

May 27, 2010

Ms. Jennifer Rand, Deputy Chief Auditor  
Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

By e-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)


**Re: PCAOB Release No. 2010-001 – Proposed Auditing Standard Related to  
Communications with Audit Committees  
(PCAOB Rulemaking Docket Matter No. 030)**

Dear Ms. Rand:

The New York State Society of Certified Public Accountants, representing 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned release.

The NYSSCPA's SEC Practice Committee and Auditing Standards Committee deliberated the release and prepared the attached comments. If you would like additional discussion with us, please contact Anthony S. Chan, Chair of the SEC Practice Committee at (212) 331-7653, Robert N. Waxman, Chair of the Auditing Standards Committee at (212) 755-3400, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



David J. Moynihan  
President

Attachment

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**PCAOB RELEASE NO. 2010-001 – PROPOSED AUDITING STANDARD RELATED TO  
COMMUNICATIONS WITH AUDIT COMMITTEES**

**(PCAOB RULEMAKING DOCKET MATTER No. 030)**

**May 27, 2010**

**Principal Drafters**

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**Robert W. Berliner  
Elliot A. Lesser**

***From the SEC Practice Committee:***

**Douglas J. Beck  
Anthony S. Chan  
Mitchell J. Mertz  
Rita M. Piazza  
Robert E. Sohr  
Stephen A. Scarpati  
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# **New York State Society of Certified Public Accountants**

## **Comments on**

### **PCAOB Release No. 2010-001 – Proposed Auditing Standard Related to Communications with Audit Committees (PCAOB Rulemaking Docket Matter No. 030)**

We are pleased to comment on your proposal, “Proposed Auditing Standard Related to Communications with Audit Committees” (the “Proposal”). We support the efforts of the Public Company Accounting Oversight Board (the “Board”) to improve the standards for auditor communications with audit committees, and we offer the following suggestions for its improvement.

#### **Communication**

The Proposal appropriately emphasizes the need for a robust, open and substantive dialogue between audit committees and auditors. Our experience particularly with many smaller and less sophisticated registrants is that the audit committee does not always sufficiently interface with management, and therefore we believe that this dialogue needs to be three-way: audit committee, management and the auditors. We recognize that the Board does not have authority over audit committees and management; however, the Proposal should encourage and emphasize the need for a robust and substantive three-way dialogue by these smaller and less sophisticated companies. To that end the Board should consider the benefits of a companion release providing guidance and best practice for a registrant’s audit committee and its management. This companion release should be issued with the approval of the SEC which has the regulatory power to provide guidance, rules, etc. to registrants and their governance practices.

With regard to the Note at the end of paragraph 12 of the Proposal, this exception reporting by the auditor is unworkable. It would require that the auditor have knowledge of every communication by management to the audit committee throughout the year, evaluate that communication, and then report to the audit committee whether or not the matters were adequately described or not communicated, and then report on these inadequately described or omitted matters. This is not a reasonable expectation that should be placed on the auditor.

Management is responsible for financial reporting and for the selection of appropriate accounting policies and practices including making reasonable estimates of the potential outcome of subjective matters. Management should have the primary responsibility for discussing such matters with the audit committee. The audit committee has the responsibility to oversee the Registrant’s financial controls and financial reporting processes on behalf of the Board of Directors and to report the results of its activities to the full Board.

## **Consultations**

The Proposal requires the auditor to communicate to the audit committee significant accounting matters on which the auditor has consulted outside the engagement team. The objective is to provide the audit committee with information about complex transactions that may be of high risk or controversial. We agree with this objective. We also believe that such consultations should be encouraged; the more thought that is brought to bear in forming a conclusion about complex accounting matters will usually result in a better outcome. The fact that consultations outside of the engagement team will need to be communicated to the audit committee, however, might cause the engagement team to re-think whether or not it wants to consult; nevertheless, full and open consultations need to be encouraged.

Some consultations, however, outside of the engagement team may be more routine in nature. For example, the engagement team may be simply confirming its understanding of the appropriate application of a new complex accounting standard. Also, the engagement team may be required to consult by firm policy on a potentially risky issue that it determines to be a normal risk based on the specific circumstances, and the consulted parties agree. The Proposal should clarify that only consultations about issues meeting the objective of high risk, controversial or unusual matters need to be communicated.

## **Comments on Specific Questions**

Below, we offer comments on the specific questions raised in the Proposal. The questions are reprinted, followed by our response.

