U.S. DEPARTMENT OF THE TREASURY

ADVISORY COMMITTEE ON THE AUDITING PROFESSION

MEETING VIA TELECONFERENCE

Friday,
September 26, 2008

The meeting was convened pursuant to notice, at 10:00 a.m., Arthur Levitt, Jr. and Donald T. Nicolaisen, Co-Chairs, presiding.

ADVISORY COMMITTEE MEMBERS PRESENT:

ARTHUR LEVITT, JR., Co-Chair
DONALD T. NICOLAISEN, Co-Chair
ALAN L. BELLER
TIMOTHY P. FLYNN
ROBERT R. GLAUBER
KEN GOLDMAN
GAYLEN R. HANSEN
BARRY C. MELANCON
RICHARD H. MURRAY
GARY JOHN PREVITS
DAMON A. SILVERS
SARAH E. SMITH
WILLIAM D. TRAVIS
LYNN E. TURNER
ANN YERGER

ADVISORY COMMITTEE OBSERVERS PRESENT:

ROBERT HERZ
MARK OLSON
TREASURY OFFICIAL PRESENT:
HENRY PAULSON, Secretary of the Treasury

TREASURY STAFF PRESENT:
KELLY AYERS
GERRY HUGHES
TIMOTHY HUNT
KRISTEN JACONI
STEVE LAUGHTON
# TABLE OF CONTENTS

Opening  
Co-Chair Nicolaisen .................................................. 4

Roll Call  
Ms. Jaconi ................................................................. 4

Secretary Paulson ......................................................... 6

Co-Chair Nicolaisen ...................................................... 9

Human Capital  
Mr. Previts ................................................................. 14

Firm Structure and Finance  
Mr. Glauber ................................................................. 19

Concentration and Competition  
Mr. Silvers ................................................................. 30

Vote  
Ms. Jaconi ................................................................. 33

Closing Remarks  
Co-Chair Levitt ............................................................ 35
P-R-O-C-E-E-D-I-N-G-S

10:10 a.m.

CO-CHAIR NICOLAISEN: All right.

Let's get started. We do have a quorum. Good morning, everybody. We apologize for the confusion in getting this meeting underway.

OPERATOR: Excuse me, sir. Are you ready for the public to be listening as well?

MS. JACONI: Yes, we are.

OPERATOR: All right. I will go ahead and transfer you over so that all parties can listen at this time.

MS. JACONI: Thank you.

CO-CHAIR NICOLAISEN: Excellent.

Thank you.

Let me start over. Good morning, everyone and again, I apologize for any confusion.

Now what do we have on?

MR. PREVITS: I'm still here, Don.

Gary Previts.
CO-CHAIR NICOLAISEN: Okay. I assume then that that was just the joining then of the public call. So but let's be sure. Let's do a roll call one more time.

MS. JACONI: Okay. Alan Beller?
Alan Beller?

MR. BELLER: Here.


MR. FLYNN: Present.

MS. JACONI: Bob Glauber?

MR. GLAUBER: Here.

MS. JACONI: Ken Goldman?

MR. GOLDMAN: Yes.

MS. JACONI: Gaylen Hansen?

MR. HANSEN: Yes.

MS. JACONI: Arthur Levitt? Barry Melancon?

MR. MELANCON: Here.

MS. JACONI: Ann Mulcahy? Rick Murray?

MR. MURRAY: Yes.
MS. JACONI: Don Nicolaisen?
CO-CHAIR NICOLAISEN: Here.
MS. JACONI: Gary Previts?
MR. PREVITS: Here.
MS. JACONI: Damon Silvers?
MR. SILVERS: Here.
MS. JACONI: Rick Simonson?
Sarah Smith?
MS. SMITH: Here.
MS. JACONI: Bill Travis?
MR. TRAVIS: Here.
MS. JACONI: Lynn Turner?
MS. TURNER: Here.
SECRETARY PAULSON: Hi, it's Hank.
Can you all hear me?
CO-CHAIR NICOLAISEN: Yes, good morning, Hank. It's Don Nicolaisen.
SECRETARY PAULSON: Oh, hi. Good morning. You know, I so much wish I was there in person with you and there today because this is something that's very important that I've been looking forward to. But as you
know, I'm spending my time differently these days.

