

**DELOITTE FIRESIDE CHAT V**  
**Role of the Auditor**  
**October 5, 2011**

**MARK PEECHER:** Good afternoon and welcome to today's Deloitte Fireside Chat, looking at the role of the auditor, and broadcast live on [www.sechistorical.org](http://www.sechistorical.org). I am Mark Peecher, Deloitte & Touche Professor of Accountancy, College of Business, University of Illinois in Champaign and moderator for today's program.

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Through its unique museum and archive at [www.sechistorical.org](http://www.sechistorical.org), the SEC Historical Society shares, preserves and advances knowledge of the history of financial regulation from the 20<sup>th</sup> century to the present. The virtual museum and archive is free and accessible worldwide at all times and currently welcomes more than 300,000 visitors annually. Both the museum and the Society are independent of and separate from the U.S. Securities and Exchange Commission and receive no funding from the public sector. The Society is grateful for the sustained and generous support of Deloitte LLP in making the Deloitte Fireside Chats possible.

The Deloitte Fireside Chats debuted on [www.sechistorical.org](http://www.sechistorical.org) in 2009 as interactive programs on current issues in financial regulation of interest to the accounting and auditing professions. Past programs have addressed the role of professional judgment, principle versus rules-based accounting and auditing standards, regulation in the audit profession, and responsibility for preventing and detecting financial reporting fraud. All these programs can be accessed at any time in the Deloitte Fireside Chats section under Programs in the virtual museum and archive.

Joining with me today to look at the role of the auditor are Robert J. Kueppers, Deputy CEO of Deloitte LLP and a Trustee and President-elect of the SEC Historical Society; and Robert E. Moritz, Chairman and Senior Partner of PricewaterhouseCoopers LLP.

Before we begin our discussion, I would like to state that the views of the presenters are their own and do not reflect those of Deloitte LLP or of the SEC Historical Society. The Society selected me to moderate the program. I have worked with the presenters to determine the topics and questions that will guide the content of our discussion.

Let me begin by asking Bob Kueppers, and I will be using first and last names today for clarity, the following. Bob, what has been the historical value proposition offered by the financial statement audit, and by the financial statement auditor within the financial reporting supply chain?

**ROBERT KUEPPERS:** Thanks, Mark. Fundamentally if you look back, the world didn't really begin in 1933 but we pretend it did. The independent auditors' overriding goal is to contribute to investor confidence by providing reasonable assurance of the fair presentation of a company's financial statements. Many of us believe that the financial

statements themselves and the derivative information, is really the bedrock of the functioning of the capital markets, just because it is so foundational to understanding a company's balance sheets, and income statements are foundational to understanding a company's operations and its status as a good point in time.

Essentially, that role has not changed in those 75-plus years. At the end of our work, we issue a singular report -- the company's financial statements. If you really think about what the auditor does, part of it comes from our attributes and part of it comes from our activity. In terms of our attributes, we are independent, disinterested, and professionally skeptical; we approach our work consistently with a questioning mindset. We have to fundamentally obtain and evaluate and conclude as to whether or not we are satisfied through the gathering of sufficient competent evidential matter to reach a professional conclusion about the financial statements overall at the end of the day. Our work includes inspection, confirmation, and physical examination of evidence, such as personally observing the inventory process that the company undertakes if they are that kind of company.

We have a lot of decisions to make. The scoping of our work, and the timing, nature and extent of our tests are based on our experience. We often call on people outside the audit team with expertise. The end of that process is a report that we like to believe does meet that overriding goal of contributing to investor confidence in the financial statements.

**MARK PEECHER:** Thank you, Bob. Let me turn it over to Bob Moritz for a second, related question. Are stakeholders today confident that these historic value propositions will have sufficient continued value relevance? And, Bob, if you would, please address both the audit process and auditor characteristic? I ask in part because I frequently, perhaps too frequently, hear that the audit has become a little more than a commodity.

**ROBERT MORITZ:** Thanks, Mark. Let me reiterate what Bob Kueppers said which is again our goal and the value proposition we bring is that we are independently assessing whether the financial statements are in accordance with GAAP in providing more assurance around that and for public companies with certain materiality thresholds they are certainly doing in an environment that is appropriately controlled. If you ask our stakeholders today, I would tell you that they would not respond in saying first there is value coming from that independent objective assessment for the financial statements.

I think in your question though you asked specifically, is there continued value relevance? And now you are going to the issue around the expectations gap. And in that regard you have to think about, one, is what we are attesting to in the financial reporting supply chain, what exactly the investors and other business partners, stakeholders et cetera relying on in terms of making their business decisions around either capital investments or partnerships or other aspects associated with that. So I think as we look at it today, when we sit down and talk to the combination of investors, board members, management team members, regulators, stakeholders, banks, creditors and like, I think they do see value. The question is when you look at the changing financial reporting model, the supply chain, so to speak, that's changed a lot over the last number of years. It has changed when you get continuous information now coming out of Wikis, press releases and the like, it comes out with a whole lot of investors and what are they relying on to make their investing decisions. I think before we get into the role of the auditor, you do have ask yourself the question, what is the information that people broadly

defined are relying on when making various decisions, and whether they take and need an independent objective view as to whether there is credibility in that information. That seems to be what I call the root cause issue.

