts as something of a damper on those informal conversations. Because if, you know, if there are lawyers around in the room, people will start to wonder about whether there is something that has to be disclosed is being done. And that kind of thing.

The combination of actual, of disclosing the actual agreements when they come to, when they happen, and having that damper effect, feels to me as though, it's probably worth the, worth the downside that somebody may be able to point to the relative lack of these disclosures, and say, "This isn't really happening."

We -- but perhaps, Barry, what your comment really is, is an instruction to Alan in drafting our document, as a whole, to be up front about this. So that nobody can sort of, nobody can twist us around on it, in the way that you were suggesting could occur. And to say that, "We don't expect to see very many disclosures because we think that a lot of this is informal. But that this is an attempt to kind of push back on it a bit." And that, you know, anyway, to somewhat ensure ourselves against the downside risk you were describing.

MR. MELANCON: Yes. That may be helpful. I don't know how you actually word that. But I appreciate --

MR. SILVERS: Oh, Alan's a very, a very creative guy.

MR. MELANCON: I appreciate the consideration.

CHAIRMAN LEVITT: Duly noted. Damon, I think you have our marching orders on this.

MR. SILVERS: Yes.

CHAIRMAN LEVITT: Thank you. Let's see if we have --

MS. JACONI: Arthur, Arthur, we do need to make a decision to go ahead and draft the report. Start drafting.

CHAIRMAN LEVITT: Why don't we have the staff call the roll?

MS. JACONI: And this is just what we, what our General Counsel's Office wanted us to do was, just make sure people were comfortable with the starting, with the decision to start drafting a report. Fully recognizing that the Subcommittees will be meeting over the next couple weeks before our meeting that we now are rescheduling from April 24th to early May.

So I'm going to call roll and if, you can just say, "Yes," or "No". That would be helpful.

Again, it's just the decision to go ahead and start drafting the report.

MR. PREVITS: Kristen this is Gary Previts. Do you need a motion from me or from another member of the Committee for that effect? And then, use the roll call as a yes or no? Or what do you want to do?

CHAIRMAN LEVITT: I called for a --

MR. PREVITS: Okay.

CHAIRMAN LEVITT: -- a --

MR. PREVITS: And I'll second it if that's necessary. And thank you.

MS. JACONI: And I'll call roll.

Alan Beller. Alan.

MR. BELLER: Yes.

MS. JACONI: Okay.

Amy Woods Brinkley.

(No audible reply.)

MS. JACONI: Rodge Cohen.

(No audible reply.)

MS. JACONI: Tim Flynn.

MR. FLYNN: Yes.

MS. JACONI: Bob Glauber.

MR. GLAUBER: Yes.

MS. JACONI: Ken Goldman.

MR. GOLDMAN: Yes.

MS. JACONI: Gaylen Hansen.

MR. HANSEN: Yes.

MS. JACONI: Arthur Levitt.

CHAIRMAN LEVITT: Yes.

MS. JACONI: Barry Melancon.

MR. MELANCON: Yes.

MS. JACONI: Rick Murray.

MR. MURRAY: Yes, with the caveat that there are some major issues that we've discussed very productively today that could ultimately reshape the emphasis of the report. And I'm assuming that proceeding to draft won't preclude us from that.

MS. JACONI: Okay.

Don Nicolaisen got off.

Gary Previts.

CHAIRMAN NICOLAISEN: Still here and I say, "Yes".

MS. JACONI: Oh, okay. Sorry.

Gary Previts.

MR. PREVITS: Yes.

MS. JACONI: Damon Silvers.

MR. SILVERS: Yes.

MS. JACONI: Rick Simonson.

MR. SIMONSON: Yes.

MS. JACONI: Sarah Smith.

MS. SMITH: Yes.

MS. JACONI: Bill Travis.

MR. TRAVIS: Yes.

MS. JACONI: Lynn Turner.

(No audible reply.)

Thank you Bob.

Chairman Volcker. He may be off too.

Jeff Mahoney.

MR. MAHONEY: Yes.

MS. JACONI: Okay. Amy Woods Brinkley.

(No audible reply.)

Rodge Cohen.

(No audible reply.)

Okay. That's it. We just called member roll.

CHAIRMAN LEVITT: Okay. I think this has been a productive discussion. There are a number of issues that clearly have to be refined and which a number of us have differing views on.

I think it's terribly important that what emerges from our deliberation, something that will move us in a positive direction rather than a document which is so muted by consensus, it really doesn't say very much.

I don't sense that. We're now entering the most important phase of our discussions. And I think it's Don's responsibility and mine, together with the Committee heads, to see to it that each individual committee moves on towards specific conclusions.

If that means that some members of those committees differ from those conclusions, I think we have to consider that -- move us towards coming up with something that is merely a matter of merging disparate views into a document that nobody can really say has a point of view.

It's absolutely essential that this document has a point of view. And each of the committees have instructions. I know that it's not going be easy just listening to the conversation.

But I think that's a mission that the Chairs of the Committee must undertake.

MR. GOLDMAN: Arthur, this is Ken. I would just add, I mean, to me, the conclusions have to be in the form of actionable and, you know, impactful kinds of suggestions. So that at the end of the day, you do see something has changed and completed. As opposed to just a bunch of words.

CHAIRMAN LEVITT: I agree with that.

Okay. Thank you everybody for giving as much time as you have. And the attention that you have to this.

We will be in touch and thank you

Kristen and Treasury staff in the midst of everything else you're doing these days to give us this commitment that is very helpful.

MS. JACONI: Thank you everyone for participating.

(Whereupon, the above entitled matter was concluded at 2:32 p.m.)