May 30, 2023
By email: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards; PCAOB Rulemaking Docket Matter No. 049

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's (PCAOB or the Board) proposed new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (proposed standard or proposed AS 1000) and other proposed amendments to PCAOB Standards. We support the objectives of the proposal as set forth by the Board to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand and apply.

General Observations

We support the PCAOB's mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The principal areas of focus in the Sarbanes-Oxley Act of 2002 were the following four key areas: 1) independent oversight of public company audits by the PCAOB, 2) audit committee responsibility for hiring, firing, and overseeing the external auditor, including fees and independence, 3) enhanced transparency and executive accountability, including the requirement for the CEO and CFO to certify financial reports quarterly and internal control over financial

CENTER FOR AUDIT QUALITY
555 13th Street NW, Ste 425 E
Washington, DC 20004

(202) 609-8120
www.thecaq.org

reporting (ICFR) annually and the independent external auditor attestation on ICFR (based on size of the issuer, as defined), and 4) enhanced auditor independence rules (as overseen and approved by the independent audit committee).

These provisions, which have proved to be durable, protect investors. The auditing profession is committed to its role among the various stakeholders in the US financial reporting ecosystem to protect investors. The provisions of the Sarbanes-Oxley Act reflect a recognition that the quality of financial reporting is not solely the responsibility of auditors. Rather, it takes company management, audit committees, auditors, and regulators working in concert to foster a system that supports both high-quality financial reporting and audits.

As the Board acknowledges in the release text accompanying the proposed standard, "…investors form expectations from a number of sources, including potentially the language of the standards themselves..."[1] As such, it is in the interest of investors and other stakeholders that the auditing standards are clear regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor's report, including the potential limitations.

The Board states on Page 50 of the release text, "The proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards. Thus, no unintended consequences were identified apart from the benefits and costs discussed above."[2] Notwithstanding this assertion, in our view, certain elements of the Board's proposal would expand the auditor's responsibilities and will create confusion for stakeholders, including investors and other users of auditors' reports regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor's report. These consequences – intended or not – have not been contemplated in the Board's economic analysis.

Key Observations

- The proposed standard and related amendments will result in more significant changes than what the Board describes within the release text. Certain aspects of the proposed AS 1000 go beyond current standards and expand the auditor's responsibilities. As such, it does not appear the economic impact of such changes has been contemplated within the Board's economic analysis.

- We agree with the auditor's fundamental role to serve the public interest within the financial reporting ecosystem and enhance the confidence and trust of investors in financial reporting. However, the auditor's role should not be confused with a legal duty owed to investors.

- It is not appropriate for the auditor to be required to make an evaluation of fairness that goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. As stated in extant AS 2815.03, "The independent auditor's judgment concerning the "fairness" of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that

[1] Proposed AS 1000 release text, Page 42.
[2] Proposed AS 1000 release text, Page 50.

framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements."

- Certain proposed changes, such as those related to the principles of due professional care, reasonable assurance, and professional judgment, and the distinction between the responsibilities of management and the auditor, may lead to misunderstanding about the auditor's role and inject confusion into the established legal landscape associated with the role of the auditor. This is not in investors' best interests and will introduce needless uncertainty for auditors and other stakeholders.

- The proposed language used to describe the requirements related to the auditor's competence may imply that the competence required of an auditor to conduct an audit cannot be achieved through the composition of an engagement team with appropriate collective knowledge, skill and ability. Additionally, such language may imply an inappropriate expectation of expertise in areas beyond accounting and auditing.

- Certain of the proposed requirements – specifically those related to the proposed definitions of professional skepticism and the proposed requirement for the auditor to take into account relevant guidance such as releases accompanying the standards, amendments, and rules of the PCAOB - are overly broad and do not provide the auditor with sufficient detail, nor a sufficient framework to allow them to effectively and consistently comply with the proposed requirements.

- We support the proposal to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, subject to sufficient time to implement such a proposal.