Now to your second question, I think when you look at the audit process and the auditor characteristics that are embedded in, not only with what Bob Kueppers started off with in terms of us being independent and objective and the like, and bringing forth a series of processes to gather sufficient evidence to come to those conclusions. Those today work very well. Obviously, there is a number of issues today saying whether or not the independence and objectivity is a sufficient level, which is something that as we know that PCAOB is looking at today and there will be some debate over the next couple of months. No different than what is going on in Europe right now. But I would say that again the characteristics of the order viewed by the stakeholder groups are well suited for the role as defined today. And second that the processes that we put in place are well suited for the expectations we have today as defined. But now the question is what should be that role going forward? What should be the report and the mechanism for providing the information to those stakeholder groups? I think that is the better and more informative questions that we are having discussions over the next couple of months that we will get into in a few minutes.

**MARK PEECHER:** Very good. I would like to switch gears just a little bit and broaden the lens. In the title of today's Fireside Chat, I alluded to the financial reporting supply-chain, not just the auditor whom we have primarily been discussing. I might turn this to Bob Kueppers and ask you to briefly lay out the major players in the corporate reporting model today and their roles.

**ROBERT KUEPPERS:** Actually, that is a perfect place to go. Obviously, Bob Moritz and I are thinking first and foremost of the role our firms play and our professionals perform but we obviously can't do it alone. I think of it as four key players in order to get a set of financial statements prepared, audited and out the door, if you will. Management first and foremost has the primary responsibility for preparation of the financial statements and more specifically financial management, CFO, chief accounting officer, the controller and all the rest. Internal audit and I recognize that internal audit is not required by rule or otherwise but most major companies have an extensive internal audit group. The external auditor, which is what we have been discussing so far, and the audit committee. I have often used an analogy to discuss how those groups working together can have a great outcome and what happens sometimes when they are not working so well. I analogize by saying, think of each of those four players as principals in a string quartet. Everyone is playing a part; it is unique and it is distinctive. And when everything is in tune and in sync, music is truly made, but when people are playing at their own tempo or are not listening to one another, what you get is a bunch of noise. So they are complementary but they are unique. Management can prepare, internal audit can do an incredible amount of work, but there has to be an audit committee to make sure the controls work is properly done. The external auditor, I have already talked about a little bit, and this is all done in the oversight of the independent audit committee which is made up today solely of independent directors or members of the company's board of directors.

So, when things go wrong and things do sometimes and you analyze, you look back with hindsight and say, "What happened?" It is often the case that one or more of those four

principal players did not pay attention or did not execute their responsibilities to an appropriate degree.

**MARK PEECHER:** I like that analogy. Most string quartets to be very good need to have practiced together for a very long time. What I would like to do now is focus on a highly relevant topical issue. I will turn first to Bob Moritz for this and I would say to Bob, clearly there are some doubts today regarding the continued ability of the current auditor reporting model to be a value added part of the financial reporting supply-chain. Critics argue that the pass/fail auditor report provides no insight about the experience and know-how of particular auditors who conducted the audit or about the nature of the specific audit completed. For example, very little clues about materiality thresholds and very little information about close calls and the auditor's assessment of the reasonableness of management's accounting estimates. The PCAOB has been looking at this issue and the comment period for its concept release on the auditor's reporting model just closed. Bob Moritz, can you summarize the options being looked at and how and why these various options could add value or perhaps have unintended consequences?

**ROBERT MORITZ:** Let me first off make a couple of comments on the PCAOB's process and its efforts. We, collectively the profession, applaud the efforts that the PCAOB is putting forth for two reasons. One, it goes to the issue of ensuring the relevancy of the profession and any time we look at in improving that relevancy we believe that is a good thing. Second, what the PCAOB has done with its concept release is ask for input from all stakeholders and again as Bob Kueppers talked about there are a number of stakeholders in the corporate reporting supply-chain and all of them have points of view, multiple points of view, around their perspective of going for relevancy and value of the auditor in the reporting supply-chain. So what the PCAOB has done is put forth a few options for the possible change to today's auditor report. What it does, is say whether or not we should think about expanding the current auditor's report and providing, for example, more explanatory paragraphs, matters of emphasis, so to speak, is one option which would allow for the auditor to provide more insight around some difficult areas Mark alluded to in terms of where perhaps there were close calls or judgments made both from management's perspective and our views on that, or our perspectives relevant to, for example, scope of the audit in terms of maybe a risk assessment of how we might have thought about a particular area or two.

