The meeting came to order at 10:00 a.m. in the Cash Room of the Department of the Treasury, 1500 Pennsylvania Ave, NW, Washington, DC. Arthur Levitt Jr. and Donald T. Nicolaisen, Co-Chairs, presiding.

PRESENT:

ROBERT K. STEEL UNDER SECRETARY FOR DOMESTIC FINANCE

DAVID G. NASON ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS

ARTHUR LEVITT, JR. COMMITTEE CO-CHAIR

DONALD T. NICOLAISEN COMMITTEE CO-CHAIR

ALAN L. BELLER COMMITTEE MEMBER

AMY WOODS BRINKLEY COMMITTEE MEMBER

MARY K. BUSH COMMITTEE MEMBER

TIMOTHY P. FLYNN COMMITTEE MEMBER

ROBERT R. GLAUBER COMMITTEE MEMBER

KEN A. GOLDMAN COMMITTEE MEMBER

GAYLEN R. HANSEN COMMITTEE MEMBER

BARRY C. MELANCON COMMITTEE MEMBER

RICHARD H. MURRAY COMMITTEE MEMBER

GARY J. PREVITS COMMITTEE MEMBER

SARAH E. SMITH COMMITTEE MEMBER

DAMON A. SILVERS COMMITTEE MEMBER

WILLIAM D. TRAVIS COMMITTEE MEMBER

LYNN E. TURNER COMMITTEE MEMBER

ANN YERGER COMMITTEE MEMBER

ROBERT H. HERZ OBSERVER

MARK W. OLSON OBSERVER

ZOE-VONNA PALMROSE OBSERVER
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UNDER SECRETARY STEEL: Well, good morning, everyone, and welcome to the Department of Treasury. Thank you for being here today at the initial meeting of the Advisory Committee on the Auditing Profession. I want to extend my gratitude as well as that of Secretary Paulson and the Department to all the members of the Committee. We appreciate the generosity of your service.

I want to thank in particular the Co-chairs of the Committee, former Securities and Exchange Commission Chairman Arthur Levitt, Jr. and former SEC Chief Accountant Donald T. Nicolaisen. The high regard in which these two gentlemen are held is reflected in the willingness of the distinguished individuals gathered around this table to serve as members of the Committee. As many of you know, this Committee stems from capital markets competitiveness initiatives that Secretary Paulson has spearheaded throughout his time in Washington. Nearly a year ago, the Secretary delivered a speech on the need to maintain and enhance U.S. capital markets competitiveness. He specifically pointed out the sustainability of the auditing profession as a vital
component to this competitiveness. The link between the auditing profession and capital markets competitiveness was established during the adoption of the federal securities laws almost 75 years ago. To assist in restoring investor confidence and encouraging capital development after the 1929 crash, the auditing profession itself lobbied for independent audits of financial statements as a key part of the legislative reforms that Congress was then considering.

Agreeing with the profession, Congress mandated in the federal securities laws independently audited financial statements for all public companies. Certifying financial statements, the independent auditor would help accomplish the aims of the Securities Act of 1933, "To restore the confidence of the prospective investor and his ability to select sound securities and to bring into productive channels of industry and development capital which has grown timid."

Congress has decided then -- had decided then to bestow on the public company auditor a critical role of trust, integral to investor confidence, integral to the flow of capital. This trust clearly broke down at the beginning of the
century when public company accounting scandals challenged the credibility of the auditing profession.

Congress, then considering what would eventually become the Sarbanes-Oxley Act of 2002, harshly reminded the profession, "The franchise given to public accountants by the securities laws is conditional. It comes in return for the CPAs' faithful assumption of a public trust."

To restore credibility in the profession, the Sarbanes-Oxley Act mandated several major changes, the most prominent being the move from self-regulation and peer review to a system of federal oversight. The Public Company Accounting Oversight Board, whose creation has been termed the centerpiece of the Act, now registers and inspects all public company auditing firms and sets and enforces auditing standards. The Sarbanes-Oxley Act also enhanced auditor independence standards, required mandatory auditing firm partner rotation and strengthened the audit committee's role in monitoring the auditor and the audit process.

Five years have passed since the passage of this landmark legislation. The profession continues to adapt to these changes as it reasserts its role in enhancing investor confidence and the
competitiveness of our capital markets. At the same
time, the profession faces considerable challenges.
Secretary Paulson outlined these challenges in his
competitiveness speech last fall. I repeat his
precise words. First, given the performance of
accounting to our financial system, is there enough
competition? Secondly, will our reformed accounting
system produce the high quality audits and attract the
talented auditors we need? And lastly, do auditors
seek detailed rules in order to focus on technical
compliance rather than using professional judgment
that could be second-guessed by the PCAOB or private
litigants?

In conclusion, the Department has charged
this Committee with developing recommendations taking
into consideration issues impacting the sustainability
of the auditing profession including but not limited
to those raised by these questions. Neither the
difficulty nor the importance of this task should be
underestimated. Again, we at Treasury are most
grateful for your service. Secretary Paulson and the
Department eagerly await your recommendations and I
now yield the floor to the Co-Chairs for their
meeting. Thank you very much.

CO-CHAIR LEVITT: Thank you. I hereby
convene this exercise with Don. In terms of meetings and timings, I know how precious your time is and how much you have given to this effort. I promise you that with your cooperation, we will stay right on schedule. Five minutes means five minutes. As is evident from the working discussion outline, our charge is considerable. All of us want robust markets and a vibrant and effective accounting profession. Yet, our responsibilities are fairly serious ones.

Investors are willing to commit capital to our markets because they have confidence in the quality and the integrity of financial statements that are prepared by public companies and certified by independent auditors. Investor confidence in that financial information does not merely fuel markets but makes them possible. We can't afford to break the trust and confidence of investors in our markets today. That's absolutely the most critical ingredient. We must keep in the forefront of our analysis and debate the public responsibility that the independent auditor assumes.

One area that we will be considering in greater depth is the auditor's responsibilities in searching for and discovering fraud. What can we learn from past billion dollar financial statements...
blow-ups so that our recommendations address those problems and insure as best as possible that they won't happen again. If there's a billion dollar error, investors must be able to rely on auditors to try to discover it. In my view, the best protection for auditors against investors looking to recover losses from them is to insure that the audit has provided reasonable assurance that the numbers can be trusted. I think investors are willing to come to the table and discuss ways to limit unnecessary litigation against the profession, but only if the profession measures up to its obligations when finding fraud.

This includes detecting billion dollar errors in financial statements. It includes telling investors the whole truth with respect to their findings. That type of frank communication will better serve the interests of both investors and auditors. Likewise, a culture of audit quality requires individuals who are willing to and do call out of bounds. Even the most brilliant auditors superbly trained and infinitely resourced will not achieve our objective of a quality audit unless the auditor is willing to and does act as the referee. In my vision, this isn't a passive reporting role. It's an act of running up and down the field calling it as
it is role.

Also, we need to keep in mind that even the best resourced audit performed by the best-trained, most brilliant auditors will not meet the need of investors if independence is compromised. It takes dedicated, talented, knowledgeable people to perform quality audits. That means the profession needs to be able to attract talent into their ranks. In the past century, other professions such as the legal and medical, have found that they've had to substantially upgrade and extend their system of education in order to meet the increasing needs of the public.

Manny Cohen, one of my many predecessors as Chairman of the SEC, noted in a report almost three decades ago that the profession needed to make significant improvements to the studies of those who desire to enter the auditing profession. I hope we can find a way for the accounting profession and educators to accomplish this challenging task before another decade runs its course. Finally, balanced oversight and a culture of auditing quality are necessary to avoid the kind of lapses that led to Arthur Andersen's tragic demise that can shake the very foundation of our economy. Competition,
while important, does not always promote the values of objectivity and transparency which must be the hallmarks of the auditing profession. Efficiency is a false objective if the public trust is compromised or lost as a result of lack of effectiveness. It's important that we preserve as Leonard Spacek described it, "The greatest social value of the auditor's, the honor in carrying out the auditor's duties and the privilege of bearing such a critical public responsibility."

Don?

CO-CHAIR NICOLAISEN: Thank you, Arthur. I'm delighted to be here and I'm most appreciative of the commitment that all of you have agreed to make in working with this Committee. I think we're here at an opportune time in that unlike certain other points when the auditing profession was look at, we're not in an absolute period of crisis, so we can take the time to give some considered and measured thought process to what we go through. It's obvious that the auditing profession has long been studied. There have been plenty of reports that have been issued. Each of you received a bibliography of four or five inches of just touching on the surface of articles that have been written about the profession. So I think it's clear
that it is important, it is important to our capital markets. It's the life blood of integrity and trust that investors depend on as they make their investing decisions.

The profession is not static. It has changed dramatically over the past five years. Post-Sarbanes-Oxley there have been a number of changes, not the least of which is the PCAOB oversight. There's also been additional consolidation. We're now with four giant firms that serve a very substantial piece of the capital markets. Audit committees are more deeply engaged. There's an interest spreading around the globe in the use of international accounting standards and that certainly is an interest that's being looked at here, the auditor's report on internal controls, not just on financial numbers.

Accounting standards have not become any simpler. They remain incredibly complex and as we move to greater and more use of fair value and mark to model numbers, the auditor skill sets are changing as well. I think we're looking at the complexity of rules that have developed and evolved over the years within the auditing profession. There probably are some opportunities to take a look at whether that can be simplified as well. Everyone that I've talked to
has expressed the view that they believe audits are better today than they were five years ago. At the same time, there is some concern out there that, perhaps, the auditor has become overly interested in protecting its interest and in some of the checklists and some of the things that are being done seem to be redundant and have a cost impact and should be studied as well.

The environment to do this, as I said earlier, I think is appropriate. It's a great time because we're not under absolute crisis or we'll be able to look at this in a very studied way. My hope is that we would focus as a committee on development of recommendations that are more principles-based than rules-based. Any rule that gets written for the auditing profession and for that matter, the accounting profession tends to have a life to them and I think we can do most service if we focus on those attributes, those traits, those concepts, those skill sets, those things that the auditor brings to the table that are unique and that can be most valued by investors if looked at on a principles approach.

So, I'm enthusiastic about this. I think we have a great opportunity to move forward the auditing profession and to deal with a number of the
complex issues that that profession faces. Arthur.

CO-CHAIR LEVITT: I'd like to introduce a number of members of the group this morning. First Amy Woods Brinkley is the very important Global Risk executive for Bank of America based in Charlotte. Mary K. Bush to my immediate right is President of Bush International, serves on the boards of a number of publicly traded companies, Briggs and Stratton, Discover Financial Services, ManTech Corporation and United Air Lines and the Pioneer Family of Mutual Funds.