### **A. Objectives of the Auditor**

1. Are the objectives of the auditor in the proposed standard appropriate? If not why? Should others matter be included in the objectives?

### **Response**

We believe the objectives in the proposed standard are appropriate. AU 310.05 requires that the auditor establish an understanding with the client and document that understanding which includes, among other things, a description of the auditor's responsibilities. Communicating to the audit committee an "overview of the audit strategy and timing of the audit" provides the audit committee with a clear understanding as to the reasons for the audit scope and underlying risks that concerns the auditor.

By "providing the audit committee with timely observations that are significant and relevant to the financial reporting process," the audit committee can make recommendations to the auditor to expand the scope of work or require management to take necessary action to improve the financial reporting process and seriously address auditor and audit committee concerns on a timely basis.

The last objective of "evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit," places a greater responsibility on the auditor. This requires the auditor to evaluate the effectiveness of the audit committee and requires the audit committee to be actively engaged in the oversight of the audit and financial reporting process. While we believe this would be a positive in improving the

process and ultimate outcome, there needs to be guidance when the auditor concludes the two-way communications are not adequate.

We do not believe any other matters should be included in the objectives.

2. Are the objectives adequately articulated? Should the articulation of the objectives focus on the outcome that should be achieved by performing the required procedures?

**Response**

We believe the objectives are clearly articulated. Furthermore, we do not believe the articulation of the objectives should focus on the outcome since that is a matter of auditor judgment.

**B. Establish a Mutual Understanding of the Terms of the Audit**

3. Is it appropriate for the proposed standard to require that an engagement letter be prepared annually? If not, why?

**Response**

We believe it is appropriate for the proposed standard to require that an engagement letter be prepared annually. The engagement letter is the primary document memorializing the understanding with the audit committee and the company as to management's and the auditor's respective roles and responsibilities. Requiring the letter annually serves to reinforce and remind the parties to the letter of that understanding. Moreover, the audit committee can change over time and therefore, the new members must become fully acquainted with these roles and responsibilities shortly after they are appointed and the annual engagement letter provides that vehicle.

4. Are there any other matters that would enhance investor protection that should be added to the engagement letter? If so, what other matters should be included in the engagement letter?

**Response**

The engagement letter represents the understanding between auditor, audit committee and the company and should not offer protections to the investor. Any attempt at using the engagement letter to provide investor protections might increase the auditor and/or audit committee's exposure to liability. A GAAP compliant 10-K with appropriate disclosures, among other sources of company information, allowing the investor to make informed decisions is the best protection. Although discussed in AU 310.06, the description of the auditor's responsibility for the detection of fraud is one matter that we believe should be added to an engagement letter and emphasized to ensure the proper communication of the role and responsibilities of the auditor.

**C. Obtaining Information Related to the Audit**

5. Is the proposed requirement to inquire of the audit committee appropriate? What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

**Response**

Yes. The audit committee becomes aware of information concerning matters impacting the financial statements that management may not fully share with the auditors. The requirement for the auditor to make inquiries of whether the audit committee is aware of other matters relevant to the audit is overly broad and vague. It would be helpful if guidance were provided in the standard as to specific matters of inquiry such as the audit committee's knowledge of the company's governance policies; anti-fraud programs; inherent risks, control risks, and the company's risk tolerance (both in total and in specific areas); accounting estimates, significant accounting policies, liquidity and solvency matters, *etc.* In addition, the auditor should inquire regarding any concerns that the audit committee has, in effect, asking, "What keeps them up at night?"

**D. Overview of the Audit Strategy and Timing of the Audit**

6. Are the requirements to provide information on the auditor's audit strategy and timing of the audit appropriate? Does the auditor need more guidance related to the requirement to provide information on the auditor's audit strategy? If so, what type of guidance would be helpful?

**Response**

Yes. Audit committees consist of directors independent of management and can better fulfill their oversight role over the financial reporting process and internal accounting controls through a clear understanding of the auditor's audit strategy and how this addresses audit risk. Audit committees can then aid in the audit process by exerting pressure on management where the auditor is encountering difficulties in the process. The auditor should communicate an overview of the audit strategy early in the audit if it is to have the necessary effect. The guidance for the auditor to provide information on the audit strategy is sufficient. We agree with the guidance in paragraph 9 that the communication of an overview of the audit strategy not provide specific details that would compromise the effectiveness of the audit procedures. This guidance is particularly important and should be given greater emphasis by its direct inclusion in paragraph 9 (i.e., not as a note thereto). The detail of what information is communicated should be determined by the auditor's judgment.