The second thing that they have put on the table was an option, is should the auditors do something similar to what the management does today which is what I call an AD&A or Auditor's Discussion and Analysis which is now allowing us, the auditing profession, to move from a role of attesting to financial information or other disclosures, to one of asserting. You in essence call the auditors out and ask them to put forth their point of view rather than attest to management's point of view. And the other option that they put forth is whether or not our current audit report should be expanded to include elements of the management MD&A, which today is excluded from the set of financials as we would define them. All of these have pros and cons to them. When you look at any one of these, they really get to the issue of, will this further satisfy the need of investors for additional information that they believe the auditors are privy to that they are not getting in today's form of the audit report, or that other stakeholders are not providing for them? Because again, as Bob Kueppers talked about earlier, would you have a number of stakeholders when you think about the role of management, the board, audit committee and ultimately the auditors? So, I think there is an option here to enhance the value and

relevancy of the auditor in the eyes of the investors or other people that have put forth these proposals. And again there are pros and cons to each of them. And the question that you have today is, is it enough to further satisfy the needs today or are there other things that should be thought about differently?

I think one of the challenges and you asked about unintended consequences that we need to be careful of is, it leads from my own personal point of view, we need to be smart about changing the role of auditor, as defined today from a body that attests to management association either over the set of financials or over control environment that they openly are providing, to one of being an asserter providing new or different above and beyond. That has a potential which obviously had to be debated of changing the relationship that auditors have, for example, with audit committee members or auditors today have with management or of course if you want to remain independent and objective and bring the right amount of skepticism around providing an attestation report in some form or shape. But nonetheless this would actually now move us to a position of asserting certain things. So, that is one example when you think about the unintended consequences. Another unintended consequences is thinking through depending on what kind of information the auditors might now be attesting to, is the question of, do we have the right skill sets necessary to do so. So, for example, if you think about MD&A, many people have thought through what elements of MD&A should be there as key performance indicators, value propositions that are being discussed or perhaps risk factors, obviously the unintended consequences around skill sets. And another unintended consequences to make sure that in fact the cost benefits are through sufficiently, not to say, does this make sense for again the collective group of stakeholders, both at looking at it from not only the investors' eyes but also the board's eyes, standard setters say this could well have been management in themselves. So, I think these are great proposals to start the dialogue and argue. I think we can go further in terms of the expectation gap to make sure that some of these things, as well as others are considered going forward and those are the things that the profession and others are hopefully going to be weighing in on. And I would ask for those out there listening to this that we encourage everybody that has an interest in this, a vested interest, participate and provide that feedback is that you believe that the PCAOB and the profession would benefit from that feedback that we are hoping to gain doing this exercise.

**MARK PEECHER:** Thanks very much, Bob, for those views. I would just note for any doctoral or undergraduate students that a good place to look is the PCAOB website and those comment letters yourselves, and try to dissect what is being said there. I would like to give Bob Kueppers a chance to provide his perspective on any intended adverse reporting of facts. But also I would like to ask you to specifically comment on something to which Bob Moritz alluded, which is, how do we think about the costs or how should we think about the cost of providing any new auditor communications or new parts of an auditor's report? One reason I ask is, isn't there already often little enthusiasm for increasing audit fees year after year on audit committees? Another related question is, would the costs of these proposals be differentially recoverable for alternative new services, for example what Bob Moritz referred to as the AD&A, Auditor's Discussion and Analysis versus an expanded use of explanatory paragraphs?

**ROBERT KUEPPERS:** There is no enthusiasm for increasing fees. But first, I want to build on what Bob Moritz was saying here. This is a result of working with clients for many, many years. I am going to call out a couple of points related to close calls. There is no question that, in almost every set of financial statements, there is some area for a

manufacturing company that could be a warranty reserve; they are the more difficult estimates to land on for management and no surprise, they are one of the more time consuming areas where we have coverage in the audit to get comfortable that the estimate is reasonable. So, the notion that close calls need some special disclosure consideration troubles me in the following sense. These are often what I call the most carefully analyzed, carefully discussed issues and they actually might end up being the best decisions that are made in the process of preparing a set of financial statements. The fact that they are difficult or might fit some yet to be written definition of closed call sort cast a doubt on almost out of the box, and a report that we might generate as an auditor. I think there are two issues, one is it shouldn't undermine or replace our basic conclusion that a financial statements taken as a whole fairly present in accordance with GAAP and I think everyone we have talked to said, "We don't want to lose that because that has failed" is extremely valuable and this I report today, you can tell if there are extra paragraphs or something non-standard. I call it a red flag for readers of our report.

But the second thing that that implies is actually more interesting. A lot of the kinds of information that is being discussed now that others could add to their standard report are the very kinds of things that we spend a lot of time and incredibly effective and interesting dialogue with the audit committee. I would like to use the term dis-intermediation that the people who look at the financials want to cut out the audit committee and go directly to the results of that process. My experience suggests that faithfully capturing that dynamic in a written report may just not be possible. It is an iterative process, there is give and take, there is back and forth, we do provide reports for the audit committee's benefit on a number of areas that are set out as standards. But the real value comes from the audit committee doing its job, questioning management, challenging the auditors when there are differences among the two in terms of the accounting treatment, and arbitrating the outcome to a good place. The value there is not as visible as some might want it to be, but the role is crucial and I think that role has been strengthened certainly in the last ten years or so with Sarbanes-Oxley given the duties that were set out by Congress some ten years ago.