See below for responses to specific questions outlined in the release with further details and our recommendations related to these observations.

Specific Feedback

Q1. Are the general principles and responsibilities described in the proposal appropriate for audits performed under PCAOB standards? Are there additional principles or responsibilities that are fundamental to the conduct of an audit under PCAOB standards that merit inclusion in the proposed standard and amendments? If so, what are they and how should they be addressed?

We believe that reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment are appropriate general principles for audits performed under PCAOB standards, and that these principles and related responsibilities provide a foundation for the proper performance of the audit in accordance with the PCAOB standards.

However, the language in proposed AS 1000.01 may lead to misunderstanding about the auditor's responsibilities. We are concerned the proposed language will inject confusion into the established legal landscape in this area. We agree with the auditor's fundamental role to serve the public interest within the financial reporting ecosystem and enhance the confidence and trust of investors in financial reporting. As noted in the release text, "the independent public accountant… owes ultimate allegiance to the corporation's creditors, stockholders, as well as [the] independent public."[3] However, this "allegiance" should not be confused with a legal duty owed to investors.

As such, we recommend the following revisions to paragraph .01 of proposed AS 1000 (language to be deleted is ~~struck through~~; language to be added is underlined) as follows:

> .01 Auditors have a fundamental obligation to ~~protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports, and that obligation governs the auditor's~~ conduct an audit in accordance with ~~work under~~ the standards of the PCAOB~~. An audit primarily benefits investors, who rely on the audit to~~ in order to provide an objective and independent opinion on whether the company's financial statements are presented fairly, in all material respects, and, if applicable, on the effectiveness of the company's internal control over financial reporting. An audit ~~properly~~ conducted in accordance with PCAOB standards and the related auditor's report are intended to enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, internal control over financial reporting.

Q6. Are the proposed requirements related to the auditor's competence clear and comprehensive? If not, why not?

With respect to the competence requirements described in .07 and .08 of proposed AS 1000, we believe it is appropriate that such requirements are applicable to the engagement team collectively, including specialists used to assist the auditor. This is consistent with AS 1010, which refers to the audit being performed by "*a person or persons* having adequate technical training and proficiency as an auditor." (*emphasis* added).

We appreciate the importance of the engagement team collectively having a sufficient understanding of the industry in which the company being audited operates. While this understanding is typically the result of the engagement partner having industry knowledge and experience, there could be circumstances in which the engagement partner relies on other senior members of the engagement team or other individuals within the firm for industry support. For example, some companies may operate in multiple or emerging industries, in which case the engagement team could be composed of a mix of people with knowledge of the different relevant industries. The "Note" in proposed AS 1000.07,[4] when considered in combination with the example in the release text that states, "For example, an engagement partner with significant experience in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee the audit of a financial institution,"[5] could suggest that such an engagement team, even if assisted by specialists and supported by subject matter experts within the firm, may not have the competence to perform an audit of that issuer.

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[3] Proposed AS 1000 release text, Page 16, FN 21.

[4] Proposed AS 1000.07, Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

[5] Proposed AS 1000 release text, Page 20.

Additionally, while we believe it is reasonable to expect an auditor (i.e., an engagement team, collectively) to have expertise in auditing and accounting and to have knowledge of relevant SEC rules and regulations, we do not believe the auditor is expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation, including the legal profession. Proposed AS 1000.07 may be interpreted to mean that an auditor is expected to have a level of expertise in SEC rules and regulations similar to that which would be expected of a lawyer. Lastly, we believe the reference to "the firm's policies and procedures" in proposed AS 1000.07 is unnecessary and redundant.