Timothy Flynn is Chairman and Chief Executive Officer of KPMG. Robert Glauber, with whom I've worked for many years served as Chairman and CEO from September 2001 to 2006 after becoming NASD's CEO and President in November, 2000. Bob is currently a lecturer at Harvard's Kennedy School of Government. Ken Goldman is Chief Financial Officer of Fortinet. Gaylen Hansen, another one of our western delegates, serves on the Colorado State Board of Accountancy and board of directors of the National Association of State Boards of Accountancy. He's also an audit partner at Ehrhardt Keefe Steiner and Hottman, P.C.

Alan Beller was the Director of the Division of Corporation Finance of the SEC, Senior
Counselor to the SEC from 2002 and 2006. Alan is currently a partner with Cleary Gottlieb Steen and Hamilton and I would say that in talking about Alan the words that most readily come to mind are wisdom and balance, words I think all of us would like to have associated with our efforts.

Barry Melancon is the President and Chief Executive Officer of the American Institute of Certified Public Accountants. Richard Murray is Managing Director and Chief Claims Strategist of Swiss Re. Gary Previts is President of the American Accounting Association and a Professor of Accountancy at Case Western Reserve University.

CO-CHAIR NICOLAISEN: Let me continue with the list, Damon Silvers is an Associate General Counsel for the AFL-CIO. He has experience with corporate governance, pensions amongst many other things. Sarah Smith is a Controller and Chief Accounting Officer of Goldman Sachs. She also serves on a number of committees at Goldman Sachs, including the Risk Committee. William Travis is currently on the Board of Directors of McGladrey & Pullen. He was previously Managing Director and Chairman. William has been President and CEO of Bailwick Data Systems since 2007.
My good friend, Lynn Turner served as Chief Accountant at the SEC from 1998 to 2001, currently serves as a Senior Advisor to Kroll Zolfo Copper. Ann Yerger, CFA, is the Executive Director of the Council of Institutional Investors and Ann, we're very glad to have you here. Also there are several members who were not able to make this first meeting. Let me introduce them to you and I'm sure we'll see them at our next session. H. Rodgin Cohen is Chairman of Sullivan & Cromwell. Anne Mulcahy is Chairman and Chief Executive Officer of Xerox Corporation. Richard Simonson is Executive Vice President and Chief Financial Officer of Nokia Corporation and Paul Volcker, who has served as Chairman of the Board of Governors of the Federal Reserve System and was recently Chairman of Trustees for the International Accounting Standards Committee is also serving on this Committee.

Let me also introduce those who are observing on behalf of various important bodies and constituencies. First, Robert Herz, who is the Chairman of the Financial Accounting Standards Board in Norwalk, Connecticut. Mark Olson, who is the current Chairman of the Public Company Accounting Oversight Board, the Board that oversees the auditing
profession. Zoe-Vonna Palmrose, whom I've known for a very long time, I've been on the Board of Advisors out at USC's accounting school for many years and Zoe-Vonna is a Professor at USC. She's currently the Deputy Chief Accountant for Professional Practice in the Office of Chief Accountant at the SEC.

There are also several observers who could not make this first meeting. Let me introduce them as well. Conrad Hewitt, who is the Chief Accountant of the SEC. Michel Prada, who is Chairman of the regulatory agency in France, Sir David Tweedie, who is Chairman of the International Accounting Standards Board. So at this point, I'm going to turn the program over to Alan Beller. Alan, who is a member of the Committee has also agreed to serve as counselor to this Committee and I had the great pleasure of working with Alan for several years at the SEC and I appreciate the intellect and comments that you're about to deliver at this point, Alan.

MR. BELLER: Don and Arthur, thank you very much. I've been asked to explain in a few minutes going over the discussion outline that is in the materials that have been provided to the Committee. This is a discussion outline, to be clear, that was prepared by the co-chairs and by -- with the
assistance of Treasury staff and some other contributors. The Committee does not have to take ownership of it. It's been provided as a beginning guide to the Committee's thinking and work. It obviously is not intended to control the Committee's thinking and work but rather to provide a starting point. As it says, it's a working discussion outline. It will be made available to the public on the committee website. It is a -- since it's a working discussion outline, I guess it's also potentially a work in progress. As comments develop about this outline, it will be left to the co-chairs to decide if they want to make further revisions or move onto other matters. If there are revisions, they will also be made available on the Committee website.

And the outline will be published in the Federal Register as I understand it. So that's sort of where we are in terms of process. In terms of substance, as a guide to the Committee's thinking and work at the commencement of our process, I think it's evident from the outline that we face a serious, difficult and complex subject. The outline divides our work or the thinking about our work into three general topics. There is a section of the outline that I think is quite important but is largely, by
There has been prior work done in the area of studying the audit profession. Indeed, we couldn't quite fill this room but we could certainly fill the space inside this table with the studies and publications and thinking that have been done in the past about this and one of the things that we'll -- this Committee will be charged with is thinking about those prior studies and that prior history and what we can learn from it.

In terms of the three areas into which the outline and the -- preliminarily the work of the Committee will be divided, those three are first, human capital and its impact on audit quality. Second, the auditing firm and the audit organization financial resources and finally, the structure of the auditing profession, competition, concentration, independence and other professional standards.

Now, digging into those three separately for just a moment, drilling down a little bit further, in the human capital section, the outlines suggests that the work of the Committee will include consideration of recruitment and training by the auditing firms, that it will include consideration of education, accounting education. It will consider
issues of retention by audit firms and it will include consideration of the impact of complexity and globalization on the various human capital issues.

In terms of audit firms and the audit, the outline suggests that the Committee's work will include consideration of licensing standards and supervision and monitoring of the profession, both individuals and firms. It will include consideration of issues of liability. That's already been touched on by both Under Secretary Steel and Don and Arthur.

It will include issues of insurability and it will include consideration of issues of transparency and governance of the auditing firms.

Finally, the section on professional standards will include consideration of independent standards, consideration of other professional standards and rules. Just an example would be rotation for example. It will include consideration of the economic model that the profession currently operates under and it will include consideration of issues of concentration and competition.

Again, the issues of complexity and globalization are part of the context and the backdrop against all of those various issues will be considered. I believe it is fair to say that the
purpose or the approach of this working discussion outline has been to be value neutral. It does not espouse any particular positions on any of the particular issues that I've just mentioned. The word "consider" appears more often than any other word in the outline, including the word "audit". And that really is the intent here. The purpose of this working discussion outline is not to provide a direction for the Committee's thinking. That's the Committee's job. It is to provide a series of issues that at least as an opening matter, it was thought that the Committee might wish, would wish to consider.

The last thing I'd say about the discussion outline is that it begins with a -- I'll end at the beginning, it begins with a set of overarching principles. And the purpose of that is really, I think, quite simple. There's a lot of detail in this outline. There's a lot detail about particular kinds of things that need to be looked at as part of a consideration of the auditing profession and how it goes forward, but there does seem to be a relatively small series of principles that ought to provide at least in the thinking of the outline's authors, a context and a backdrop for all of those various complicated questions. And there are a series
of about six bullet points that set out the overarching principles. Rather than summarize them, I'm just going to read the first three, because I think they do provide the overarching principles for the Committee's work. The first one, "To further the mission of the Department of the Treasury, to promote and encourage prosperity and stability."

Those of you that are familiar with the Treasury's mission statement will hear -- know that those words are exactly the Treasury's mission statement. "To promote and encourage prosperity and stability by" and there are two thoughts here, "both improving the quality of the audit process and audits and insuring the viability and resilience of the public company auditing profession."

The second bullet point links those two main themes, "Enhancing the quality of the audit process and audits should contribute to the viability and resilience of the public company auditing profession." You can't think about the viability and resilience of the public company auditing profession without thinking about the quality of the service they provide, the quality of the audit process and audits.

And finally, "Confidence in the public company auditing profession is enhanced and
strengthened when the profession operates in a manner transparent to investors and market participants and adopts governance best practices." The remaining bullet points talk about some subsets of what would be generally viewed as improving the quality of the audit process and audits and a series of sub-points as to things that should contribute to the viability and resilience of the auditing of the public company auditing profession.

But again, as I say, speaking for the authors of this outline, those overarching principles are sort of the starting point against which the various detailed items would be assessed. I think that's a description of where we are to start with and I'll turn it back to Arthur and Don. Thank you very much.

CO-CHAIR LEVITT: Let's each of us have a five minute opening session. I'll introduce first Amy Woods Brinkley.

CO-CHAIR NICOLAISEN: Maybe just a reminder to everyone that you push the button on the right. When you see the green light come on, you know, you're ready to speak.

MS. WOODS BRINKLEY: Thank you for that tip. To the Co-Chairmen and members of the Committee
on behalf of my teammate the Bank of America, it is a pleasure to join you. I want to thank Secretary Paulson and Under Secretary Steel for assembling this Committee and for focusing the efforts on improving the competitiveness of the United States in the global marketplace. The effectiveness of the audit profession is indeed an issue that relates directly to the health of our economy. Our capital markets rest on a foundation of investor confidence and that confidence relies directly on the credibility and the quality of the audit process. As important, the viability and resilience of the audit profession is essential to the competitiveness of US industry.

As a major financial institution, our perspective on these issues is two-fold. First as with other companies represented on the committee, we are a large consumer of auditing services and like other large companies spend tens of millions of dollars for services provided by auditors.

Second, as a bank, we are a provider of financial services. In extending credit and other financial services to our clients, investing for our clients or investing for our own needs, we rely on the quality of audited financial statements as part of our decisions and our judgments. So as with other
financial services providers, we are affected by the issues facing the audit profession, both directly and indirectly. Now, as the discussion outline makes clear, the challenges facing the auditing industry are complex and interconnected. We have all witnessed the stress on the profession induced by the vast increase in the complexity of accounting rules, a multi-jurisdictional oversight environment, heightened regulatory activity, and significantly increased legal exposure. The concentration of audit firms leaves large public companies with limited choices among a few large firms. And this impact moves downstream to middle market companies which, in turn, face more limited choices among qualified firms to handle their business because some large firms have mostly exited the middle market. Now, the problem of limited choices becomes compounded when a global company needs additional external audit capacity in the event of a special circumstance. Most often, the additional services must come with global reach and deep technical expertise. Add to this the requirement that the supplemental audit resources must be independent and free of conflicts and the choices are concerning few.

The result of all of the issues facing the
audit firms is that many public companies are experiencing an increase in the cost of audit services. Now, as a company that is intensely focused on attracting, retaining, and developing world class talent, that we need to compete, we are also concerned about the significant challenges the profession faces in building human capital. Because of the growing scope and complexity of the needs of their clients, audit firms truly need the best and the brightest. However, I am told a variety of issues is clogging the talent pipeline for the profession and raising questions about the intermediate to near-term viability of the industry.