As to your question of cost, if we expand our role to include other elements of reporting or assurance or disclosure, a rigid source of disclosure, there is no question there will be some cost. A lot of the debate is centered around the fact that auditors already know a lot that these things or that should already be in the audit working papers, therefore it is free. Any time you do a report, there is additional quality control, there is additional review, there is going to be some element of cost. And of course today, that is what this project is about, we did not yet have the standards with which we would have to comply. So if there is some cost, the whole notion of value is the information is worth it to those that ultimately foot the bill. So, if there is some cost, so be it, but I think that should be part of this debate is the value add information whatever the cost has classic cost benefit kind of consideration.

**MARK PEECHER:** Let me shift gears here just a little bit and focus instead of on a very topical issue which we will start to resolve in the next several months. And let me ask Bob Moritz the following, whatever happens in the near term with respect to the auditors' reporting model, the investing public will benefit from, very clearly from deeper thought about the changing role of the auditor over the longer term. And we understand, Bob Moritz, that you are heading up an endeavor by the Center for Audit Quality, also known as the CAQ, to take a longer view and to better understand and prove the role of the

public company auditor in the future. So can you tell us a little bit about what is going on with the CAQ in this regard?

**ROBERT MORITZ:** Yes, sure, Mark. Just for people's benefit, the CAQ is an organization that is a combination of representatives of the auditing profession, as well as some public interest members outside of the auditing profession, that does really focus and allow us to come together in this profession say what is it we need to do differently to enhance the quality as well as the integrity of financial reporting process and the role that we play in it. And coming out of the financial crisis, it was clear to us that there were a number of areas of improvement across all the stakeholders including for the auditors. The auditors today have not been viewed as causing the financial crisis, but nonetheless the question has been raised of what could or what would we do differently going forward? So, as a profession under the CAQ, we came together and said two things, number one, status quo is not an option. We, as a profession should be more proactive in thinking through our evolving role and making sure of addressing the needs of our larger stakeholder group.

And second, we concluded that we did not want to put a point of view forward without first engaging and collaborating with other stakeholders. So the work stream that I am leading, and I am just leading on behalf of the entire profession and a number of representatives from the entire profession are helping with the work and doing a great job is, first of, to do the convening of those stakeholder groups. So we held a series of dinners around the country which have brought together in groups of anywhere from 15 to 20 people, investors, standard setters, board members, audit committee members, management being CFOs, CEOs, controllers, et cetera, lawyers and others that are participatory in this process, including representatives from outside the United States that happen to be able to join us. And our question being that we have done to date has come up with, the following observations. To your first question you asked today, there was a consensus that there is value in the audit today but it is appreciated by all of the stakeholders and, yes, the model always could be better, definitely does give us a level of consistency in evaluating whether the financial statements, and in some cases, controls are acting in accordance with the standards set forth. But it is something that is in fact looked at regularly.

The second thing that came through this was the frustration with the reporting model itself. We got into debates around the information that is being provided, we got into debates whether it is too much, too little, not the right information, not the right time, when you look at, what I call the historical, our reliance on 10-Ks and 10-Qs now moving away from that, at times, to more analyst presentations, press releases and data bytes from whatever source maybe out there in a technology-driven world. But there was frustration, there was a lot of rule-making and compliance, more so than what was believed to be the original requirement which was the best mechanism to communicate to investors. And as a result then the question became what is it that a number of stakeholders could do differently? Could, for example, the preparers of financial statements do a better job in clarifying in plain English, not only the financial results but also the risk factors are the key performance indicators that had the responsibility to put forth to the investing community? Could, in fact, to Bob Kuepper's earlier point, the audit committee members that play a critical role in the supply-chain do more in terms of disclosures to investors to perhaps its annual statements to read the proxy, to talk better about the kind of conversations it is having both with management, the auditors and

some of those calls that Bob Kueppers alluded to? And finally could the auditors change what they do?

And in this regard, it was well beyond what the PCAOB has put forth in its concept release which we would view as changes to the today's auditors' report. So, for example, the question put on the table was, should you, in fact, move forward to provide some level of assurance to be determined around management's articulation of risk factors? And know that risk factors are not necessarily are just limited to financial statement risk but rather business risk? And whether the auditor should play that role versus somebody else as an example? Additionally, the topic of what information is provided and when in terms of being relied on by investors is first the question, second could auditors play a different role? So, for example, as you go back and Bob alluded to the role of others has been around for many centuries but if you do go back 80 some odd years ago when the '33 and '34 Acts came about, it was clear that eventually it did rely heavily on your 10-Qs and 10-Ks. Today, some groups of investors rely on that, other groups of investors do not and they do rely on more analyst presentations coming from the street. Maybe the day traders are relying on xyz insight. The individual investors might be reacting to press releases that go out, and the question at the end of the day was if there in fact is some kind of information that would be considered material to the investor, one, is the investor trusting that that information has the appropriate level of credibility to it and integrity, and is there a need for, again independent third party source to objectively and independently assess whether that in fact is the case to enhance trust in the information that is being provided and ultimately relied upon in making investment decisions.