As such, and to more closely align the language in proposed AS 1000 with that used in other PCAOB standards, we recommend the following revisions to paragraph .07 of proposed AS 1000 (language to be deleted is ~~struck through~~; language to be added is underlined):

> .07 The audit must be performed by an auditor or auditors who, with the appropriate assistance of specialists as needed, collectively have~~s~~ the competence to conduct an audit in accordance with applicable professional and legal requirements. [FN 6 excluded] Competence consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements ~~and the firm's policies and procedures~~, including experience in the industry in which the company being audited operates and knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations. The measure of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time.
>
>> ~~Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.~~

Q7. Are the proposed requirements and related descriptions of the general principles (i.e., reasonable assurance, due professional care, professional skepticism, and professional judgment), clear and comprehensive? If not, why not?

It is in the best interest of investors and other stakeholders that the auditing standards provide transparency regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor's report, including the potential limitations of an auditor's report. While we support the Board's objective of modernizing the auditing standards, as noted above, we are concerned that certain elements of the Board's proposal, including the proposed elimination of certain contextual language from the extant standards, may have the effect of introducing confusion and reducing the level of such transparency. Some of the concepts in the auditing standards are relatively technical and complex, making contextual language helpful in describing and facilitating a reader's understanding of what they are and sometimes, even more importantly, what they are not.

Specifically, our observations and related recommendations are as follows:

Due professional care

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As stated within the release text, "The concept of due professional care is described in AS 1015 by quoting a 1932 legal treatise. We [the Board] believe the reference to that treatise is unnecessary and are proposing to describe in plain language the concept of due professional care, without changing its meaning."[6] While we agree that referring to a 1932 legal treatise seems outdated, we recommend certain concepts regarding the potential limitations of an auditor's report and what investors and other stakeholders can expect of an auditor in the performance of an audit – which is good faith and integrity, but not infallibility – should be retained, particularly because the proposal expressly states that the meaning of due professional care is not changing. Retaining this concept provides investors and other stakeholders with information that may be important to their capital allocation decisions.

As such, we recommend the following revisions to paragraph .09 of proposed AS 1000 (language to be added is <u>underlined</u>):

> .09 The auditor must exercise due professional care in all matters related to the audit. [FN 9 excluded] Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements<u>,</u> [FN 10 excluded] <u>but does not imply infallibility</u>. <u>An auditor should possess the degree of skill commonly possessed by others in the public accounting profession. But even a skilled auditor acting in good faith may at times make an error in judgment. The auditor may be determined to be responsible for losses caused by the auditor's own negligence, bad faith, or dishonesty, but not for losses related to pure errors of judgment.</u> For engagement partners, [FN 11 excluded] due professional care includes (1) appropriately assigning responsibilities to, [FN 12 excluded] and supervising, [FN 13 excluded] engagement team members; [FN 14 excluded] (2) determining that the audit is properly planned [FN 15 excluded] and performed to obtain reasonable assurance; [FN 16 excluded] (3) evaluating that significant findings or issues are appropriately addressed; [FN 17 excluded] (4) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence; [FN 18 excluded] and (5) determining that required communications under applicable professional and legal requirements have been made. [FN 19 excluded]

Reasonable assurance

We strongly support the Board's proposal to retain the concept of reasonable assurance and the corresponding description from AS 1015 as a high level of assurance. However, we have concerns regarding the exclusion of the description of the limitations of an audit currently provided in AS 1015 paragraphs .10 through .13. Certain concepts discussed within these paragraphs have continued relevance and provide valuable context regarding the potential limitations of an auditor's report and what investors and other stakeholders can expect of an auditor in the performance of an audit, specifically, that the auditor is not an insurer and the auditor's report does not constitute a guarantee (as the Board has not indicated in the proposing release that it has changed its view on this topic). We believe this level of transparency is in the best interest of investors and other stakeholders and provides them with information that may be important to their capital allocation decisions.

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[6] Proposed AS 1000 release text, Page 22.