At colleges and universities, many students face increasing educational requirements to enter the profession. A generation of accounting professors is nearing retirement with insufficient replacement in sight and curricula need updating to produce students with both the general and the technical skills required.

Now on the other end of the experience spectrum, audit firms face supply challenges of senior partners with the experience and the ability to inherit the accounts of their major clients. It is incumbent on all the stakeholders to guide the audit
profession to new solutions that will provide value for the client and instill confidence among investors. Again, I look forward to working with you as we all strive for a strong sustainable audit profession that is truly essential to our economic well-being.

CO-CHAIR LEVITT: Thank you. Mary.

MS. BUSH: Thank you. I am also delighted to be here and I congratulate also Secretary Paulson and Under Secretary Steel for having the foresight to take a good hard look at the future of the auditing profession which, of course, as many have said here, is vitally important to US capital markets, to global capital markets and as well to everyday people who have their savings, their retirement plans invested in the capital markets through mutual funds, 401(k)s and the like.

Coming to participate with this Advisory Committee for me is like coming home, since I worked at the Treasury in the early `80s. And I just want to tell you a little story because it relates to what we're doing here. I had been a banker in New York. I was on the corporate side of the banks and of course, had every 10Q and 10K and every bit of financial information one might want when trying to do a transaction, and of course, first to analyze the
company and its ability to handle the financing and to repay it. So here at the Treasury, as I said, this was 1982, on August 13th, the Mexican Finance Minister walked to the door of the Treasury and he said, "We are out of reserves. We have no money to pay our creditors, our banks, our suppliers". And then of course, the Treasury had to get into the business of bridge loans, bridge lending.

Later Brazil and Argentina came along. But here's what was really shocking to me. What was shocking to me was when a couple of CEOs of major international banks walked in the door a few months later and they said, "We have absolutely no idea how much we, the banks, combined have outstanding to Mexico, to Brazil, to Argentina". And having been a corporate banker with access to financial information, that to me was very shocking. And as you know, I'm sure, that led eventually with the Treasury's support, to the formation of the Institute of International Finance to begin to gather that information.

I tell that story simply because it is an indicator of how important reliable, thorough, complete, transparent information is to the capital markets, whether it's a company or whether it's a country. We are going through, I think, a shift,
change in financial reporting which Don eluded to. I
do believe that we will eventually shift over time
from GAAP to the International Financial Reporting
Standards. Of course, it is going to take some time.

It's going to take a lot of study. I suspect that we
will also be looking into that issue.

With that change, of course, more of a
change to principles-based accounting. So as those
shifts occur, and as we try to assure quality audits,
which is emphasized in our discussion outline, I think
that it's going to make judgment all the more
important. It has always been important in the audit
profession. The latest revisions by the PCAOB with
regard to 404 again, put judgment more back in the
picture but I think that as that shift takes place to
principles-based audits, that judgment will be even
more important. Now, it's not easy to figure out how
someone gets good judgment. There's no easy
definition. Time and experience, of course, are
important, but what else? Is there learning
surrounding judging the economic value of transactions
that would be useful. Is there additional learning
surrounding understanding transactions that would be
useful and what are the methodologies that might be
important, might case studies and apprenticeships be
more important? These are some of the issues that I think we should address.

Secondly, Amy mentioned attracting the brightest and the best. I think that in order to attract the brightest and the best, that it is important that people who are considering getting educated in this field and coming into this field to work, that they understand the huge value added that the audit profession provides to the global capital markets. It is not just a service. It is not just bean counting as accounting was traditionally referred to. But it is really fundamental to the reliability of financial statements, to protecting the value of those trillions of dollars that many people invest in our markets.

I think in view of that also, we do need to take a look at the curricula of the schools of accountancy, especially for those of us who do not have degrees in accounting. Are the curricula focused enough on the complexity of financial transactions, on complex financial markets and the interactions and on also complex global businesses?

Two other points I would like to make. And one is integrity. And that's another one of those things that, you know, it's very difficult to figure
out how you get at integrity. It's not necessarily something that can be taught. It has always been important. I think that as judgment takes on an even bigger weight in what auditors have to do, that it will be even more important. Integrity has always had high social value in the financial world but how is it transmitted? Is it only through cultural values? I think it's very tough issues like that, that we need to address as well.

And lastly I will mention the issue of competition and the big four. There are hundreds of smaller firms. I've learned from Mark Olson that they audit at least 1,000 firms in the United States alone and 800 abroad and the question that I think we might want to address seeing is that we are down to just four major firms, is how can the reliability, credibility and capabilities of the smaller and medium sized firms be made more transparent. Thank you.

CO-CHAIR LEVITT: Thank you. The monitors will stay on. She just used some of your five minutes. And if we could each kind of pay attention to the monitors we will stay on time. I just used 10 seconds of your time.

MR. FLYNN: I really am glad to be here, Arthur and Don, thank you for inviting me to this very
important discussion and I look forward to working
with all of you in the months to come.

    I've been a member of the auditing
profession for 28 years. I saw a lot of change in my
profession over that period of time, but nothing
compares to the change that my profession has gone
through in the last five to six years, driven, I
believe in the first instance to restore public
confidence in the audit profession because of some of
the issues that happened in the late -- early 2000,
late 1990s.

    Over 100 years of self-regulation has give
away to an oversight body. The PCAOB, I think, has
had a positive impact on our profession and overall
audit quality. Audit firms have rededicated
themselves to core service, to a core mission,
providing audits and protecting the integrity of the
capital markets, in strengthening the audit process,
the risk architecture, enforcing and reinforcing
ethics and compliance in everything that we do.

    But improvement is a continuous process
and the pace of change has accelerated. The forces of
globalization, integration of stock exchanges around
the world, the competition for talent across our
profession and industry, the expansion of oversight
bodies throughout the world, the rise of emerging markets like China and India. The growing complexity of financial instruments and financial transactions, the explosion of private equity and the money being important to companies across the globe, the convergence of IFRS and US GAAP, all these factors will signal a time of greater change going forward.

I believe that the changes that we'll talk about over the next couple of months, the continued strength and sustainability of the auditing profession, will be as important to that strength and sustainability as the changes the last five years have made to overall reliability and relevance of what we do in the auditing profession. So it's fitting for a time for serious discussion around these issues of sustainability, and accountability.

I commend Secretary Paulson and Under Secretary Steel for having the vision to assemble this outstanding group of individuals for this purpose. We've organized our work, as Alan talked about, in three areas, around the supply of talent, around concentration and competitiveness and around the business structure itself for the profession. Each of these are critical to the overall point of sustainability and they all must be addressed.

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together. They can't be separated. The accounting profession's ability to deliver quality audits and serve the capital markets begins and ends with our people. I ran human resources for KPMG for five years before I took over running audit and now CEO. Every day I lived the reality of the importance of our people. I traveled across the country and would go to campuses and talk to students. They want to join our profession.

Enrollments are up in the accounting profession across the campuses. They are excited about the opportunities in front of them. I also spent time talking to our people. Most of the time I talk about retaining our people and keeping them within the profession and convincing my most senior partners and managers this profession is right for them. And the risk and pressure they feel about their job, while real, are important, and that their judgments are valued by the capital markets and regulatory environment.

I'm proud of the progress the profession has made in retaining our people. All the big firms are recognized in the Fortune 100 best places to work, Working Month's best places to work, and Business Week's 50 best places to launch a career. Small or
medium sized firms are recognized in local communities and the states with innovative employee recognition programs. We've made tremendous progress in retaining our people but turnover remains in the high teens and low twenties in our profession.

As hard as it is to attract our talent, retaining them is difficult as well. And the turnover is highest at the senior management ranks, our most experienced people in executing our audits on a daily basis. So we have to look at the talent of our people, no question about it, in retention. We have to make sure that the opportunities for talent should exist across the entire spectrum of firms. We must look to remove any tangible barriers to entry of the audit market and promote market-based policies that encourage choice among auditors.

As we consider the question of competition and concentration, a couple of things should be kept in mind. Of the companies listed on the US Stock Exchange, the number of companies, almost half are audited by firms other than the big four. But when we get to market capitalization, almost all market capitalization is audited by the big four. We must not confuse concentration though, with competition. There is tremendous competition among the
professionals today in winning new work. You only
have to ask the partners and managers on the
marketplace every single day. But it's important to
have robust competition within our profession. We
must look for ways to increase and encourage
competition and expand choice.

We must also understand that there is
great risk of concentration if it continues to
contract below the four firms today. We have to make
sure that there aren't litigation or other regimes
that threaten the existence of major firms. We have
to take a hard look at the business structure of
auditing firms. We need to ask ourselves, is the
business model developed decades ago the right model
for today in the 21st Century?

Does the model allow for sufficient
investment in talent, specialization in skills,
technology, methodologies? Does it permit an adequate
integration to deliver constant high quality services
across the entire globe? Are we nimble enough to
respond to fast changing markets to evolve our
services and investment information that's needed in a
digital age? If not, we need to look at our structure
itself. I would challenge this group not only to look
at litigation reforms such as that but look beyond the
substantive litigation. Look more to the basic structure of the firms today. How do we free up the marketplace, get access to capital?

Most firms are partnerships today. Should we look at a corporate model? Let's look at complexity. Other things are driving litigation costs and the structure itself and say, "How can we as a profession do a better job". And let me just close by saying, whatever we do, I've got to stop here but whatever we do, whatever we do, there's two tests we should make against every decision. Does it improve audit quality and does it help the investor?

CO-CHAIR LEVITT: Okay, Bob, Tim took two minutes of your time.

MR. GLAUBER: Okay, I'm going to talk about some of the things Tim didn't. I'm very flattered to have been invited by the Secretary and by the Co-chairmen to participate in this. I'm not sure why they asked me because I know relatively little about the auditing industry. I was a financial markets regulator and self-regulator and, perhaps, it's the perspective that I can talk from. I wanted to pick up where Tim left off and talk about the organization and financial resources and concentrate on that portion of the agenda.
As all of you know, and know better than I, I think, Congress decided to out-source corporate auditing back in 1933 to independent public accountants rather than have somebody else do it, particularly the SEC.

CO-CHAIR NICOLAISEN: Please put the Blackberries away.

MR. GLAUBER: Thanks. Over the years, accountants migrated into a set of diversified consulting services and, of course, those twin facts that independent accountants were paid for their opinions by the firms that they evaluate and that they provided a wide range of consulting services for these firms, lead inevitably to conflicts of interest. The parallels for example, to rating agencies, are obvious and indeed, Arthur has written about that on occasion, but the point I want to make is the conflicts in interest exist everywhere. Many of them simply can't be eliminated and the challenge is to manage them effectively.