But again, Don and Arthur, thank you very much. So this is very important and you know, this industry's terribly important.

I know all of you have devoted a lot of time to the Committee and Subcommittee, you know, many of you have demanding full-time jobs. All of you are busy and I also want to thank Mark and Bob and Conrad for serving as observers. Thank you very much.

You know, I was thinking as I looked at my schedule this morning, I remembered back at -- March 2007 sounds like a long time ago. You know, that -- I remember George Schultz telling me the days will be long and the years will be short. But for me the days have been long and the years have been long.

But I remember we got together. We had the conference at Georgetown University.

What's that? Someone is -- I'll
keep going.

CO-CHAIR NICOLAISEN: Please do.

SECRETARY PAULSON: Someone is --

CO-CHAIR NICOLAISEN: We can hear you just fine, Mr. Secretary. Go ahead.

SECRETARY PAULSON: Okay. When we thought about competitive U.S. capital markets, I think all of us thought that accounting was right front and center because you know, you got -- the lifeblood of capital markets are the financial statements and the sustainability of the auditing profession, critical to investor confidence in our capital markets and you know, since that time, this has only become clearer given some of the developments.

So I'm grateful for you, you know, continuing with your efforts here and all the work you've done. I am going to very much welcome and be here to receive your final report next week after you vote today and I hope and believe what you're going to do is
going to contribute to shape the necessary work of improving investor confidence in our financial markets.

And I know you're going to vote on several very significant recommendations including a market stability recommendation and I think that's very important and again, I thank you.

I look forward to reading your recommendations and I really, really appreciate what you've done and thank you for your service to the United States as, you know, the best place in the world to do business.

And we've got a lot of work to do in a lot of areas to get us back to where we should be, but your work is an important part of it.

So Don or Arthur or anyone else, any comments, questions for me before I go out?

CO-CHAIR NICOLAISEN: No, we
appreciate it very much that you've joined us, Mr. Secretary. It's extremely kind of you and we wish you all the best as you move forward in your undertakings today.

SECRETARY PAULSON: Okay. Thank you all and I really appreciate it. Thanks.

CO-CHAIR NICOLAISEN: Thank you. All right. Let's try it.

MS. JACONI: I'm going to renew taking roll. I think I was at Ann Yerger?

MS. YERGER: Here.

MS. JACONI: And Arthur Levitt has joined us. Anyone's name I haven't called? Thank you.

CO-CHAIR NICOLAISEN: All right. We have an echo in ours. Does it sound all right to the rest of you?

MR. PREVITS: It's okay here, Don.

CO-CHAIR NICOLAISEN: Perfect. Then I'll live with the echo. It's like we're broadcasting from a chamber some place.

Again, good morning. Thank you
very much for a year's patience and hard work
and a lot of effort in exchanging views in
areas where I know we've had some very long
and enthusiastic and thoughtful discussions
and inputs.

I'm quite confident that what we
have today is a very good product and I think
that in the balance we'll be able to go
forward with some recommendations that will be
very helpful in improving an audit profession
that has already made great progress
particularly with guidance and standard
setting and oversight of the PCAOB.

Our meeting today, I wanted to
comment first on two areas of additions that
came in in your package that you should have
all received over the weekend or Monday
morning and in that package, we've included a
background section. The background section is
intended to be a neutral discussion of the
auditing profession that provides background
on certain basic information such as revenues,
of the source of those revenues, some commentary about governance practices of the firms, some commentary as best we were able to gather at the global networks and other background information.

That will be a part of the report and to the extent that there's any Committee commentary as to are the facts not right in that, please feel free to get to Kristen or to raise it today. We certainly do want that to have the same rigor that every other part of this report has had.

Secondly, Arthur and I have added our commentary. That is not part of the Committee's report. That is separate and apart and we want to make it very clear that we're not asking the Committee to approve what we have to say. What we're trying to do in that is simply express our appreciation for a lot of hard work that was done by a great many people as well as to provide the encouragement to continue the process and I think we're
better equipped with a regulatory environment of today with the PCAOB being in place to be able to see continuing progress in the quality and ability for the public to place confidence in the auditing profession.