7. Is it sufficiently clear which types of arrangements should be communicated to the audit committee related to the roles, responsibilities and locations of firms participating in the audit?

**Response**

While the proposed standard makes it clear that the auditor should communicate to the audit committee "the roles, responsibilities, and locations of firms participating in the audit," we believe additional guidance should be provided to make an exception from this requirement with respect to firms in the same international partnership or network. Because of the use of a common audit methodology, common training, *etc.*, many firms accept the work of firms so affiliated as their own. Therefore, we do not believe disclosure of this information about these firms would be beneficial to the audit committee when the principal auditor is taking responsibility for work of other auditors. Further clarification of the conditions which need to be communicated should be provided. Guidance is needed on what information about the roles and responsibilities of other auditors would be relevant and on the level of detail required



## **E. Accounting Policies, Practices and Estimates**

8. Are the proposed requirements regarding the auditor's communication responsibilities with respect to accounting policies and practices sufficiently clear in the proposed standard (*e.g.*, is the difference between a critical accounting policy and a significant accounting policy or practice adequately described?)

### **Response**

Generally, we believe the requirements are sufficiently clear. It would be helpful to clearly define *significant* and *critical* accounting policies in Appendix A and provide additional examples of the differences between a *critical* and a *significant* accounting policy and give examples of each.

9. Is it helpful to include in the proposed standard the communications required by the SEC relating to accounting matters?

### **Response**

Yes. The audit committee should be informed about the impact of applying proposed or anticipated new accounting standards or regulatory pronouncements. This would enable the audit committee to oversee and evaluate how management is addressing new pronouncements, whether they are being addressed in a timely manner, and what impact they will have on the financial statements.

10. Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated with the audit committee?

### **Response**

Yes. We believe the nature of critical accounting estimates is clearly defined in terms of subjectivity, judgment and material impact on the financial statements.

11. Are the communication requirements regarding critical accounting estimates appropriate? If not, how should the proposed standard be modified to provide appropriate information to the audit committee?

### **Response**

Yes. When critical accounting estimates involve a range of possible outcomes, the basis for the assumptions selected in arriving at those outcomes should be communicated to the audit committee. The audit committee is then in a better position to understand and evaluate the subjectivity and sensitivity of the assumptions and their impact on management's estimates.

## **F. Management Consultations with Other Accountants**

12. Should this requirement be expanded to include consultations on accounting and auditing matters with non-accountants, such as consulting firms or law firms?

### **Response**

As to whether the requirement to communicate consultations by management with other auditors should be expanded to include consultations on accounting and auditing matters with

non-accountants, we believe the need for such communication should be left up to the auditor depending on the facts and circumstances and the significance of the consultation to the financial statements.

### **G. Going Concern**

13. Is the communication requirement on going concern clear? If not, how could this be clarified?

#### **Response**

Item G *Going Concern* provides “if the auditor’s doubt is not mitigated...the proposed standard requires certain additional matters be communicated.” The last sentence of the second paragraph of item G, page 14, of the proposed standard provides: “If the auditor’s doubt is not mitigated and the auditor concludes that there is substantial doubt about the company’s ability to continue as a going concern, the proposed standard requires additional matters be communicated.” It is not clear what additional matters need to be communicated when the auditor’s doubts are not mitigated. If the proposed standard’s requirements apply in both instances, then the standard should identify the additional communication requirements that apply where the auditor’s doubts are mitigated.

### **H. Corrected and Uncorrected Misstatements**

14. Are the requirements appropriate regarding the communications for uncorrected misstatements?

#### **Response**

Yes. The requirement that the auditor provide the audit committee with a schedule of uncorrected misstatements and the basis for the auditor’s determination that they are immaterial allows the audit committee to better assess the entity’s internal accounting controls and identify processes and judgments requiring improvement. Further, we believe that the note in paragraph 18 of the proposed standard contains a requirement and should be elevated to a paragraph in the standard (i.e., not as a note).

15. Should all corrected misstatements including those corrected by management be communicated to the audit committee?

#### **Response**

We do not believe that all misstatements corrected by management need be communicated to the audit committee. First of all, it is not always possible for the auditor to identify misstatements identified by management. Second, self-correction of errors identified by management is a strength of the internal control structure which occurs throughout the year. Nevertheless, it should be left to the auditor’s judgment whether to communicate to the audit committee unintentional misstatements corrected by management. For example, the auditor may want to communicate those that were material to the financial statements or are symptomatic of other financial reporting and internal control issues within the company that need to be addressed.

## **I. Other matters**

No comments

## **J. Form and Content of Communications**

16. Like the existing standard, the proposed standard would allow the auditor to communicate many matters orally or in writing. Should the standard require that all or certain matters be communicated to the audit committee in writing? If only certain matters should be communicated to the audit committee in writing, what are those matters?

### **Response**

We agree that the auditor should communicate to the audit committee the matters in the standard either in writing or orally, unless otherwise specified in the standard. However, we strongly encourage these communications be in writing. We recommend deletion of the note to paragraph 23 as it may not be practical for the auditor to include in the audit documentation a copy or summary of management's communications provided to the audit committee, particularly if management's communications to the audit committee were made orally. Any significant oral communications by the auditor should be documented in the audit work papers.

## **K. Timing**

17. Are the requirements in the proposed standard on the timing of the proposed auditor's communications appropriate? Should only certain matters be communicated annually? If so, which ones?

### **Response**

Yes. We agree that audit committee communications should occur in a timely manner. Providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process is a key objective of the communications.

We believe that the proposed standard should emphasize that the discussion of the terms of the engagement, audit strategy and significant risks should be discussed *with the audit committee* early in the planning phase of the audit.

We also agree that all of the required communications should be made at least annually but suggest that the second sentence of par. 24 be modified as follows: The appropriate timing of a particular communication to the audit committee depends on *the auditor's judgment with respect to* factors such as the significance of the matters to be communicated and corrective or follow-up action needed.

However, we are concerned about the requirement that all communications required by the proposed standard be made prior to the issuance of the auditor's report. The schedule for audit committee meetings frequently is prepared well in advance, based on anticipated audit completion dates and filing requirements. Unanticipated events sometimes occur which may delay the completion of all necessary audit procedures until after the latest meeting date. At the time of the scheduled meeting, the auditor may only be able to give a detailed status report, with a discussion of the open audit issues which need to be resolved.

Other commitments of audit committee members may preclude scheduling a subsequent meeting in a timely manner, even if held telephonically. Obviously, significant matters uncovered during the audit and in completing the final audit procedures, or matters resolved differently than discussed at the time of the preceding audit committee meeting, should be communicated to the audit committee before the issuance of the report, even if it necessitates extending the filing deadline. However, if the resolution of the open audit issues is as initially discussed, then follow-up communications should be permitted after the audit report is issued.

Also, the Proposal is unclear if Rule 2-07 of the Commission's Regulation S-X provides an exception to the requirement in paragraph 25 of the proposed standard. Rule 2-07, as it relates to registered investment companies ("RIC"), should be incorporated fully in the proposed standard as the timing requirement for communicating with the audit committee of RICs. In addition, the standard has not addressed the auditor's review of interim financial information and related communications with the audit committee.

#### **L. Adequacy of the Two-way Communication Process**

18. Does the requirement to evaluate the adequacy of the two-way communications process promote effective two-way communication? Is more information on this requirement needed?

##### **Response**

The requirement to evaluate the adequacy of the two-way communications is only the beginning of the process. Additional information is not needed; however, audit committee members must be educated about the new PCAOB requirements and engaged in the process before the auditor and audit committee can have effective two way communication.

#### **M. Other Communication Requirements**

19. Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include?

##### **Response**

Yes. As discussed in the standard, most of the requirements are retained from AU 380 and are appropriate and sufficiently clear. The new requirement for the auditor to communicate departures from the standard auditor's report is appropriate. The audit committee needs to understand the reasons for any departure because of both regulatory concerns and the impact it could have on the users of the financial statements.

20. Are the matters included as significant difficulties in paragraph 21 of the proposed standard appropriate? What other matters should be included as significant difficulties?

##### **Response**

Yes. The matters in the paragraph are appropriate. The matters communicated should be expanded to include those matters in which there may be questions as to the integrity of management.

21. Are any of the requirements included in the proposed standard inappropriate for auditors to communicate to audit committees based on the size or industry under audit.

**Response**

No, we do not believe any of the requirements are inappropriate for communication to audit committees based on the size or industry under audit.