In this industry the choice was self-regulation. And I believe obviously, and I'm very biased, that self-regulation can work. It needs to be independent and I think in the late `90s there was some evidence that it didn't work as well as it could
and the result, of course, the answer was SOX. Sarbanes-Oxley, I think, clearly produced market benefits. I think everybody would agree that the quality of audits is just much better now than it ever was before. Certainly, the number of earnings restatements has decreased markedly. But to put it a bit politely, I suppose, there were a number of unintended and often times negative consequences of SOX for its costs. I recall your memory back to the SEC's statement on the cost of SOX and particularly Section 404. The estimate was $91,000.00 per firm. It turned out to be something of an under-estimate. Auditors clearly expended far more resources to do their job than was anticipated. As a consequence and despite the elimination of many of the consulting services auditing firms provided or were permitted to provide, clearly audit firm revenues have gone up dramatically.

And despite PCAOB inspection, there is still serious concerns, I think, with auditor internal organization in governance. Why these outcomes? Obviously, a number of reasons. Audit costs and resources used have been so high because first of all, the ambiguity of the PCAOB audit rules, which great steps forward have been taken to deal with those.
Second, auditor liability; as some of the material we were given pointed out, the liability and litigation costs in the industry have gone from a little under eight percent of revenues in 1999 to over 14 percent of revenues in 2004. And most importantly, this has made auditors quite naturally extraordinarily risk averse and careful in what they do. It's just a natural reaction.

On auditor governance, despite PCAOB oversight of audits, governance is still subject to limited oversight and quite opaque. What to do about both governance and cost, particularly those arising from the risk aversion and conservatism of auditors? On governance, I think there is a need for both more transparency and perhaps some other mechanism for outside oversight. On the risk aversion conservatism of auditors, there are a number of possible steps that I know we will consider, some of which -- all of which have been considered from time to time, some have been put in place.

As I mentioned before, the PCAOB has replaced AS2 with AS5 which has gone a great deal in the direction of clarifying the rules of engagement. Other approaches that need to be considered by us, I think, are better access to insurance for audit firms.
Liability caps on auditor suits has been done in some of the EU countries; Germany, Belgium, Austria, and some others permit this.

Limitations imposed by companies themselves on the amounts for which the company or its shareholders will sue auditors. This is done in the UK. And finally, incorporation, as Tim mentioned, as an organizational form to replace the current LLP/LLC structure. This could provide both capital to attract insurance, diversify risk in the marketplace and introduce shareholders and boards of directors as a device for affecting corporate governance. I hope and I'm sure that this Committee will consider all of this.

CO-CHAIR LEVITT: Thank you. Great. Ken?

MR. GOLDMAN: Thanks. Maybe I'll cut my time by going fast and talking fast. I thought I would do a couple things and thank you for inviting me. I thought I'd give you a quick rundown, a little bit of who I am just to give you a perspective of some of my comments. Then I'm going to give six or seven observations just to get us thinking. But I have been on the West Coast practicing finance since 1974. I've been CFO of private and public technologies companies since 1981. I actually have something like 90
quarters of a public company CFO. I've taken a couple of companies public. I'm on a number of both public and private boards. By the way, I did leave Siebel a year and a half ago and started a new company but I'm on a number of public and private boards, all of which I end up as the, for lack of a better way, always the audit committee chair, mainly because no one else wants it.

I served on FASB's Advisory Council for four years back in 2000, 2003 time frame. So I've sort of been a practitioner here relative to -- really since 1981 as a CFO. Let me give you my thoughts and again, I really have thought long and hard about this as I was traveling out here last night. First, I think it's been a mistake when we went from eight major firms to four firms. It makes it very hard if you're inside a company, you want to use one for your auditors, one to help you on your various 404 matters, one for taxes, so forth. So I think that has been a challenge for us.

Two is, we talked about it in terms of SOX, as someone said one to 403 were great. When we got to 404 we had a little challenge. Actually, I think frankly a lot of 404 was things you should have been doing anyway. So I think it was directionally
correct. I think the issue there was frankly, implementation and how we did it. Also, there was always a question of definitions. I would have defied anyone to understand what material weakness, the definition of material weakness or significant deficiency used to be and understand the double and triple negatives.

Three, I think the concept of PCAOB is great. On the other hand, as I watch it from day-to-day, and I see this from being a CFO, I see it from a board. Very frankly, I see, frankly, over the years accounting firms, quote unquote "running scared" sometimes over how PCAOB is going to look at everything they do. It causes -- it changes how they think and some of it I'm not sure is always good.

Robert, you mentioned a number of restatements going down. Actually, the number of restatements has gone way up. I think maybe it's now starting to go down but the number of restatements has gone up dramatically as also is in some of the materials and I think -- it isn't just by the way, quote, unquote, "the small tech companies people like to blame". It's by some very, very large companies and so you have to question why.

My own point of view is two things. One
is I think the whole materiality concept and the
threshold, but I also think the real biggest issue and
this is probably the number one point I really want
to make, is really the complexity that we have today
in accounting, both in terms of the new pronouncements
which are in many cases, hundreds of pages long, as
well as the fact there's really -- this is probably
the only profession where there's no one rule book. I
was sort of going through it last night, if you want
to go figure out how to do something, where do you go?

    Well, you go to FASB pronouncements or
FAS's. You go to the FASB interpretation notes of
FINs. You go to APB opinions. You go to EITFs, you
go to TPAs, you go to SEC speeches. You go to staff
accounting bulletins, statement of positions, SOPs.
There's no one place to find an answer in this world
of accounting that we have developed over the years.
And so again, both the complexity and the fact that
there's no one rule book result in basically one
thing, virtually anything of a complicated nature goes
to the national office. Very rarely can you get
anything complicated resolved at the local level. It
goes to the national office and then for them to get
it resolved, they go to the SEC and they have a
dialogue there and then they decide how they want to
account for it. And then the question is, is it going to be a precedent or not a precedent. So that is made, again, the complexity very, very hard.

So my sixth point from what I see, and again, I see all four firms in terms of my being an audit committee chair, I also see non-four firms. My own opinion is the level that I see of accounting personnel is very uneven. I see it in terms of people -- the number one thing I do as an audit committee chair is I look for the strongest engagement partner that can be in that company. As Tim Flynn knows, there's one guy he has who I love, who I bring every time I can to -- as I become a chairman of an audit committee because again, I want the strongest individual I can but again, I see the quality does vary.

The seventh point, I'd say is clearly litigation is a challenge, I know my time is up. I've got one more point. Litigation is a challenge. I think that's already been made. The last point I'd say is -- and I have some kids, and I -- that are in middle school, high school and now college, and the one thing I think would be a great idea would be to have accounting taught at the high school level and have it taught at the college level and have a
required course which would help children as they
become adults take more responsibility for their own
personal investing, understand accounting and not
always rely on someone else.

So with that I'll stop.

CO-CHAIR LEVITT: Gaylen.

MR. HANSEN: Thank you. I'm Gaylen Hansen. Thank you so much for inviting me to
participate in this esteemed Committee. I've been a
practicing auditor for over 30 years now, and I'm with
a small firm in Denver. We have about 250 CPAs in our
firm and to Ken's point, I am the national office of
our firm. So we don't have to go very far hopefully
to get answers to those questions. I am recognizing
that the reason I am on this committee is because of
my involvement with state boards of accountancy.

I'm a member of the Colorado State Board
of Accountancy. I'm also on the Board of Directors of
the National Association of State Boards of
Accountancy. I thought I would briefly give a very
quick overview of state regulation of public
accountancy in the United States. It starts with the
Constitution, surprisingly and the 10th Amendment of
the United States Constitution. And there,
professional licensing is reserved to the states.
This amendment is only one sentence long. Sometimes it's referred to as the commerce clause. It states, in full, "The powers not delegated to the United States by the Constitution nor prohibited by it to the states are reserved for the states respectively or to the people."

Through their constitutional authority, states have chartered and empowered Boards of Accountancy with the sole statutory oversight to establish licensing and practice requirements for all CPAs in each of the 50 states and five territories. Pursuant to this authority, State Boards of Accountancy are engaged in the regulation of all auditors of publicly traded as well as privately owned governmental and not for profit organizations. In addition, the Sarbanes-Oxley Act of 2002 contains specific provisions for cooperation between federal and state regulatory authorities in the inspection, investigation and discipline of CPAs and CPA firms auditing public companies.

State boards set accounting, auditing and ethical practice standards for all CPAs and their firms. Although not required to, and I repeat that, although not required to do so, they have historically exercised the option of adopting standards developed
by recognized private sector standard setters, including those of the Financial Accounting Standards Board and the American Institute's Auditing Standards and Ethics Boards.

Working with State Attorneys General State Boards have the authority to prosecute and discipline CPAs and their firms for violation of SEC, PCOB, GAO, DOL and other federal agency standards. Disciplinary actions range from reprimands and sanctions, mandated continuing education, monetary fines, and practice restrictions all the way to license suspension, revocation, and suspension of a firm's practice privileges.

State boards set minimum requirements for moral character, higher education, experience and examination for licensure. Boards are statutorily responsible for administering the uniform CPA exam required of all those who desire entry to the profession. They also set standards for mandatory continuing professional education and peer review. Members of state boards are drawn from a diverse spectrum of volunteer CPAs and public members coming from all levels and types of CPA practice, industry, government, not-for-profits and academia.

Most are appointed by state governors and

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serve subject to term limits. With respect to NASBA, all 55 Boards of Accountancy are members of the National Association of State Boards of Accountancy. NASBA's primary role is to serve as a facilitator and forum for the Boards allowing for the exchange of views and providing research and guidance. Most of NASBA's activities are directed towards cooperative coordination of federal and state regulatory systems, professional practice standards, practice monitoring and discipline.

NASBA was founded in 1908 to aid states in developing uniformity of licensing procedures. Since that time, it has evolved into a broad-based organization that deals with all aspects of state regulation of CPAs. With the passage of Sarbanes-Oxley, the activity of NASBA with the SEC on behalf of the 55 state boards has increased significantly.

I really appreciate being invited to participate in this program and I think that we have a lot of ground to cover and I look forward to working with each and every one of you.

CO-CHAIR LEVITT: Barry?

MR. MELANCON: All right. We're skipping you, huh? You already had your shot. Thank you, Arthur and Don, the Co-chairs, and Secretary Paulson
and Under Secretary Steel for inviting me here. I had
the opportunity to and maybe the distinct honor of
representing the broadest spectrum of what it is we're
talking about here. We have about 335,000 members of
the American Institution of CPAs and about half of
those work in corporate America and about half of
those work in public accounting firms. We're the
largest professional accountancy body in the world.

Alan, in his opening remarks, talked about
how you could fill up the center part of the tables
with papers and previous reports on all of the issues
that are in our outline. And the fact of the matter
is that we have been involved in most of those and in
fact, we could probably fill up three because there
are actually three elements to it. There are
obviously the elements of which we're here to talk
about, which is the public company environment and the
auditing of those.

There is sort of an equal perspective on
every one of those issues that relates to the private
sector which is about half the US economy and clearly
today, there is sort of an equal debate which overlaps
in many instances on the international side. I think
that as we sit here today, the positive thing about
this discussion is that we are talking about a lot of
these issues in the relative calm of an environment that has already produced a significant amount of change and one in which I think the profession and corporate America and the investing public and obviously regulators have all adapted to in the past five years and in fact, I think our profession has demonstrated over its 120-year history an incredible ability to be adaptive to change and we look forward to the work of this Committee and believe me when I say that we take the work very seriously and we will take the output very seriously in dealing with any proposed changes that come about from our discussion and our debate.

I do want to address just a few points and many of them have been talked about as we've gone around the table. The top two priorities of our profession clearly reside in the notion of people, or as we refer to the pipeline of people into our profession, and quality. They are obviously interrelated and quality has many aspects as well. As has been mentioned, the pipeline of students, at the college level, is an issue that we clearly began focusing on in the late 1990s and have invested significantly as the AICPA alone, not to count the firms and all their individual investment in that
area. We have invested more than $30 million in the last five years in this particular endeavor. Today college enrollments in accounting are at record levels. And our real challenge, as we look at the demographic changes of America and of the world, is to make sure that we leverage what is in that pipeline of students in the most positive way for the profession and thereby for investors in shoring up the auditing process.

A full pipeline does not necessarily mean success in that process and as I like to say, a full pipeline doesn't mean that it will be there tomorrow and so our challenge in making sure that that is achieved on a going forward basis is very important.

My friend Gary Previts, I'm sure, will comment on the PhD issue to some degree but having people in front of those classrooms that are qualified to teach whatever the curriculum is designed to be is a major challenge that we have.

The fact of the matter is that when we look at the demographic realities of the firms, when we look at the demographic realities of the profession, and society as a whole, and I think it's easy to point just to the profession, the CPA profession here, but it is society as a whole facing
significant demographic challenges because of the baby
boom population, the aging of that relatively small
two generations that follow the baby boom generation
and a comparatively larger but still smaller than baby
boom generation in the millenniums. So people is a
very critical element of our profession going forward.

And I said the second point was quality.
Clearly we have to have the quality people in order to
do a quality job but in doing a quality job we have to
have a renewal, I believe, which has been the theme of
many commentators, on the issue of sort of a re-
entrenchment into professional judgment. Professional
judgment, however, has many, many different attributes
to it. And one is the word and actually, Arthur, you
used it in your opening comments, the issue of balance
and balance in the system that professional judgment
is delivered in. The regulatory system, the standard
system, the -- clearly the legal system that has been
mentioned as well.

Also, the issue of balance from the
standpoint of expectation from an investment
perspective which I'm sure we will touch on as well.
That being said, the profession today, after going
through these significant changes, and what I like to
say is that we have gone through a more difficult
challenge than any other profession in the history of the United States over about a two to three year period, we have survived that very well. And the good news is, is that in the concentration point, there is a lot of evidence to point that the next tier of firms are going through a very similar process that occurred in the `60s and `70s when those networks that began to get developed in that time actually produced what was then the big eight and now it's the big four firms.

It is a different environment today for them to grow, but the US leadership in that is very, very, very prevalent and in fact, more active today than any other time since the 1960s when the big eight did grow through that process. The difference is, is that we have to have an environment that allows that to happen. Thank you.

CO-CHAIR LEVITT: Richard.

MR. MURRAY: I share the honor of being among you and thank Under Secretary Steel and the Co-Chairs and the staff for having brought us to an opportunity point at a critical time to address these issues. The audit liability crisis was first discussed and recognized in 1967 when, with the collapse of one of the major railroad systems at the time, auditors were required to pay the magnificent
sum of $2.3 million in liability and it was deemed
threatening to the continuity of the profession at
that time. I was just beginning practice about that
time, was involved and have spent the last 40 years
either representing, practicing, managing or insuring
auditors nearly always with a high degree of pride in
the work that I was supporting or trying to serve.

I note that in the comments thus far, Don
Nicolaisen has said we're not in a period of crisis,
which is helpful. Barry has just noted that it's a
period of regulatory calm. I do hope that you are
correct but I am concerned that the relative calm
really is a product of five years of economic growth
and that we may be in the eye of a five-year period of
calm in a commercial storm that doesn't really
represent the comfort that we're taking from it.

I would commend all of those involved in
preparing the discussion outline. I think it's an
excellent tool for us to work forward from. I'll
focus only on those aspects that I think are critical
to all three components of the projects. The
liability and insurability of the audit profession,
these are issues that have been wrestled with by the
European Union studies in the last couple of years, by
the several studies conducted in the US last year and
they have been a frustration because it has been extremely difficult for any of the serious attempts made in those exercises to obtain real meaningful and guiding information that would allow the design and the development of real solutions. So I would like to focus on those issues, particularly the elements of them that lie outside the control of the firms or the profession to help bring an additional dimension of understanding to this project.

There are three specifics I would very briefly address. We must have and obtain credible current data about the liability dynamics and the liability regime performances as they bear upon the accounting profession. What is available to us and to those working this issue in recent years has been dated information based upon public sources rather than sufficiently current private sources and we tend to measure the wrong thing. We measure today's spending on liability which reflects acts performed on average five to seven or eight years earlier. What we should be looking at is the acts performed today and what the cost of them will be five years from now when those liabilities mature and become a further challenge to the profession. That 10 to 15 year gulf of mismeasurement is a serious deterrent to
understanding the problem. I would also hope we can focus on an understanding of the obstacles to effective insurability because the insurance profession does wish to perform its role in the public interest but there are obstacles and there are difficulties in dealing with the dynamics of audit liability that are not generally understood. You will find in the bibliography bits and pieces of insight but no comprehensive recognition of what the interactive dynamics between insurance and audit liability will be.

And finally, something that Tim Flynn commented on, which is the business model of the profession and how it relates to those other factors, liability regime behaviors and insurability potentials. It is interesting that the major crisis recognized by the profession on insurance began in 1985 at a time when the insurance market collapsed around the profession. The solution then was mutualization of risk on a global basis between the then eight firms.

Mutualization is no longer an option. Four firms simply can't mutualize and regulators wouldn't let us if we tried. So we are at a point where it seems to me one of the challenges facing this
Committee and one of the opportunities it has is to link a sound study of the business models, the regulatory regimes, the liability regimes, and the genuine interest of the insurance industry in trying to adapt to and provide solutions compatible to our business dynamics that will allow quality audits and investor services to be enhanced.

CO-CHAIR NICOLAISEN: Great, thank you very much. Some of you probably are wondering why we skipped Alan. We haven't really. He just is positioned to speak just before Chairman Levitt and I do. So Alan, so you don't walk away either. Let's move onto Gary.

MR. PREVITS: I want to thank everyone for the opportunity to serve. It's certainly going to be, I think, a challenging experience and the kind of thing that is going to demand a lot of our care and attention. We're probably at that tender point where just about everything that needs to be said has already been said, just not everyone has said it. So I want to try to cut down on my comments to say that this is, as an educator, a career educator, an opportunity to share with you some perspectives about where I hope we can go with these studies particularly in the area I would focus on in the human resource
area.

CO-CHAIR NICOLAISEN: Could you speak up a little bit?

MR. PREVITS: Certainly. Whatever solution we do propose, I hope, will have the characteristics of being global, long-term and of course, strategic. Having said that, we have a lot of data gathering to do if we're going to substitute for our best guesses some things that are based on facts. It's already been suggested that the demographics of this particular period are not -- are challenging not only to our discipline but to all the disciplines and some of them have been more active than others in addressing it.

There are data bases which our organization, an organization which I currently am involved with, the American Accounting Association, is currently assessing and that data, I hope, will be of interest to the organization that goes forward. Tim mentioned the enthusiasm that he finds when he meets on campus with individuals who are probably already accounting majors. I think that I can best summarize the concern I have in the HR area and conclude my remarks by saying, often when I encounter students in the first accounting course, particularly after
they've tried to master debits and credits, as one student came up to me after one exam and said, "Why would anyone want to be an auditor of a public company"? And that's the answer that I had to come up with to inspire talented young people and that gets to the sense of purpose of what accounting and auditing does in our capital market system. And there is an answer to that, that students respond to and it's a very noble professional answer. Thank you.

CO-CHAIR NICOLAISEN: Thank you.

MR. SILVERS: Gary wasn't kidding, he was going to be brief. I'm Damon Silvers and I represent -- I work for the AFL-CIO. Our 10 million members have about $5 trillion in capital invested on their behalf, largely to provide them with a secure retirement which they feel very strongly about as I think most Americans do who look to the audit profession to insure that the financial statements they read for all sorts of purposes are largely accurate.

The breadth of that reliance is not actually limited to investors. Any time anyone thinks about doing business with a company in any respect and a public company, and doing business is a very broad category, the financial statements' accuracy is at the
bedrock of all the decision making in that area. Public authorities in thinking about tax policy, workers in thinking about both from a collective and individual perspective what their employment decisions are going to be, customers, suppliers, in addition to both debt and equity investors. So the importance of this project is -- cannot be underestimated.

Of course, like everyone else, I would like to thank the secretary for inviting both me personally and the people that I represent as an institutional matter to be here. I think it shows the sort of leadership and we've come to rely upon, Secretary Paulson, Bob Steel and to our Co-chairs.

The real problem that underlies all the complexity that many of the prior speakers have eluded to is that auditing, like many aspects of corporate governance is a profound principle-agent problem. The people who select the auditors and negotiate with them day-to-day on behalf of public companies, are not, by and large, the people who ultimately are relying upon the accuracy of the financial statements and as a profound and irresolveable conflict of interest that occurs in a short term basis, in terms of the desire of the management of companies to get comfortable answers, which is in direct conflict with both the
interests of all the people I eluded to earlier and getting accurate answers and hopefully, the commitment of the profession to doing the job right. That problem breeds everything else that we are dealing with, all the complexities and effort to manage that conflict.