So, overall as we have gone through the first phase of this process, it was to bring together groups of people to come up with different points of view, which again I would argue there were many. And the benefit of this was we did have multiple stakeholder groups around the table as opposed to a single stakeholder group, which obviously everybody comes in with their point of view. And what this did was a great job of bringing a balanced perspective and a more informed perspective to the kind of things that people are interested in and would be supportive of. So, we had some good recommendations coming out. The next stage is for us to think through, what are the possible lists of recommended changes that, in fact, we should be thinking about and that goes to what the auditor's role maybe but as a product, are there other changes that we could give to other interested parties for other stakeholders in the supply-chain? Again, for example, looking at what Bob Kueppers talked about from an audit committee perspective, maybe moving away from the kind of information in today's proxy statements to something that is more qualitative in nature that does get to the kind of conversations that maybe they are having in a privileged way with, not from a legal perspective but a privileged relationship that they have between the audit committee members and ultimately the auditors themselves. Our goal at the end of this next step is to come up with a series of recommendations for consideration to discuss them with one of the stakeholder groups but to the standard setters. The other conclusion is that it was very difficult for people to voluntarily make changes either to their financial reports and all used reports there, because it wasn't the financial statements but it was reporting generally. Because if you are not the first mover, would there be an implied penalty on that? And second, if in fact auditors change something differently or goes to Bob Kuepper's point earlier, will some unintended consequences be that in fact it will be looked at negatively because it is an exception to the norm?

So, again we want to be smart about what kind of proposals we put forth and the recommendations we put forth, ultimately take them maybe to a proposal stage at a later date. But the good news here is, I think the profession is trying to be more proactive and less self serving and is saying to itself, what is it that we can do as a convener of the stakeholders' group in the financial reporting supply-chain and what is that we can propose to be done differently, well beyond perhaps what regulators today are thinking about?

**MARK PEECHER:** Very interesting food for thought and as I think about a lot of things you said, Bob Moritz, I am just contemplating a little bit. It made me wonder whether auditors, if you think about the skills that auditors have today, it is going to take the kinds of activities to do what they do today, do they have the kinds of skills that will help them do what they are going to be asked to do tomorrow? Bob Moritz was talking about auditor involvement in looking at management's articulation of risk factors and even business risk factors, so I would couple to that business modeling skills and related skills. So, Bob Kueppers, is there an investment in human capital that needs to be made?

**ROBERT KUEPPERS:** It is a great question and let me just make a separate point and then I will just do my best to answer your question. I was just thinking as Bob Moritz was taking us through the CAQ efforts on the role of the auditor, it is a pretty big undertaking that he is ably leading.

This program is called the "Role of the Auditor." The concept release on the auditor's report poses a lot of questions about the activities the auditor might not be doing today but should we consider making changes, and that sort of a role of the auditor. And then we have got the CAQ project which is called 'The Role of the Auditor'. What I am trying to say is that the standard setting project that is underway right now will go wherever it goes, in whatever time the PCAOB determines to conclude it. I think the distinction though is, CAQ's work is actually trying to take an even longer view, and I don't know, Bob, if you picked a certain point in time but in the next five or ten years where is this going to evolve to, where should it evolve to? How can we be the most responsive to the people that value the product we produce, and are we producing the right product? So, it is very strategic in that sense. All this gets very confusing because it all sounds alike but they are directionally the same, the mechanisms are different.

On your question of, do we have the skills today for what you will have to do tomorrow? Of course, the easy answer is, I don't know because I am not sure exactly where we are going. I will tell you this though that as you think about some of the feedback we get from investors particularly those that say, "We value the financials but we don't use those as the foundation for an individual investment decisions, we are much more attuned with press releases on new products and prospects with the company going forward, maybe press releases wherever the news is for the quarter that might be driving more investment decisions." The truth is that the firms as organizations, particularly the larger firms have all of these skills that can be deployed against with an audit team. I think your question though fundamentally says, "As we hire so many young people right out of school, do they have the skills they need?" And the answer to that is, sort of, because we spend a lot of time training people and those specialties develop over time as you gain experience. I have always wondered, for example, whether the best auditor might be someone that has not only the accounting background, the auditing skills which you can teach a little bit but generally through experience gain, who also had financial

analyst credentials, had those kinds of abilities to have insight beyond whatever is on a sort of piece of paper in front of you, is true that when we deploy a team of partners, managers, staff. If you take that ladder of experience you look at it as a total body, it is not just what just the individual brings to the table, we have a tremendous breadth of skills beyond what you may otherwise assume.