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As such, we recommend the following revisions to paragraph .14 of proposed AS 1000 (language to be added is <u>underlined</u>):

> .14 Reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence. [FN 25 excluded] The auditor is able to obtain reasonable, but not absolute, assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected. <u>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot, therefore, obtain absolute assurance that the financial statements are free from material misstatement, whether caused by error or fraud, or about whether any material weaknesses exist as of the date of management's assessment. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from the nature of financial reporting and the nature of audit procedures. Since the auditor's opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her report does not constitute a guarantee.</u>

Distinction Between Responsibilities of Auditor and Management

The distinction between the responsibilities of the auditor and of management is important for users of financial statements to understand and for the efficient and effective functioning of the capital markets. As stated in the release text, "The proposed standard [further] retains the distinction between the responsibilities of the auditor and management and expands those responsibilities to include an audit of ICFR. We [the Board] are proposing to streamline the language from AS 1001 and describe the respective responsibilities by leveraging the language used to describe the responsibilities in the auditor's reports on the audit of financial statements [FN 57 excluded] and the audit of ICFR. [FN 58 excluded] The phrase "the financial statements are management's responsibility" encompasses the preparation of the financial statements by management, including adopting sound accounting policies and establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements."[7]

Certain language from paragraphs .02 and .03 of AS 1001 that describes the distinction between the responsibilities of the auditor and management and explains the premise on which the audit is conducted is important to retain. One of the reasons for the success of the Sarbanes-Oxley Act is not just the elements that have enhanced audit quality, including the establishment of the Board, but the important elements that strengthened the quality of financial reporting, which is management's responsibility. It is critically important for stakeholders to clearly understand this distinction.

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[7] Proposed AS 1000 release text, Page 26-27.

As such, we recommend the following revisions to paragraph .13 of proposed AS 1000 (language to be added is <u>underlined</u>):

> .13 The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to:
>
> a. Obtain reasonable assurance about whether:
>
> (1) In an audit of financial statements, the financial statements are free of material misstatement, [FN 22 excluded] whether due to error or fraud; [FN 23 excluded]
>
> (2) In an audit of internal control over financial reporting, material weaknesses exist as of the date specified in management's assessment; and
>
> b. Provide the auditor with a reasonable basis for forming an opinion. [FN 24 excluded]
>
> Note: In an audit of financial statements, the financial statements are management's responsibility and the auditor's responsibility is to express an opinion on the financial statements. In an audit of internal control over financial reporting, management is responsible for <u>establishing and</u> maintaining effective internal control over financial reporting and for assessing the effectiveness of internal control over financial reporting, and the auditor's responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting. <u>An audit is conducted on the premise that management has acknowledged and understands that they have responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of these matters and internal control is limited to that acquired through the audit. Thus, the fair presentation of financial statements in conformity with the applicable financial reporting framework is an implicit and integral part of management's responsibility.</u>

Professional Skepticism

As stated within the release text, "The proposed standard retains the concept of professional skepticism in substantially the same form as it is described in AS 1015. The proposed standard describes professional skepticism as an attitude that includes a questioning mind and a critical assessment of information related to the audit. In describing the concept, we propose to use 'information related to the audit' rather than 'audit evidence' (as described in AS 1015) to emphasize that application of professional skepticism extends beyond the information used as audit evidence in arriving at conclusions on which the auditor's opinion is based. For example, by exercising professional skepticism in the preparation of Form AP, the auditor may become aware of inconsistencies in total audit hours reported by another accounting firm participating in the audit and take corrective action."[8]

While it is reasonable and practicable for an auditor to "... exercise due professional care in all matters related to the audit," as required by proposed AS 1000.09, including in the preparation of Form AP and other reports to regulators, the extension of the concept of professional skepticism in proposed AS 1000.10 from the extant critical assessment of "audit evidence" to a critical assessment of "information related to the audit" is overly broad. There may be a significant amount of information related to the audit, and without a more specific definition, it is unclear what this requirement encompasses. Additionally, while AS 1105, *Audit Evidence,* provides a framework for the auditor to use in critically assessing audit evidence, it is unclear what framework the auditor would use to perform a critical assessment of information related to the audit that goes beyond audit evidence.