There are a couple of comments in there that have caused some of you to say that you would want us to be careful to label it our views, the views of the co-chairmen, and that they're not necessarily views shared by other members of the Committee and we certainly will do that. We've taken that under advisement. We certainly will do that.

With that, I would like to begin as we have in each of these previous meetings to review the changes that each Subcommittee chair would care to comment on. Those things that are deemed of significance since the last draft which was dated July 22nd.

So let me begin with the Human Capital Section and Subcommittee Chair Gary Previts, I'll turn it over to you.
MR. PREVITS: Thank you, Don. Thank you, Arthur and I want to express my appreciation on behalf of our Subcommittee, to Co-Chairs for your support and guidance and of course, to the staff and particularly to the members of the Subcommittee. It's a hardworking group and it's a pleasure to work with them.

I'll try to be brief in this summary. It is the final summary on our Subcommittee activity.

A significant change, there was a 12-line addition plus some footnote support amended in the prologue to our section to recognize and acknowledge the work place successes of the profession in recent years. Those came through in the comments since our July meeting and with the assistance of staff, those successes have been appropriately acknowledged.

The remainder of the text in the recommendations aside from some wordsmithing
in the summary black-letter language under recommendation 5 is almost identical in all respects to prior versions and I'll just briefly summarize those recommendations since we are going to vote.

Recommendation 1 and its sub-parts emphasize the need for current and market-based content in the curriculum and professional examinations going forward. It touches on aspects such as availability of low-cost or no-cost access to develop -- in developing authoritative searchable databases and there are proposals on that matter in the hopper right now as Bob Herz is well aware and we're hopeful with support of that nature we can go forward and begin to really drive change in the curriculum. Not an easy thing to do.

The second item I personally consider to be the centerpiece which is the focus on improving the representation and retention of minorities and in this
recommendation, there are several specific actions depicted and encouraged including Historically Black Colleges and Universities.

That's the second recommendation as I said. I just personally view that as the centerpiece.

The third deals with the faculty-supply issue which we all have been focused on. David Leslie's study provided us with uniquely crafted information at the time of our meetings in January including how to best find a balance point in a variety of backgrounds most valuable to higher education's role in preparing individuals for the profession.

Cross-sabbaticals have been suggested. The need for access to research data to unplug the pipeline into doctoral research at doctoral institutions as Bill Kinney pointed out especially in the auditing areas and of course, the new doctoral scholars program launched with support of the firms and
the institute. Suggested actions are already under way and that's very positive.

The fourth recommendation is simply a reminder that we need regular information to address the irregular nature and lack of data upon which good decisions can be made about orienting and guiding important decisions about demographics in academic profiles and so forth.

Still a challenge, but the filings in January that provided some information about hiring on the part of the firms and the restatement of the AICPA's supply and demand data are hopeful signs that we can begin to build forward.

The final recommendation is kind of strategic and vital. It's a keystone to the future and that's the recommendation to create a commission to study accounting higher education. It calls upon the AAA and the AICPA to undertake this activity and hopefully that will occur sooner and not later.
Even in light of the extreme focus on current market conditions, I think this is -- these recommendations fit in the generic category and while we're hopeful that they can be addressed, you know, relatively soon, everyone's aware of the fact that we're in unchartered waters and hopefully as we see our way through those, we'll come back and recognize the importance of these as well.

I would leave it there and ask the Co-Chairs if they have any other questions or any members do.

CO-CHAIR NICOLAISEN: Thank you very much, Gary. Committee members, any comments? Questions?

If not, Gary, thank you very, very much for your efforts and we think that the contribution that's been made by you and members of your Subcommittee has been outstanding. Tremendous amount of data that has been digested and then converted into some very, very good recommendations. So again,
thank you very much.

Let's move next then to Chairman Bob Glauber. Bob has been the Chairman of the Firm Structure and Finances Subcommittee and Bob, we certainly want to express our appreciation to you in working through some of the areas that have been most energetic and I think you have done an outstanding job and your committee has been deeply engaged and we're appreciative of that as I believe investors and others around the world are. So I will turn it over to you at this point.

MR. GLAUBER: Thank you, Don. Can you hear me?