Now, in that context nothing is more important than the notion of the profession as a profession. What does that mean? That means fundamentally that auditors are acting not -- auditors are not for sale. It's very simple. All that talk about profession, it just means one thing, they are not for sale. They are not and they should not be thought to act on an incentive compensation basis. So when we talk about human capital as bullet point one in our outline, which in many ways is a good way of describing many of the challenges facing the profession and in another way it's sort of a mistake, right, because it assumes that we're engaged in a fundamentally financial calculus on the profession.

And I would argue that in many ways we ought to rethink what we're doing in reality to that part of our work but in our work as a whole to really be more focused on the notion of how do we build on the idea now more than a century old that this is a
profession? It's not for sale, fundamentally different in many ways than capital. Now, these -- we that here are gathered together have to do this if we're going to have any success in what is frankly a very politicized environment, where we bring many different perspectives to bear on this project and where in many ways time is short. The only way in which we will succeed, and by success, I mean, have an impact on the real world as opposed to produce a document, is if we adopt an approach that does not prejudge the factual issues, nor adopt a sort of selective approach to the facts. I'm very heartened by Alan's introduction and his commitment to doing so. It's certainly been my experience with Alan that that's always what you get when you ask Alan to do a job.

However, I am troubled by some of the details in the outline in respect to this issue. For example, and here I may shock some people. I don't know for a fact that it's true that auditors can't get insurance. I'm neither an insurance broker nor an auditor, just a representative of investors. I just simply don't know if that's true or not. I recognize that the audit profession has said it's true, but in my experience things are always available. It just
may be for a price you don't want to pay. Secondly --
so my point about that is I'm more than willing to
investigate that question and more than willing to
learn that it is true. But I would prefer not to
assume that at the beginning of the discussion.

Secondly, the document very prominently
notes a liability number, a total liability number.
It's reflected in the percentage side of one of the
previous speakers, 14 percent, eight percent of
revenues. What happens to that number when you take
out Enron and WorldCom? As Richard said a moment ago,
what is that number today? Those seem to me to be the
relevant questions and how does that number compare to
the investor losses in those situations. More
fundamentally, this is the most controversial issue
we're going to deal with, liability, the most, without
a question and there are some of our friends from the
press who have joined us who are frankly going to
write about this as though it's only about liability
and we know that's not true but that's how it's going
to play in some quarters.

All the more reason not to prejudge
anything. And I would say that we ought to think in
one respect -- many people said there's a liability
crisis. I don't know. No committee of this kind was
convened in early 2001, for example, when a liability
crisis was about to happen and an integrity crisis
that hurt our members very much. So I don't know
whether we have a liability crisis, but I will say
this; when each of us walk out this door, we are
responsible to total strangers for our conduct. And
there is no liability cap.

If I hit a pedestrian driving in my car,
if I drop a brick on someone by accident as I walk out
of this building somehow, I'm answerable for the full
extent of the injury if I violated my duty of care and
that's to a stranger whom I've made no commitment to
and whom I hit accidentally. I would suggest that the
real issue with liability is what should the standard
be because on the other hand, while it would seem to
be unfair that there should be no liability for
auditors who have taken on and are paid for the
enormous responsibility of seeing to it that trillions
of dollars in assets are accurately described, when I
walk out of this building, I'm answerable to every
human being I bump into, on the other hand. On the
other hand, it just can't be the case that auditors
should be responsible in court for every error that
they make because they will make errors and not all of
them should be answerable in court.
So, with that point of view, I would urge that we take those two points into account. That we put all the facts on the table and that we not prejudge any of the issues. On that basis, I've very, very grateful to be here and look forward to our work together.

CO-CHAIR NICOLAISEN: Thank you, Damon. Sarah?

MS. SMITH: Thank you.

CO-CHAIR NICOLAISEN: Sarah, a little louder, please.

MS. SMITH: How is that better? I appreciate the opportunity to participate in the work of this Advisory Committee and look forward to assisting Secretary Paulson, Under Secretary Steel and the Chairmen in their goal of sustaining a vibrant auditing profession. My own participation will be from the perspective of a preparer of financial statements and a member of the financial management with a large global and public institution and further, one that operates in the complicated world of financial services and I would say that those of us in the preparer community are all too aware of the importance of an independent and high quality audit process in insuring the credibility of our financial
statements and in maintaining the confidence of our investors and we applaud the effort to review and potentially improve the auditing profession.

With respect to the working outline provided for our discussion, the list of issues seems far-reaching and comprehensive and frankly quite daunting but given the intertwined nature of many of the concerns effecting the auditing industry such an extensive review is surely to be expected and while one hesitates to add to the task before us, I would make the following observations for consideration.

First, with respect to retention, this is clearly a critical issue for the auditing profession and one that deserves a significant focus. However, it's perhaps worth noting that the auditing firms are the training ground for the accounting profession as a whole, not just for future auditors and corporate America is absolutely dependent on a steady stream of qualified accountants who have been trained as auditors and who subsequently moved from the accounting firms to the public to become preparers of financial statements and the financial management of all public companies. This results in a healthy seeding of the accounting audit and control culture throughout the finance functions of corporate America.
and it's something we would surely want to insure continues as in and of itself, this contributes to high quality financial statements and assists in the ultimate quality of the audit in question.

So I'd say the issues surrounding how do we attract a sufficient number of talented people to the accounting profession as a whole, particularly given continued increases in demand, and how to insure they're sufficiently trained and educated when they do join the accounting firms would seem to be at least as important, possibly more so than insuring that accounting professionals once in the accounting firms can be persuaded not to leave them.

Certainly, I'd ask whether the committee should consider whether there are any best practices with respect to insuring audit quality and a sustainable auditing profession that we could observe in countries other than the United States and I didn't see that in the outline and I wonder whether there might be, for example, other approaches to attracting people into the profession or different ways of training accountants or otherwise helpful comparisons that can provide insight into the issue the profession faces here in the United States.

And on the subject of international
considerations, should the Committee specifically consider what sort of requirements and training will be needed for auditors in the future in order for them to be able to meet the challenges of an increasingly international marketplace. Consideration of impact and benefit of one set of global accounting standards is, of course, very important, but there are many other specific skill sets that will become very critical in an increasingly international arena and there are steps that can be taken today to insure that the US accounting profession will be considered a leader in being able to produce auditing and accounting professionals able to cope with such complicated demands.

And finally, should the Committee consider whether auditors should be required to comment on the extent to which an entity's financial statements reflect overall economic reality in addition to whether or not they're rendered in accordance with US GAAP, in other words, does a sum of the parts compiled in accordance with the existing rule set give an accurate overall picture of the financial health of an entity and if not, what needs to be understood to insure such an accurate picture can be given and that is only a very thinly veiled reference to the further
use of fair value.

So thank you for considering these suggestions. I look forward to participating in this debate and I note I'm handing over 45 seconds to Mr. Travis.

MR. TRAVIS: I'll try not to use them. First of all, I feel very privileged to be a part of this important Advisory Committee. I look forward to working together to develop recommendations to --

CO-CHAIR NICOLAISEN: A little louder.

You may need to get a little closer, too.

MR. TRAVIS: I'll try again. In response to Gary's remarks, I'd like to say that I'm very proud to say I've been a member of the auditing profession for more than 32 years. It's given me great opportunity and challenge to have a fulfilling career and an enjoyable life and I think that's a message that we can deliver to campuses over and over again.

I read the discussion outline and I found it to be a comprehensive summary of the issues that are relevant to our task. One of my responsibilities on the Advisory Committee is to represent the views or help represent the views of mid-sized and smaller public company auditing firms, who will have an important stake in our dialogue.
With that in mind, I'd like to make four specific comments. First of all, I believe one of our greatest challenges for us to consider in the sustainability of the audit profession is that auditing is a public interest service that must be governed by leadership of audit firms with a deep understanding of and commitment to the concepts of expertise, objectivity and independence.

Consequently, our work in the audit firm governance area should assess how to insure audit firms and their professionals are committed to doing the right thing to insure audit quality is consistently delivered regardless of the challenges presented in their organizations by growth and profit objectives.

The second comment is many mid-sized and small public company audit firms are well-suited to serve certain segments of the public company market. However, these firms typically do not have the same collective brand of the big four that helps them attract top talent and new clients. While I agree a brand is something that is earned through consistent actions, I do not believe the marketplace currently recognizes the expertise and audit quality delivered by some non-big four firms. I believe that there are
opportunities to help the non-big four firms to improve market recognition without being unfair to the big four.

The third comment is, I believe that the regulatory structure requirements are unnecessarily challenging for all audit firms. In particular, mid-sized and small public company audit firms have few alternatives to provide better access to the growth capital needed to expand their competitive capabilities and their geographic scale and to protect their individual partners. Firm structure, licensing and regulatory approach are important issues for our group to consider.

And finally, the ability to track, develop and retain talent and expertise is the critical life blood of audit firms. A significant challenge for retention of personnel in mid-size and small audit firms is the extreme seasonality of our business during the winter season. This reality places enormous pressure on audit quality and balanced lives of our professionals. During my career, it was common to lose very talented staff who simple didn't want to live through another busy season or didn't want to become a partner and have to work those kind of hours.

So I ask that as we consider the issues before us,
that you consider these comments as being relevant to our analysis. Thank you.

CO-CHAIR NICOLAISEN: Thank you. Lynn.

MR. TURNER: Thank you. Thank you, Under Secretary Steel, Arthur, Don and my thanks also to the Treasury staff who to date have been most helpful as well. So thank you. If I was still teaching, I suppose some of my students in the classroom, having heard the remarks so far today, would turn around and say, "Why would I ever join that profession". So let me set the record straight, somewhat to start with.

I joined the profession over three decades ago and I found it to be a wonderful profession and I wouldn't change anything. I'd go back and do it all over again. The firms have just reported -- many of the firms have reported this last year record revenues, record profits. The average partner is in the top one-half of one percent of the economic wage earners in their towns and cities that they come from and since Enron, the passage of the new auditor independence rules, enrollment in the profession has -- or enrollment in the accounting classes has jumped substantially as compared to before that, probably more so because the profession basically guarantees you a job when you get out of school than Enron.
And all this in light of the fact that business has grown extremely complex. I found it interesting the people sit there and say, "We've got an extremely complex situation." I think Mary K. did a wonderful job of laying out the complexity in the transactions and the financial markets today and yet we expect an audit to be something simple. I don't know how you reconcile those two, especially if you're trying to use a principled approach and I hope when we deal with principles, it will be something less than the 450 pages of SEC executive disclosure principle based rules. So I think principles and rules are all in the eye of the beholder.