So, to me this is a fascinating question and I often have recruited auditors from other parts of our firm and say, "Would you guys just spend three years in emerging acquisitions?" He was doing financial modeling of transactions. I love to have people that are non-traditional in terms of the skill sets that they bring to an individual engagement team, and then the trick here is to match up the right people with the right clients to make sure you have got the horsepower you need to do a good job.

**MARK PEECHER:** Bob Moritz, one of the things that Bob Kueppers just mentioned was, on some audit teams, there is going to be some value if one member of that team has perhaps something akin to financial analyst credentials. It brings up another question, a question sometimes I get as a professor. If auditors do not have all the skills that they have or will need to acquire for tomorrow's services or even more contemporaneously, if the investing public really has a very little way of knowing which auditors do possess these skills and which do not. Start thinking about the implications and, of course, I think about implications for college curricula but sometimes I get questions about, why is it, for example, that CPAs, accountants stop with that basic credentialing whereas medical doctors often will go on to be credentials further, for example, by the American Board of Orthopedic Surgery and even within that some sub-specialty credentialing sometimes occurs as with hand surgery? Or maybe your perspective is that this can all be addressed through careful ongoing professional training. So my question is, how do investors know more about the specific capabilities of particular auditors?

**ROBERT MORITZ:** Mark, it is a great question, I guess to first follow up with Bob Kueppers comments. Again, where we go with all this I think is obviously up for debate but we do want to make sure it is a thorough debate and not just assumed that it is going to this place or that place or wherever over periods of time. So, this will evolve over time which goes back to then, are we evolving the relevant skill sets of the people that, A, are in college and universities today and, B, in our firms, to be able to exercise and bring that relevant auditing, accounting and industry experience and functional experience to be able to do the job? I guess there are a couple of reactions, first and foremost, at the end of the day, we are now a regulated business and so we do have a regulator in the PCAOB that is doing a few things, not only it is individual examinations of audits, but also taking a look at the over-arching control systems in the firms to make sure that they are doing all they need to do to ensure a quality audit, that includes taking a look at what kind of people are you recruiting, what kind of training goes on? Are you actually bringing to them the right relevant experiences, as well as training necessary to do the job again to understand the different skill need that are existing today? And to Bob Kueppers point, it is a combination of what gets done in the classrooms, it is a combination of what gets done on the job. And also lets keep in mind it is consistent with what I call the supervisory responsibilities of our leadership teams to make sure that those experiences and knowledges are shared collectively within firms and for that matter across the profession, when it matters most to make sure that we are doing all we can to ensure ultimately that ultimate obligation and mission statement.

So, as I look forward, there is a question of whether or not you need additional credentialing. Now, keep in mind, many of our people do have that additional credentialing. You talk about tax professionals, the credentials they have, when you look about and listen to some of our IT people with IT becoming a bigger and more important part of the audit. So, I think, as we are looking forward and look ahead to the evolving role of auditor and think through what is it that is needed today regardless of extending the role of an auditor, that has changed over time. Number two, as we extend that perhaps to different places, what are the needs and the skill sets and how the colleges, as well as we make sure that we bring together the right education, experience and exposure so people are best positioned to serve the ultimate need? And then finally the combination of the regulatory environment by which we operate as well as the competitive environment by which we operate is actually still a good governing mechanism to make sure we have the right skill sets, which again I will go back to, for example, when we propose on new pieces of work. And I was at one yesterday where the audit committee was specifically asking our firm, tell me more about the experiences and the people you have in xyz area, that aging is another governance mechanism when you are looking at the audit committee and saying that they are responsible for the hiring and or dismissal of individual auditors and it is their responsibility to look at the qualifications of the firms going out today.

So I think it is work in progress, but I do think there is some natural governance mechanisms regardless of enhancements of certifications and to the extent that there is a need for additional certifications or enhancements or leveling of certifications. I think the market demands will create that and we will see the adjustments both in what gets done at the academical level as well as the firm level and then also with the standard setters in the credentialing organizations that we have here in the country. Not only here in the U.S. but obviously as you think about that question, a much broader question globally as well. Bob and I for best part today have been talking about the U.S., this similar issue has equal implications throughout CPAs or the equivalents around the world that they continue to do the same and eventually will talk about something called worldwide standards and obligations as well but that is yet to come.