As such, we recommend the following revisions to paragraph .10 of proposed AS 1000, which would revert back to the language in extant AS 1015.07 (language to be deleted is ~~struck through~~; language to be added is <u>underlined</u>):

> .10 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of ~~information related to the~~ audit <u>evidence</u>.

We offer our observations regarding the introduction of the concept of auditor bias in proposed AS 1000.11. As stated within the release text, "[In addition,] in exercising professional skepticism, the auditor would consider the impact of management bias and the auditor's own bias that could affect the auditor's own judgments. For example, the tendency to seek confirming information can lead the auditor to seek audit evidence that is only consistent with management's explanations, or to favor conclusions that are consistent with the auditor's initial beliefs. In exercising professional skepticism, the auditor could mitigate such bias by being aware of 'confirmation bias,' considering alternatives provided by others, and seeking contradictory information as evidence. [FN 47 excluded]"[9] While we acknowledge that an auditor, like any person, may be susceptible to bias, we believe that AS 1105, *Audit Evidence*, addresses the auditor's requirements related to obtaining sufficient appropriate audit evidence, the assessment of which inherently encompasses consideration of auditor bias. The requirement to consider potential bias on the part of the auditor as currently proposed in AS 1000.11e is overly vague, is not accompanied by a framework with which to perform such an assessment, and may create an undue burden on the auditor to identify and document their consideration of any and all possible ways in which their judgments could be affected, as well as how such considerations have been addressed.

As such, we recommend the following revisions to paragraph .11 of proposed AS 1000 (language to be deleted is ~~struck through~~):

> .11 The auditor's exercise of professional skepticism includes:

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[8] Proposed AS 1000 release text, Pages 23 – 24.
[9] Proposed AS 1000 release text, Page 24.

a. Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence; [FN 20 excluded]

b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;

c. Not relying on evidence that is less than persuasive;

d. Not assuming that management is honest or dishonest; and

e. Consideration of potential bias on the part of management~~ and the auditor~~.

Professional Judgment

We also have concerns regarding the definition of "professional judgment" in proposed AS 1000.12. The inclusion of the clause 'such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements' creates a strict liability requirement in PCAOB auditing standards. The inclusion also does not take into account the reasonableness of the auditor's conclusions and could result in hindsight challenges of auditor's judgments.

The definition suggests that, for one to conclude that professional judgment was exercised, the course of action that an auditor takes must not only be "appropriate in the circumstances" but also cause the audit to be performed "in accordance with applicable professional and legal requirements." This definition may turn out to be, in many cases, a circular one in that the question of whether an auditor complied with professional and legal requirements will often depend on whether a particular decision was within the scope of their professional judgment. Additionally, the definition implies that, should the conclusion be reached that an applicable professional or legal requirement was violated, then by definition the auditor did not appropriately exercise professional judgment. This implication would be contrary to the established interpretation of an auditor's responsibilities, which recognizes that reasonable observers may disagree regarding whether applicable standards were complied with while agreeing that the matter in question was within the purview of the auditors' professional judgment.

As such, we recommend the following revisions to paragraph .12 of proposed AS 1000, which retains certain concepts from the existing definition of "professional judgment" in AS 1001.05, (language to be deleted is ~~struck through~~; language to be added is <u>underlined</u>):

> .12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience <u>in determining which auditing procedures are necessary in the circumstances</u> to ~~make informed decisions and~~ reach well-reasoned conclusions <u>and afford a reasonable basis for the issuance of the auditor's report</u> ~~about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements~~.

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Q9. Is the proposed requirement for the auditor to take into account relevant guidance such as PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB appropriate? If not, why not?

Relevant guidance such as PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB provide useful information that can be helpful to auditors in applying the requirements of the standards. With that said, we offer some observations regarding the challenges of complying with the proposed requirement in FN 26 of AS 1000.15 in a consistent manner as proposed.