CO-CHAIR NICOLAISEN: Yes.

MR. GLAUBER: Well, good. Let me begin by thanking the Subcommittee members for their perseverance, their commitment, their endlessly professional behavior and their enduring good humor throughout this very difficult task.

I also want to thank most
profoundly and profusely the staff headed by Kristen. The staff have been simply unending in their support of us and responded to all that we've asked of them.

And finally, I'd like to thank the Co-Chairs for their guidance and support throughout this effort.

With your permission, the permission of the Co-Chairs, I'm just going to note the changes rather than the entire recommendation since I think we've been over this a number of times and I'm sure you want to keep this meeting as short as functionally possible.

CO-CHAIR NICOLAISEN: Certainly.

MR. GLAUBER: First of all, there is a change to Recommendation 1 which recommends a fraud detection and prevention center. The center has been looking for a home and it has happily found one. The PCAOB has agreed to host that and I want to thank Mark Olson and the members of the PCAOB for
working hard with us to find terms and conditions under which they would feel comfortable hosting that. So that now is part of the recommendation.

The other major change in what you have is not a recommendation, but it is a section on page 24 and following of changes -- dealing with changes to the litigation liability environment and as I say, it does not contain specific recommendations.

The Subcommittee discussed over a number of weeks and months a wide range of possible changes most of them bearing on basically catastrophic litigation risk. Things like caps on damages confronting audit firms, caps on appeal bonds, the right to appeal, denial of motions to dismiss, Government insurance of audit firms, bilateral indemnification agreements between companies and audit firms and also which is referenced in the co-chairs' chapter, the possibility of federalizing some of the claims against audit
firms although that doesn't really deal with catastrophic litigation risk.

The Subcommittee I think agrees that litigation and that the environment of the litigation should be fair and rational in serving the needs of audit firms and the investing public. But it really could reach no consensus on whether or not the current system is indeed fair and rational or on any proposed changes.

So what we've done in this section after reciting some of the data that were collected to inform us is to express the views of broadly two groups, the audit firm group and the investor group, and that is contained in a series of bullet points in this section and that really is I think a reasonable summary of that section. Again, as I say, we could reach no consensus on any changes, reforms to the litigation liability environment and so we include just this section.
Don, I think that really is all I need to say and obviously I or the Subcommittee I'm sure would be happy to answer any questions.

CO-CHAIR NICOLAISEN: Thank you very much. Any questions or comments from other members of the Committee?

MR. MURRAY: Don, it's Rick. Just for clarification, while I would be among those that Bob has identified as expressing audit firm related views, I don't consider myself to be a representative of the audit firms in doing so.

MR. GLAUBER: That's a very, very proper point, Rick, and I apologize. We have clustered the points of view in two groupings and it would be wrong to suggest that people whose views are expressed in those two groupings represent specifically audit firms or the investing public and I think you're quite right. Thank you, Rick.

MR. HANSEN: Bob, this is Gaylen. I
would have a similar sentiment even though I have been grouped as you said with the investors. I don't necessarily view myself that way. I was asked to represent NASBA and the state boards. Also somewhat representative of small audit firms.

MR. GLAUBER: Absolutely and again, my apologies to you Gaylen as well as Rick and all the other members of the Subcommittee for my inarticulate characterization.

MR. SILVER: Bob?

MR. GLAUBER: Yes.

MR. SILVER: Bob, this is Damon. I'm happy to be represented as an investor, but I have a question about something else on the document.

The discussion of auditor -- of large auditor financial statements that states that they will be -- that recommends that in 2011 they prepare GAAP financial statements and prepare and provide them to the PCAOB on a confidential basis.
Can you explain to me in light of the comments of our chairs which are obviously not for us, but their comments, whether you believe that that statement leaves it open to the -- that the parts in our report leaves it open to the PCAOB as to whether those statements should be made public or is it recommending or are we recommending that they not be made public?

MR. GLAUBER: I believe it is silent purposefully on that and I would say my view would be the way to characterize it is to say it leaves it open. It does not recommend that they make it public. It does not recommend that they not make it public.