**MARK PEECHER:** I think that Bob Kueppers may want to jump in here.

**ROBERT KUEPPERS:** Yes, just a follow up comment because I couldn't say it better than Bob Moritz. But I was thinking as he was speaking about one thing that we don't talk about all the time but tremendous value of industry expertise is a good example. I have a partner named Charlie and Charlie has been doing audits of essentially investor-owned electric utilities for almost his whole career. That one individual has seen more than any training I could ever give him, and he has got CPA after his name but I could not even come up with a credential that would capture the value of that experience. It is important to realize that the client or the audit committee will often ask about our expertise but they are not expecting that that the lead partner is going to have every element that is needed but they are expecting that the lead partner can tap into those resources. So everything from certified fraud examiners of whom we have many on staff to not only attack specialists but somebody that understands with depth a certain weird kind of tax credit that is at issue at this company, that is the level it has to get down to. I think it is very hard, Mark, to step back and say, "Here is the answer. Here is the credential we all need." I think it is more of a portfolio approach, and if we do not have it in the firm, we would go out and get it for an individual need.

I think it is a complicated but fascinating question as we get this role of the auditor work to its logical conclusion, whatever that is. I think it is part of the whole series of questions that we are trying to answer.

**MARK PEECHER:** Let me thank you, Bob Kueppers for that and together those answers obviously have a lot of harmony, good food for thought. I want to actually go back to your string quartet for a moment because I think that as students develop their understanding of the environment in which auditing takes place probably one of the least understood roles is that of the audit committee. It is easy for me to see how. Management is held accountable by good auditors and an auditor is now held accountable by what Bob Moritz was saying, it is a regulated profession by inspections and other means, and, yes, by this threat of legal liability. How is it that audit committee members are held accountable for discharging their fiduciary duty to protect shareholders? Unlike auditors, aren't audit committee members given a bit of a more of a safe harbor under the business judgment rule?

**ROBERT KUEPPERS:** I can guess that audit committee members themselves might not agree with you. This judgment rule is interesting but the point is that all audit committee members are board members first. They have fiduciary duties not only because of their board membership as full fledged independent members of the board but they have additional responsibility because of the charter of their audit committee. I am not a lawyer so I cannot play that speculation game but I will tell you that the charter of the audit committee is something that audit committees I am familiar with spend a lot of time on, and while there maybe minor changes from here to there, it is constantly under discussion and review. I think it is less about accountability because I think audit committee members are accountable at the end of the day. It is a shame that the public does not understand with sufficient clarity and depth the importance of how the audit committee works. I was kidding around on this topic saying, some investors have said, we would like know more about what goes inside that audit committee room and my footprint response is, let us just put the meetings on YouTube. The problem with that is there is so much of what is discussed in that audit committee room and in executive sessions is by design not a public activity, but extremely important and in my experience very effective.

One of the ways to unveil the mystery here is to really think about a better way, and a lot of people would not agree with this, but for the audit committees to report their activities. Bob Moritz just said it is in the proxy. What is in the proxy? Because as board members, members of the board, shareholders have to vote for their elections, so you put it in the proxy because there is more information. Why wouldn't it make more sense to put that in the 10-K right alongside management's report, the outside auditor's report, report on internal controls because this is like going to a concert where only three members of the string quartet are listed in the program. It does not make any sense to me. And I will argue another day whether the cello or the viola, or whatever, I just know the audit committee is the second violin. But I am telling you that there is so much good that is done and where we have not done a great job as a system is giving people the insight as to the activities of the audit committee. But that could be solved for with a more responsive kind of reporting regime.

**ROBERT MORITZ:** I think, Mark, maybe before we just get into the next question, I will do a follow up on Bob's point here. I think there is clearly, as Bob said, a lack of transparency what gets discussed in that board room. But again for a good reason

because again if anything were to be listened to and taken out of context, very similar to what we talked about with a matter of emphasis in his own opinion, it really does perhaps lose the relevancy of the comment and, in fact, take away the responsibility of the audit committee management to then deal with that comment and without candidly implicating in any way, shape or form the investor itself for the lack of knowledge around that. But I will say that we need to be smart around this role of the audit committee because again it is not a role of management, it is a role of governance and there are certain fiduciary responsibilities that they have that are outlined. Some of them were outlined further at SOX when Section 404 came out in terms of its obligations for its interaction around the financial reporting model and the auditor's role, specifically within that. So, again as people think about these different roles, that is why we want to make sure we bring together lots of points of view before going through and changing anything to make sure that we are really addressing some root cause issues as opposed to just a surface level issue, which at the end of the day is around meeting our expectations, so we have got to make sure that we are clear in terms of how do we meet most of the expectations but maybe not those that just came to a lot of us throughout this topic.

**MARK PEECHER:** Bob Moritz, let me stick with you here and ask you a question. Suppose you had the capability to talk to some students, who are thinking about going into the profession. And they were wondering what rewards do auditors get if they do a particularly sound job at the audit, or what rewards does the management get for somehow going beyond the mere compliance mentality? Students might see that auditors are expressly disallowed from whistle blower money while others are eligible for it according to the Dodd-Frank provisions, and one that is difficult for me to explain is when an auditor takes a stand and walks away from a fee generating client because of questions perhaps about internal controls or financial reporting. There is really no direct pecuniary reward. As far as I know, audit firm compensation systems do not explicitly reward auditors who unearth material mis-statements or help engineer walking away from clients or do they?