As part of its standard-setting process, the Board may issue multiple documents, including concept and proposing releases, over a period of years setting out its intent in relation to proposed standards. To facilitate auditors' appropriate consideration, it would be helpful for the PCAOB to codify and clearly delineate what is relevant guidance in the accompanying release (for example, the Executive Summary, Background, Overview of Final Rules). We believe it would be appropriate for such accompanying release text of only the final standards to be authoritative, as previous discussions in proposals or concept releases may have been superseded as a result of cumulative changes made during the standard setting process. Further, information from economic analyses presumably would not be considered relevant guidance. Revising the manner in which relevant guidance is presented would also better afford stakeholders the opportunity to comment on this guidance during the rulemaking process. Additionally, we recommend that the Board clarify what is encompassed within "Board-issued guidance," as there is currently no category of guidance available on the PCAOB website with this heading or description.

As such, we recommend the following revisions to paragraph .15, FN 26 of proposed AS 1000 (language to be added is <u>underlined</u>):

> .15 The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors.
>
> > Note: The auditor should take into account relevant guidance[26] applicable to the audit.
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> FN 26: Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the <u>final</u> standards and <u>final</u> rules of the Board.

The Board states in the release text that, "To the extent that auditors are not taking into account relevant guidance applicable to the audit, as proposed in paragraph .15 of the proposed standard, those firms would also incur one-time and ongoing costs related to methodology and periodic training for relevant guidance."[10] While we agree with this statement, it may not capture the full extent of costs that will be incurred. Even when auditors have been taking such guidance into account – whether at the individual engagement team level or as part of a firm's guidance and methodology – it may not have been done in

[10] Proposed AS 1000 release text, Page 48.

a consistent and formal manner. Additionally, without codification and clear delineation of what is relevant guidance, as described above, such costs will be even higher.

Q10. Are the proposed amendments to clarify the meaning of "present fairly" appropriate? If not, why not?

As stated within the release text, "Our [the Board's] proposed movement of requirements from AS 2815 into AS 2810 includes an important clarification of the auditor's existing responsibilities. Specifically, the amendments would clarify that the auditor's evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. U.S. federal securities laws prohibit the financial statements and company disclosures from being materially misleading, [FN 67 excluded] which is a broader concept than mere compliance with the applicable financial reporting framework. Presented fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework. However, the existing standards may not be sufficiently clear that the auditor's obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework."[11]

We do not agree that the auditor has an existing responsibility under the extant standards to evaluate the fairness of the financial statements beyond the evaluation of whether they are presented in conformity with the applicable financial reporting framework. Currently, AS 3101.08e (to which the Board has not proposed changes as part of this exposure draft) describes that the first section of the auditor's report must include the following elements – "An opinion that the financial statements present fairly, in all material respects, the financial position of the company as of the balance sheet date and the results of its operations and its cash flows for the period then ended *in conformity with the applicable financial reporting framework*. [FN 16 excluded] The opinion should also include an identification of the *applicable financial reporting framework*." (*emphasis* added). As directly referenced in the auditor's report, the auditor's responsibility is to evaluate whether the financial statements are presented in conformity with the applicable financial reporting framework. Additionally, as defined in section (a)(v) of PCAOB Rule 1001, Definitions of Terms Employed in Rules, "[t]he term 'audit' means an examination of the financial statements, reports, documents, procedures, controls, or notices of any issuer, broker, or dealer by an independent public accounting firm in accordance with the rules of the Board or the Commission, *for the purpose of expressing an opinion on the financial statements or providing an audit report*." (*emphasis* added).

Further, it is not appropriate for the auditor to be required to make an evaluation of fairness that goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework – particularly as part of a proposal whose stated purpose is to modernize the Board's standards and not "impose new requirements on auditors or significantly change the requirements of PCAOB standards."[12] As currently stated in AS 2815.03, "The independent auditor's judgment concerning the 'fairness' of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that framework, the auditor

[11]Proposed AS 1000 release text, Page 30.
[12] Proposed AS 1000 release text, Page 50.

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would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements."