MR. SILVERS: All right. Well, I think it's important that it's clear that that's what we're saying here and I think that the language is not -- the language I think sort of tilts otherwise and we might want to think about how to be maybe more precise that we're not -- that we're not -- that we're
silent just as you said in the document.

MR. GLAUBER: Is the language not silent? It --

MR. SILVERS: It says on a confidential basis and I think that some people who have read this document on my staff have seemed to think that that has an implication of what they would do and that caused concern to me. Although, I mean the position that you articulated was what I understood we were doing.

MR. GLAUBER: Well, again, I don't want to step in the shoes of the rest of the Subcommittee, but I believe it was the Subcommittee's intent in this recommendation simply to remain silent.

MR. SILVERS: Yes. No, that was my understanding as well. I think we now -- we now have that clear at least on the record of this call and --

MR. GLAUBER: Is that -- let me -- referring to the Subcommittee, is --
MR. PREVITS: I'm with you. I read the silence pretty clearly.

MR. SILVERS: Okay. Very good. Well, then I'm satisfied. Thank you.

COURT REPORTER: Speaker, who was that?

MR. GLAUBER: Just, Don, if I may, let me just query the Subcommittee, does my characterization of our position leave you comfortable as Subcommittee members?

MS. YERGER: Yes.

MR. MURRAY: Yes, Bob, it does particularly in recognition that the PCAOB has no constraints on what decisions it wishes to take with that information.

MR. SILVERS: Okay. Well, very good.

COURT REPORTER: Members, this is the court reporter. I need the speakers to identify themselves.

MR. MURRAY: That was Rick Murray.

MR. OLSON: This is Mark Olson and
the way I interpreted it and the way that I have understood it is that the recommendation is silent with respect to the disclosure part.

MR. SILVERS: Very good. This is Damon. Thank you, Bob. I appreciate that. Thank you to the Subcommittee.

MR. GLAUBER: Good. Okay.

CO-CHAIR NICOLAISEN: Any other questions or comments?

MR. HANSEN: Yes, this is Gaylen. Mark, how do you -- you said that you think that it's silent on that particular issue, but how do you see this working going forward? Would there be an interpretive and you'd handle this on a case-by-case basis or how do you see that?

MR. OLSON: Gaylen, we, I think, throughout have this -- what we have done is we've been -- we have not taken positions on the recommendations of the Committee.

I think our thinking is that it's our role as the regulator to accept the
industry or the profession as we find it and regulate it accordingly and our position with respect to the recommendations have not been to try to direct the outcome of them, but to add where we think we are being -- where something is being requested of us that's different from our -- either our role or our mandate and the Board has not tried to look at this recommendation, Gaylen, and suggest what our next steps would be. We're waiting for the report to come out and then look to it. So we haven't taken it to the next step.

MR. HANSEN: Thank you.

CO-CHAIR NICOLAISEN: Okay. Any other questions?

If not, Chairman Glauber and the Subcommittee on Firm Structure and Finances, thank you very much for your hard work and now, I'll turn it over to Arthur Levitt.

CO-CHAIR LEVITT: Thank you. The Concentration and Competition Subcommittee chaired by Damon Silvers came up with a number
of creative and constructive ideas.

Damon, would you want to lead off in terms of your Subcommittee?

MR. SILVERS: Yes, thank you, Arthur. Arthur, would you like me to go through the -- summarize each one or merely the changes?

CO-CHAIR LEVITT: I think the changes would be --

MR. SILVERS: All right. We really only -- I mean I think like my colleagues in the Firm Structure and Human Capital Subcommittees, we really have really only a handful of changes.

The only one that's not just a text edit really is that there's a strength -- there's an addition of some language addressing how predecessor and successor audit firms and their client relate to each other in the context of a change of auditors and the language while acknowledging that there's a complex set of obligations that are owed among
the three parties, the language strongly
encourages both the participants in these
changes of auditors and the PCAOB to insure
that there are not inappropriate costs or
barriers placed in the way of companies
changing auditors and particularly by the
predecessor firm.

Obviously, this is a concern that
is important in the context of having healthy
competition for audit services and encouraging
the growth of viable competitors in the large
company and big cap auditing markets.

So you'll find that there's an
additional paragraph or so on that subject. I
believe that is the only really substantive,
large change that's in the document from the
draft version that was made publicly
available.