**ROBERT MORITZ:** Great question. Let me deal with from a student's perspective first, which is, at the end of the day the reward for being in this profession and doing the right thing is accommodation of the experience and exposure that is going to make them a better individual later, if they decide to stay with the profession or move on and do something else. Because again it is all around the experience that these individuals get. And I think each of the firms across the entire profession goes to this value of making sure that we have got individuals with the highest levels of integrity that can put themselves in the mirror and feel good about what they did today, what impact that had, ultimately the fact was valued by the investor and other stakeholders. And that is the reward that you get is separate and distinct from compensation benefits and everything else.

I do want to take on your last point though, Mark, which is, and I am speaking with general knowledge, not specific knowledge about the rest of the firms and Bob Kueppers can have this as well. But I do know that each of the firms has a rewards system. So, for example, for their partners, that they are absolutely give enhanced rewards for demonstrating the right behaviors around quality, dealing with and finding issues, managing them in the right way, spending the time, energy and working teams collectively to get to better answers. And, yes, in some cases when we walk away from clients they absolutely are rewarded in the processes that we have in place today. I can speak on behalf of my own firm explicitly around that because we just finished our

compensation process. I know in talking to my counterparts and Bob Kueppers can answer this as well, that they have got similar mechanisms as we think about it because there are clearly risks and rewards, similarly when people don't do a good job miss things, did not handle the matter correctly, et cetera. But there is a risk to their compensation and in fact depending on the severity a fairly big risk.

So, I do want to come back to that because there is this perception that in our compensation systems we don't reward that but that is the farthest from the truth. And I think each of the firms has continued to evolve that over the last number of years as we look ahead.

**MARK PEECHER:** Let me jump in and I am not going to give this due time, but there is an elephant in the room issue that we should probably bring up in a real short time here. Bob Kueppers, maybe your response on the age-old issue of mandatory auditor rotation. How can that or can it improve the financial reporting supply-chain?

**ROBERT KUEPPERS:** I don't know that that is an age-old issue but it is a current issue, I will give you that. I think the real age-old issue is the sufficiency of independence, objectivity and professional skepticism. Anything that could improve that is good for the profession. The question on the table really is, is mandatory rotation a mechanism by which you could improve those elements? To take it to an extreme, you could change your audit firm every year. It would be as objective it could be, but you would absolutely have no idea what is going on. On the other end, should a firm be auditor for 100 years for a company? It is these long term tenured relationships that really tend to get attention. I disagree you have to be careful about the problem we are trying to solve and potential unintended consequences of having sort of an easy answer to a very complex problem. So, my hope is that our regulator and standard setter, the PCAOB will look at this issue with care and in depth before rushing to judgment on anything.

**ROBERT MORITZ:** I will wrap up on that. Bob exactly has hit what I will call the unintended consequences issue, so we need to be smart about this. But I do want to a little bit of a back test to this issue which is, you look at the financial crisis and some will argue again what could have others done differently. None of that leads to in my judgment the issue around mandatory rotation and what that would offer. It absolutely does in terms of the relevancy of what we do and what we report on. So again we want to be very clear in terms of what the problem you are trying to solve for. What are the options to solve that problem, the pros and cons? And let us make sure we come up with the right answer without having to expose ourselves to additional concerns or maybe a detriment around quality and the unintended consequences that may come from.

**ROBERT KUEPPERS:** Well said.

**MARK PEECHER:** Okay, Bob. Bob Kueppers, is there any parting words you would like to share with students about any tangible, intangible which Bob Moritz just talked about that, that tomorrow's auditing profession should be thinking about before investing their human capital in the auditing profession?

**ROBERT KUEPPERS:** I have said this before perhaps but I believe it to this day and that is that auditing public companies is a very high calling indeed. Probably the most memorable days of my life have been tough days where we have walked away from a

client in a bad situation and the professional pride of doing the right thing is more income than I can explain. Those are defining moments in one's career and I just love what I do.

**MARK PEECHER:** Bob and Bob, thank you for this informed discussion. Today's program will be an important addition to the collection of materials on auditing and accounting in the museum. The audio of today's broadcast is now available on [www.sechistorical.org](http://www.sechistorical.org) and an edited transcript will be prepared soon.

I invite you to return on Tuesday, October 18<sup>th</sup> for the next Deloitte Fireside Chat, looking at the SEC role in accounting standards setting. Professor Mark Beasley of North Carolina State University will be the moderator. The presenters will be Loretta Cangialosi of Pfizer, Bob Kueppers and Arthur Wyatt, a former partner at Arthur Andersen and Co. and a former professor at the University of Illinois. A live broadcast will take place at 2pm Eastern Time, free and accessible worldwide without prior registration. You are welcome to send in questions for that discussion to the museum by October 17<sup>th</sup>.

On behalf of the SEC Historical Society, I would like to thank Deloitte LLP for its generous support and assistance in making today's program possible. Thank you for joining with us today. Good afternoon.