The language in proposed AS 2810.30, FN 17A and AS 2810.30A not only imposes an inappropriate requirement for the auditor to make a judgment concerning the fairness of the overall presentation of the financial statements that goes beyond the applicable financial reporting framework, but also potentially requires auditors to make a legal judgment regarding certain disclosures that are not required by the applicable framework. In our view, the proposed requirement could lead to claims that the auditor would be essentially standing in the shoes of an issuer's management and its disclosure counsel and assessing whether - notwithstanding the issuer's compliance with the extensive information and disclosure obligations imposed by the applicable financial reporting framework and SEC requirements – the issuer's financial statements should contain additional information in order not to be misleading. As discussed in our response to Q6, we do not believe the auditor is expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation, including the legal profession. Moreover, professional standards applicable to the audit profession do not articulate a standard against which the auditor is to make that determination. As such, it is not reasonable to expect an auditor to be able to make legal judgments in this area.

Further, in considering the language in proposed AS 2810.30A, we assume that the term "financial statements," including the reference to "disclosures," is intended to be defined in the same way that the term "financial statements" is defined in AS 3101.01 FN1 (both current and proposed).[13] To the extent the term "disclosures" as used in proposed AS 2810.30A is intended to include disclosures beyond the notes to the financial statements and related financial statement schedules, as defined in AS 3101.01 FN1, our concerns would be broader than those articulated above.

Additionally, we are concerned that the addition of FN 17A in proposed AS 2810.30 may even go so far as to imply that SEC Rule 12b-20 17, C.F.R. § 240.12b-20 is applicable to the auditor (i.e., that the auditor has the same legal responsibility under this rule as the issuer).[14] We acknowledge that the issuer's requirement under this rule to disclose information as necessary to make the financial statements not misleading is something the auditor should keep in mind. However, it is not appropriate to indicate that

[13] Proposed AS 3101.01 This standard establishes requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements[1] (the "auditor's unqualified report").

> FN 1 This standard uses the term "financial statements" as used by the U.S. Securities and Exchange Commission ("SEC") to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, Identifying and Assessing Risks of Material Misstatement.

[14] See Appendix 2 – Proposed Amendments to AS 2810; Recission of AS 2815, FN 17A, "For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose "in a statement or report … such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.")."

this legal principle that is applicable to registrants' securities filings and disclosures more broadly be applied to the auditor – again, as part of a proposal where the cost/benefit analysis has been performed on the basis of not imposing new requirements on auditors.

We are also concerned with the proposed exclusion of the concept of "within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in the financial statements" included in existing AS 2815.04. The applicable financial reporting framework against which the auditor is assessing the conformity of the financial statements may allow for a range of acceptable alternatives. By eliminating this language, the proposed standard suggests that an auditor should make an independent assessment of the financial statements based on the auditor's own judgment, as opposed to making an objective assessment of management's application of the financial reporting framework, considering alternatives that are permissible under that framework.

Paragraph .06 of extant AS 2815 states that, "Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form." With regards to the language used in the Note within proposed AS 2810.31, which states, "The auditor should also evaluate whether the substance of transactions or events differs materially from their form," the elimination of the reference to generally accepted accounting principles (or the applicable financial reporting framework) may imply that the auditor has a responsibility to assess the substance of a transaction beyond the applicable financial reporting framework. For the same reasons outlined within the paragraphs above with respect to the concept of "present fairly," this would not be an appropriate requirement of an auditor.

As such, we strongly recommend the following revisions to paragraphs .30 and .30A of proposed AS 2810 as follows (language to be deleted is ~~struck through~~; language to be added is underlined):

> .30 The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.[~~17A~~]
>
> > Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.[17A~~B~~]
>
> ~~[17A] For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose "in a statement or report … such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.").~~
>
> [17A~~B~~] AS 2820, Evaluating Consistency of Financial Statements, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.
>
> .30A When evaluating whether the financial statements present fairly the financial position, results of operations, cash flows, and disclosures, in all material respects, in conformity with the applicable financial reporting framework, the auditor should evaluate whether:[17B, ~~17~~C]

a. The information in the financial statements is presented and classified ~~appropriately and in a manner that would be informative and not misleading to a reasonable investor~~ in conformity with the applicable financial reporting framework and is informative of matters that may affect their use, understanding and interpretation;

b. The accounting principles selected and applied by the company's management are in conformity with the applicable financial reporting framework and appropriate in the circumstances; and

c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements, and their substance does not differ materially from their form.