But as I look through the materials and the outline, I don't know that five minutes really does justice to 20 some pages of outline, Arthur and Don, so I hope you'll allow us to provide written comments but when I look at it, I do think there's opportunities for the firms to move forward and I do agree with comments that the firms are probably doing a better job today than they certainly were doing on a pre-Enron basis and I commend them, Tim's firm, Travis' firm, for the work they are doing, but they can get better I think, and I think that's important because we need to keep in mind that this is all about...
one thing, investors, and investor's confidence. And that's one of the principles that is not, surprisingly at the forefront and top of these so-called over-arching principles. This is a public franchise and if the public didn't need those financial statements we wouldn't need the public audits and I think that needs to be a significant amendment made to the very start of the outline.

The other thing is the firms have talked and appropriately talked about the governance for corporate America and the importance of that and they're dead right on that. Serving as a director or trustee of three of these organizations now, I think it's important that the firms need to step back and take a look at implementing the same type of governance procedures that we use in corporate America. It's one of those situations where what is good for the gander is certainly good for the goose in a situation.

We talk about transparency. Damon brought up the lack of transparency in the litigation issue. We see the 14 percent in the outline as far as litigation costs but there's no transparency about what caused the 14 percent. If the 14 percent as Damon mentioned, came from the Enrons and the
WorldComs, these situations where we had billion
dollar misses. And people talk about PCAOB, Mark
second-guessing the auditors. It isn't Mark that's
second-guessing the auditors, the public has second-
guessed the auditors of Enron, WorldCom, Xerox,
Bristol-Myers, Tyco, right down the line, and if
that's what's contributed to the 14 percent, then you
get a total different outcome and I think what it begs
for the outline to get more into is, if you're really
going to get to the bottom of this, you really need to
do something like the National Transportation Safety
Board does when there's a plane wreck. You go out and
you take a look at it and you figure out what went
wrong, and then you come back with recommendations for
how to turn around and make it right. And I think we
need more of that notion built in, and that certainly
goes with transparency.

And I will note that the financial
executives recommended over two years ago that these
firms should put out the same type of financial
reporting that public companies do and I do think
that's important as well.

On the competition issue, I'll just note
the reason we've only got four firms, it's not because
of Andersen's demise. It's because each of these four
firms went out with the government's approval, and acquired another one of the competitors. So we went from eight to four principally because of the firms themselves with the government blessing and quite frankly the four are so big and such behemoths you're not going to change that today, so I think I'd go back to Bill Travis' comments and the real question is then, how do you give the other firms an opportunity?

Just this last week I saw where one of the major Wall Street banks turned down a small firm and that's just flat out wrong and we need to figure out. If I had my preference, serving as a chair of a couple of these audit committees, I'd take four and divide by two, but realizing there's probably not stomach in this town for that, I do think we do need to find a way to help out the smaller firms.

And on the human resource issue, just let me close by noting in this profession, starting salaries this year, depending upon counts, are 50, $55,000.00 for a new grad hire. If you go into law school or go to Wall Street or you go into the medical profession, you get more than double that. So where do you think the smartest and brightest kids are going to go? They're going to go where the money is. They're not dumb. And they're going to go there.
And for the firms to get competitive, vis-a-vis, other fields, they're going to have to change their structure of how they've done the audit. I've signed -- I'm a handful of one of the people around this table that's actually signed audit reports, having been in the profession for 31 plus years, and I find we're still doing it the same way we did 30 years ago, and that just doesn't work any more and so I think the structure of the firms along with their governance has to change. But they also have to find a way to do that, because if they're only going to pay half of what the other professions pay, they're never going to attract the best and the brightest.

CO-CHAIR NICOLAISEN: Ann.

MS. YERGER: I don't think there's much to be said at this point except I second everything. First of all, I do second everyone's comments. It's an honor for the Council to participate in the Committee. I look forward to working with everybody here and let me also second the comment that I think this is an appropriate time for the Committee. We are not in a crisis mode which is a good thing, and I think this is very much a transformative time for the industry despite the fact that it's undergone tremendous changes just in the past five years. I
agree with Mary's comments. I think we are going to be shifting from GAAP to International Financial Reporting Standards and that has ramifications, not just in training and the folks that are coming up the pipeline but retraining the folks that are currently performing the audits and I think that's something that this group really should think about.

Just to put my comments in context, I thought I'd introduce the Council. We are a non-profit membership association of more than 130 public, corporate and labor employee benefit plans with more than $3 trillion in assets. Our members are responsible for safeguarding the assets used to fund the retirements of millions of individuals, predominantly here in the United States.

They have a very long-term and significant commitment to our US capital markets. Their average fund invests about 75 percent of its portfolio in stocks and bonds of US public companies. Given this financial stake and the fact that quarterly reports and audited financial statements are among the primary sources of information used to guide the investment decisions of Council members, the Council has long been engaged in issues involving the quality of the audit process and the strength and independence of the
audit profession and that would be whether we're
talking about internal corporate auditors or external
auditors.

We share everyone's interest here in
showing the strength and sustainability of this very
important profession. We believe the well-being of
our financial markets and the investors who entrust
their financial futures to these markets depends in
part on the quality of the information provided by
audited financials and the quality of that information
in turn, depends on the quality of the audits, the
people doing the audits, the audit process and
providing investors assurance about the accuracy,
completeness, reliability and credibility of financial
statements.

The audit profession clearly plays a very
unique role in our capital markets. It is -- it has a
ready-made marketplace because it's the only
profession that must be engaged by a company selling
securities in the US. However, it faces a host of
challenges. Some of them, such as structural issues,
seem to be very specific to the industry. Others,
such as competition to attract and develop talent, I
think are probably relevant to all industries, but we
certainly appreciate the unique needs for this
profession to continue to have a robust pipeline of trained, skilled auditors. But uniquely the US audit profession ultimately derives its strength by the public trust it earns serving as an effective independent gatekeeper responsible for high quality audits of companies seeking capital from individual and institutional investors.

Unfortunately, public trust in the profession and the integrity of the financial reporting process was severely shaken earlier this decade and it will take time to rebuild this trust. We very much support the overarching principles of this Committee and we believe that the big themes detailed in the working outline represent a very thorough review of the challenges facing the profession.

I just want to echo, really Richard and Damon's comments on the liability and insurance issues. Those are of key concern to Council members. I want to stress I come here very much with an open mind. I do think there's been a dearth of credible and current information on these issues and I think as we move forward, it's going to be very important that we get very current information and understand what the ramifications are and be able to put these numbers
in some kind of context because I think that kind of
data has really been missing and as we're thinking
about public policy considerations, I think it's
incumbent on us that we really do a very careful
review of actual facts and figures.

In the coming weeks and months as we work
together to develop recommendations for enhancing the
quality of audits and the audit process, I would
respectfully request that for each and every proposal
we examine, we carefully balance the goal of
strengthening the audit profession with the
necessities of responding to the needs and demands of
the ultimate customers of audits of the investing
public and of continuing to rebuild public trust in
the profession.

So I very much look forward to studying
lots of facts and data and working closely with all of
you to move ahead. Thank you.

CO-CHAIR NICOLAISEN: Well, thank you.
You have now heard from each of our Committee members.
What I'd ask you to do before we hear from our
observers is just stand up in place. Don't leave the
room, just stand up and stretch for a minute or two it
would probably be helpful. Then we'll hear from our
observers.
CO-CHAIR NICOLAISEN: Okay, we'll kind of wander back to our seats. Okay, well, thank you very much. I think that was very helpful to hear from each of our Committee members and as you can see, we have a range of views. Let's now turn to our observers, and we'll also do this alphabetically, so Bob Herz, would you start?

MR. HERZ: Thank you and thank you also to the Treasury folks and to Arthur and Don for allowing my organization, the Financial Accounting Standards Board, to have a seat here as an observer. I think that my role here as I perceive it, is that to the extent that what you're looking at inevitably inter-relates with the financial statements and financial reporting, accounting standards, to help provide you with any information we can in that regard that might help illuminate your discussions.

Those of you who know me, and that's, I think most of the people here, also know that from time to time, maybe more than time to time, I may offer my own personal views and insights for whatever they're worth as having been a member of the profession for some 30 years also and someone who obviously, in my role now, continues to be very much
involved with auditors and all the people around the
auditing activity. I think it is important, I think
Lynn put it, that, you know, auditing is an activity
around the financial information, the financial
statements, so the world of financial reporting, as
Alan noted, the kind of backdrop issues of
globalization, of improving the content of financial
reports, and of also reducing complexity, there's a
lot of things going on in those regards, and I would
just encourage you in your deliberations to be
forward-looking and start thinking about, as many have
done in their comments today, about the world as it
might be in four or five, seven years and therefore,
what the implications are going to be for the role of
auditors. What is it that investors in the capital
markets are going to be looking for, demanding,
wanting, and the like and think about it in that
context. In that regard, I think it's
important to note also that there is kind of another
important advisory committee going on under the SEC's
auspices on improving financial reporting and some of
its activities and insights may inter-relate with the
activities here because it will be making findings and
recommendations relating to the basic accounting model
to globalization and where we're going in that regard
and the like. I think fortunately, Kristen from the Treasury staff is an observer on that as are Mark Olson and myself, so I think that hopefully these two efforts can glean from each other as appropriate. Thank you.

CO-CHAIR NICOLAISEN: Mark?

MR. OLSON: Thank you very much. Bob and I were, as the roundtable here started, were commenting on the five-minute recommendation and we decided that it was a principles-based and not a rules-based standard that you were talking.

(Laughter)

MR. OLSON: Having observed this Treasury Department under the leadership of Secretary Paulson and Under Secretary Steel, something is very clear. That you have leadership that is very focused on financial markets and the relevance of the financial markets both domestically and internationally and they are good stewards of the resources of this Treasury. And if the audit profession has hit their screen as an issue that is in need of high level attention, that attracts the sort of talent that we see around this table, I think that that's all the indication that we need, that this is a critical issue and this is a critical industry. And therefore, I think that to
have and look at the profession from this perspective, is critical and if we do our jobs even remotely correctly, we -- this should assure that it will be a profession that will attract the best and the brightest or at least the most appropriate people over a period of time. So I'm looking forward to doing that.

My introduction to the accounting profession came when I was added as a partner to the old Arthur Young firm, almost 20 years ago and my introduction to it from a public policy perspective occurred about eight years ago and one of the first visits I had in that role was from Arthur Levitt and Lynn Turner, talking about some of the changes that were about to be taking place. But for even longer than that, I watched the banking industry over a 30-year period change in a very radical way and 30 years ago or even perhaps 25 years ago, it was clear to everybody that it was going to change. What was not clear was what the change was going to be. And to the extent that it happened in a rational sort of a way through a change in the regulatory or oversight process, it occurred not because new rules were imposed but because there was a fundamental look at the purpose of the industry and a fundamental look at
the appropriateness of the rules that were there and
the modification of some of those rules to reassert
what the important public policy role was, assuring
that it would still retain its viability. So I would
hope that as we look at our role here, we would have -
- we would not start by deciding among ourselves what
the end result will be and what we think it ought to
look like at some point, but we ought to look at its
viability and the appropriateness of the legal and
professional and competitive environment that it finds
itself in.

And I would think if I could wish upon
this group a direction, I would just simply go back to
the attributes that Arthur gave to Alan Beller, that
we should wish for ourselves wisdom and balance. And
with that, on behalf of the PCAOB, I look forward to
my participation with this group. Thank you.

CO-CHAIR NICOLAISEN: Thank you. Zoe-
Vonna?

MS. PALMROSE: Under Secretary Steel, Don
and Arthur, I would like to make a few comments but of
course, I must start by saying that the views I
express are my own and do not necessarily reflect
those of the Commission, any commissioners or staff.
That said, let me emphasize that the SEC through the
Office of the Chief Accountant is very pleased to participate as an observer in the important work of this Committee. The mission of the SEC is to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. The federal securities laws recognize financial reporting with full and fair disclosure as a critical component in this mission. And importantly, these laws recognize that having these financial statements audited by knowledgeable independent, objective accountants is a bedrock principle that enhances the credibility and reliability of the financial information issuers provide to our markets.

Even though issuers file audited financial statements to comply with the federal securities laws, many companies actually provided audited financial statements before the first laws were enacted in the 1930's. And still today we see companies in unregulated and emerging markets voluntarily contracting for audits. In other words, financial statement audits are viewed as value added. They're not just a compliance activity.

The federal securities laws have given a monopoly over audits to public accountants. In turn, audit services are regulated among which are standards
for auditing, quality control and independence. Nonetheless, these standards provide a floor for audit effectiveness. Importantly, audit firms should have incentives to go beyond the floor and compete on the basis of quality. This not only occurs from enlightened self-interest but when, for example, audit quality carries a premium and clients are willing to pay more for higher quality services.

Still, it's widely recognized that the regulatory and market changes over the last decade have significantly effected both the audit environment and the audit process. So now does seem to be an ideal time for stepping back to identify and confront the major issues we face for maintaining and improving the value and effectiveness of audits going forward. In addition, next year, 2008, will be the 75th anniversary of the first securities acts, and anniversaries, likewise, represent opportune times for reflection.

The draft outline that we're discussing here this morning contains a robust and perhaps, as Sarah noted, a daunting list of important issues. And even a cursory review of this discussion outline makes clear that audit effectiveness involves not just the audit firms and the people that work for them, in
other words, those that supply audit services, audit
effectiveness involves those that educate and train
auditors over a lifetime learning process.

Those that influence the demand for audit
services such as clients, including their audit
committees, investors and other users and management,
the conditions under which the -- the market
conditions under which audit services were exchanged
and of course, the nature of the regulations that
touched a supply and demand for audit services. The
SEC is one of the regulators of auditors and audit
services. Naturally, it's very interested in the work
of this Advisory Committee. In this regard, SEC
Chairman Cox noted in a recent speech that, "We
appreciate as regulators, we have to be aggressive in
our role as market referees and protectors of
investors' interests and at the same time, we have to
be humble in recognizing that regulation is not the
fuel that drives our markets, though it undoubtedly is
the oil that greases the gears."

In other words, we recognize the
importance of regulatory balance for economic
vitality. We in the office of the Chief Accountant of
the SEC stand ready to facilitate the important work
of this Advisory Committee in any way we can. Thank
you.

CO-CHAIR NICOLAISEN: Great. Thank you, Zoe-Vonna. Alan, back to you, if you would like to make some comments, we'd appreciate it.

MR. BELLER: Don, thanks very much. And I'd also like to join the chorus of those who have thanked Under Secretary Steel and others at the Treasury and for giving us this opportunity to tackle this complicated task. A little bit about me. I was the Director of the Office of Corporation Finance from 2002 to 2006. I think frankly, at least as important in terms of my participation on this Committee, I've spent nearly 30 years as a practicing lawyer in the corporate and securities area. I spent seven and half of those 30 years residence outside the United States in both Europe and Asia.

So I have taken a lot of American companies public but also taken a lot of foreign companies public and represent both US and non-US companies in their public market activities. Back in the days when foreign companies still listed in the United States, I helped huge numbers of them, significant numbers of them list. Finally, I am an independent director of a Fortune 100 company and I serve as a member of the audit committee of that
company. So what you will hear from me is, I guess, informed by those perspectives.

I think the most important comment I'd make is that it's important, and people have eluded to it, that this be a fact-driven exercise and I know that the Co-Chairs intend that trying to get our arms around the facts is going to be one of our early tasks and we're going to try to derive recommendations from the facts and not the other way around.

And I think the only way that we have any hope of being successful is, in fact, to be true to that process. Just a couple of other thoughts; we've -- it's clear and others have said this around the table that in doing our work, we can't take our eye off the notion of the primacy of audit effectiveness, that audit effectiveness depends upon a variety of things. Given the structure of the audit process, Damon eluded to it, there are built-in conflicts and one has to deal with those conflicts in some fashion.

We have professional standards to deal with some of those, but beyond conflicts, you eliminate all the conflicts in the world, you still haven't addressed the issue of audit effectiveness, because it's the quality of -- it's the quality of the people and the quality of the processes that produce audit
effectiveness even if you have people who are completely unconflicted. That's why this emphasis on human capital is so important and that's why this emphasis on audit firm structure is so important because you will get good -- the right people operating in the right framework is conducive to high audit quality.

Arthur mentioned at the very beginning and it's an important issue, it's becoming a front and center issue of audit quality and I think it's hard for us to do our work without keeping it in mind and that's fraud detection and how audits work in the process of fraud detection today and going forward. I've ducked a little bit of an issue when I talk about the primacy of audit effectiveness because what do we mean by an effective audit?

That seems to me, itself, to be a complicated question that has two parts, one of which is what are the standards by which we judge audit effectiveness, and secondly, frankly, is what are the expectations of an audit and what should they be? And I don't know if we're going to be able avoid that question in doing our work.

Finally, and I'm going to take 30 more seconds, Arthur, even if we deal with all these issues
of audit effectiveness, is that enough to address the
future of the auditing profession and I guess I would
submit, although it's obviously a very important part
and maybe the most important part, it's not the only
part. I think there are liability issues that
transcend the quality issue. I share Damon's view
and others, we ought to try to get enough facts that
we can make an assessment of that. I think there are
transparency and governance issues at auditing firms
that transcend the quality issues.

There's a lot of opaqueness in the
auditing profession, vis-a-vis, what investors in the
rest of the world know about it. Finally, there are
concentration and competition issues that I think
transcend the quality issues. Even if we have nothing
but perfect audits, I'm not sure we can avoid
addressing competition and concentration going forward
and finally, the issue of complexity and the issue of
globalization, it seems to me transcends the quality
issue and has to be addressed as part of our work and
so those are my thoughts.

CO-CHAIR LEVITT: We're winding up and I
want to thank everybody for really staying ahead of
time. I've got to say that the Secretary and Bob have
taken on an extraordinary high wire act toward the end
of the Administration with the odds heavily stacked against doing anything and bringing up a commission of incredibly talented, non-bashful people with very different views on some critical subjects. I think the least we owe to the two of you for this extraordinary gesture and I really believe it's an extraordinary gesture, we're going to look at this de nouveau. We're going to look at this with openness and assume that you've come to us in the spirit of good will and fellowship and we really take that to be the case.

The accounting industry, all of us agree is absolutely essential to the continued primacy of US capital markets. Congress gave you a mandate. Congress gave you a trust, and they gave you an obligation. I think that every decision based in the light of that trust and that mandate must based upon what it does in terms of confidence in the system. If it diminishes confidence, it's bad; if it increases confidence, we should be for it. All of our recommendations, I suspect are not going to be made in a vacuum. They're going to be made in the light of public judgment and political realities, public judgment and political realities.

If we keep that in mind, we keep our focus
on the enormous benefits which could come out of not just a consensus result but an effective contribution to the notion of increasing public confidence and the world's confidence in the system, not delegating it to another domicile, not mimicking some other area of expertise, not seeking the lowest common denominator to arrive at an illusory consensus but a real, working consensus.

CO-CHAIR NICOLAISEN: Thank you, Under Secretary Steel and Secretary Paulson. We certainly do appreciate the confidence that you've put in us to undertake what is, I agree with Arthur, a real high wire act. A lot of these issues have been around for a very long time. I'm extremely hopeful, being born an optimist, that we'll be able come up with some meaningful direction that will change the course in a very positive manner and so, I'm enthusiastic about it. I've appreciated so much the comments of each of the Committee members and observers. I think there's a tremendous amount of wisdom and judgment that's been exercised here and shared with us. The comments are candid.

A couple of things I've thought about in just listening today, the repetitive views that come across, I think, spot on put the investor first, large
or small. Pay attention to the investor but don't lose sight of the fact that there are many, many other interested parties that rely upon accurate and complete and honest financial statements.

Pay attention to the governance systems within the firms. Pay attention to the concentration that has developed. Don't prejudge. Let's seek the facts. I was interested in the comment that in the academic world maybe accounting should be required even at the high school level just to get people's appetite whetted. Certainly, a lot of good thoughts as we go forward.

I was also trying to jot down some of what I heard about -- I would say they were probably attributes of accounting, accountants and accounting firms. Maybe it's even what a want ad would look for, for hiring an accountant, the terms were there over and over again, they want the best, the brightest, a fellow needs to exercise sound and competent judgment on a consistent basis with consistent quality. You're looking for the professional, someone you can trust, someone who's honest, someone who has integrity, an expert, they're robust in their efforts. They're noble. They protect the interests of the public. They can manage risk. They can deal with complex
accounting matters. They're balanced. They're -- they get it right, they're proud, they have wisdom, they add value and they're transparent. They're accurate and you can go on and on with what I heard here. And I think that probably says a lot of good about the accounting profession, about the auditing profession and its future is that it is geared to and it is attracting extremely bright, extremely talented people who do care immensely about the good of society and the best of community.

So I'm enthusiastic. I think we'll do well and I appreciate your participation and ability to sit through a fairly long morning. Bob or David, any announcements before we break here?

UNDER SECRETARY STEEL: No, that's it.

CO-CHAIR NICOLAISEN: Great, thank you very much.

(Whereupon, at 12:23 p.m., the above-entitled matter concluded.)