Although if my fellow Committee
members who are on the call, if I've omitted
something, they should speak up now.

CO-CHAIR LEVITT: Do any members
have comments on --

MR. GOLDMAN: Yes, this is Ken. I agree with the characterization of Damon. I think this is the only major change and I think it's just -- the intent again is to make it more transparent and frankly more straightforward for those firms that would like to look at changing auditing firms and make it easier both relative to the predecessor as well as the successor firm. So that was the intent.

MR. SILVERS: Arthur, this is Damon again. Let me just say that I want to express my thanks to Ken himself and to Tim Flynn who worked together on devising this language on which I think they did a fine job and were a great help to the Subcommittee.

CO-CHAIR LEVITT: I'd like to echo that. I know the chairman's been through a very arduous business schedule and dealing with his colleagues requires diplomatic skills unseen in any form of human endeavor. He's
handled it with fairness and grace and I'm particularly grateful to his contribution.

Any other comments on this chapter?
If not, I think we might now then have a vote on adopting the Advisory Committee's final report and I would ask Kristen to call the role, take a vote of members.


MR. FLYNN: Yes, in favor.

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?

CO-CHAIR LEVITT: Yes.

MS. JACONI: Barry Melancon?

MR. MELANCON: Yes.
MS. JACONI: Ann Mulcahy? Rick Murray?

MR. MURRAY: On the terms as described by Chairman Nicolaisen at the outset of this meeting, yes.

MS. JACONI: Don Nicolaisen?

CO-CHAIR NICOLAISEN: Yes.

MS. JACONI: Gary Previts?

MR. PREVITS: Yes.

MS. JACONI: Damon Silvers?

MR. SILVERS: Yes.

MS. JACONI: Rick Simonson? Sarah Smith?

MS. SMITH: Yes.

MS. JACONI: Bill Travis?

MR. TRAVIS: Yes.

MS. JACONI: Lynn Turner?

MS. TURNER: No.

MS. JACONI: Paul Volcker? Ann Yerger?

MS. YERGER: Yes.

MS. JACONI: Alan Beller, are you
on? Anyone who I haven't called?

    MR. BELLER: Yes. Yes, I am. I was on mute. Yes, I vote to approve.

    MS. JACONI: Is there anyone I haven't called who's on?

The vote tally is 14 to 1.

    CO-CHAIR LEVITT: Okay. The vote approves the report 14 to 1.

    I would just like to say that I have rarely encountered a group who combined the diversity of interest on issues that sometimes were fearsomely divisive, that brought to the table the degree of intelligence, probity and most of all, civility.

    The attitude of this group, I wish this could convey itself to other great issues in our society, but I think we came to the table as colleagues seeking to do a fair and open job and maybe most importantly, prepared to listen and it wasn't always easy because transferring complex ideas into paper and
typed becomes very, very difficult, but each
of us I think made enormous contributions and
I think that we all leave this experience with
great respect for one another and I think
that's a gift we will treasure.

Speaking personally, I would like
to say that I am deeply, deeply grateful for
the friendship and support of both Kristen and
the Co-Chair Don Nicolaisen. In many ways,
this is one of the most valuable aspects of
this experience.

So thank you all for a job that was
well done and I now call for a motion to
adjourn.

MR. GOLDMAN: Arthur, this is Ken.
Before we do that, could I just say that I
did read and I just -- in all due reference to
you and Donald, I think you folks did -- in my
opinion, I read the letter. I thought it was
well done in terms of explaining the points
and maybe adding some color.

So I just wanted to personally
thank you for putting that on paper. You know, it's a reflection of what the Committee has tried to do. So thanks there and I also would like to echo the Treasury's support of this matter which was more than I think any of us would have known for help before we started on this project.

CO-CHAIR LEVITT: Thank you. Do I hear a motion to adjourn?

CO-CHAIR NICOLAISEN: I'll move it.

CO-CHAIR LEVITT: Any opposition?

All in favor?

(Chorus of ayes.)

CO-CHAIR LEVITT: Thank you.

Motion carried.

(Whereupon, the meeting was concluded at 10:45 a.m.)