[17B] This standard uses the term "financial statements" as used by the U.S. Securities and Exchange Commission ("SEC") to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, Identifying and Assessing Risks of Material Misstatement.

[17C] The concept of materiality is inherent in the auditor's judgment. That concept involves qualitative as well as quantitative factors (see AS 2105, Consideration of Materiality in Planning and Performing an Audit).

.31 As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.[18] Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

~~Note: The auditor should also evaluate whether the substance of transactions or events differs materially from their form.~~

[18] See AS 3105.24-.27 for auditor reporting considerations related to inadequate disclosures.

Q13. Is the proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention from 45 days to 14 days from the report release date appropriate? If not, why not?

We support the Board's proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention from 45 days to 14 days from the report release date.

As acknowledged by the Board in their economic analysis, firms currently have varied archiving policies and practices, and some small firms still use paper-based workpapers. For certain firms, this proposed change will require changes to systems and technology, which will take time and impacts methodology, policies, practices and behaviors. It is important that firms have sufficient time to adopt this requirement. Refer to our response to Q25 for specific recommendations.

Q25. Would requiring compliance on June 30 the year after approval by the SEC present challenges for auditors? If so, what are those challenges, and how should they be addressed?

We recommend that the effective date be tied to audits of fiscal years, as implementing the standard mid-year when audits are already in process would be challenging. This is especially important given the proposal changes not only the foundational standards, but also various performance standards.

As noted within our response to Q13, it is important that firms have sufficient time to adopt an amendment to accelerate the documentation completion date as proposed by the Board. Further, we believe that the need for firms to have sufficient time to adopt proposed AS 1000 and the related amendments is broader than just that matter.

With respect to proposed AS 1000, while the Board has indicated that "the proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards,"[15] as expressed throughout this letter, we are concerned that certain elements of the Board's proposal expand the auditor's responsibilities and will create confusion for investors and other users of auditor's reports regarding the responsibility of the auditor. It will be necessary for firms to perform extensive analyses to evaluate how the final AS 1000 will impact engagement teams and how firm methodologies and guidance will need to be updated. Additionally, it will take time for firms to develop and deliver trainings, taking into account normal training cycles. In addition to proposed AS 1000, the Board has proposed changes to various performance standards which, similarly, will take time to analyze and to build into methodologies, guidance, and training. Further, the larger firms will need time to implement any necessary changes and trainings globally.

As such, assuming the SEC approves the final standard before the end of calendar year 2023, we recommend a final standard be effective no earlier than for audits of financial statements for periods beginning on or after December 15, 2024 to allow ample time for this transition. We also ask the Board to consider the other ongoing standard-setting projects and to bear in mind that auditors could be in a position where they are required to implement QC 1000, the Auditor's Use of Confirmation standard, and AS 1000 (and related amendments) at the same time. With this pace of change, it is critical that auditors have sufficient time to thoroughly evaluate and effectively train their professionals on new and amended standards in order to avoid an unintended negative impact to audit quality.

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[15] Proposed AS 1000 release text, Page 50.

The CAQ appreciates the opportunity to comment on the Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, and we look forward to future engagement. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org) or Emily Lucas (elucas@thecaq.org).

Sincerely,

Vanessa Teitelbaum, CPA
Senior Director, Professional Practice
Center for Audit Quality

cc:

PCAOB
Erica Y. Williams, Chair
Duane M. DesParte, Board member
Christina Ho, Board member
Kara M. Stein, Board member
Anthony C. Thompson, Board member
Barbara Vanich, Chief Auditor

SEC
Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant