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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

27 May 2010

**Proposed Auditing Standard Related to Communications with Audit Committees,
and Related Amendments to Certain PCAOB Auditing Standards,
PCAOB Rulemaking Docket Matter No. 030**

Dear Office of the Secretary:

Ernst & Young LLP (Ernst & Young) is pleased to submit comments on the Public Company Accounting Oversight Board's (PCAOB or the Board) request for comment regarding the proposed standard related to communications with audit committees.

The Sarbanes-Oxley Act of 2002 strengthened the role of the audit committee by specifically vesting it with the authority and responsibility to oversee a company's external auditor. We support the Board's initiative to update the interim auditing standard to reflect the current structure of the oversight of the audit process.

Overall, we believe the proposed standard will help auditors provide meaningful information to the audit committee. Being well informed will help an audit committee to oversee the company's financial reporting process and satisfy its responsibilities to the company's investors. Effective, two-way communications between auditors and audit committees will also enhance audit quality and improve shareholder protection.

Because of the important role of the audit committee in this area, we encourage the PCAOB to work with the Securities and Exchange Commission to consider whether there is an opportunity for the SEC to issue complimentary guidance for audit committees.

In this letter we have provided certain overall comments that we believe will contribute to the Board's objective for effective and meaningful two-way communications to better achieve the objective of the audit. We also have included specific comments on the proposed standard.

We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or its staff.

Sincerely,

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

Overall comments

Objective of the standard

We agree with the Board's desire to further enhance effective two-way communications between the audit committee and the auditor. However, we do not believe the objectives stated in the proposed standard adequately emphasize the outcome of the requirement in paragraph 8 of the proposed standard for the auditor to inquire whether the audit committee is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. We recommend that obtaining information from the audit committee about matters *relevant* to the audit be added as an objective of the standard. We note that International Standard on Auditing 260, *Communication with Those Charged with Governance* (ISA 260), paragraph 9(b) and the ASB's Statement on Auditing Standards No. 114, *The Auditor's Communication with Those Charged with Governance* (SAS 114), paragraph 7(b), recognize this as an objective and recommend that the PCAOB consider incorporating this as part of the overall objectives of the proposed standard. Additionally, we believe the PCAOB should modify the requirement of paragraph 8 to emphasize that the information to be sought from the audit committee is intended to encompass a broader range of matters than is currently described, for example, possible illegal acts or instances of fraud, in addition to complaints or concerns raised regarding accounting or auditing matters.

In addition, we note that the fourth objective included in the proposed standard is focused on the auditor's evaluation of the adequacy of the two-way communications between the auditor and the audit committee. Given that an overarching objective for the PCAOB's proposal is to facilitate more effective two-way communications between the auditor and the audit committee, we recommend that the PCAOB consider whether a more appropriate objective would be to "promote" effective two-way communications with the audit committee, while maintaining the requirement in the standard for the auditor to evaluate whether the communications have been adequate to support the objectives of the audit. We believe establishing an objective to "promote" effective two-way communications more accurately reflects that the auditor is only one party to the communications process. We also believe that such an objective, which would also be consistent with ISA 260, would help emphasize to auditors the important role that communications with the audit committee serve in the successful conduct of the audit committee's oversight responsibilities, as well as the successful planning and conduct of the audit, making it clear that the ultimate goal is effective two-way communications, not the evaluation of the communications.

Improving the effectiveness of communications

We agree with the intent of the Board to enhance the quality of communications and information exchanged between the auditor and audit committee; however, the communications should be focused on providing information that the audit committee believes is relevant and meaningful to its oversight responsibilities or that is necessary for the conduct of the audit. We are concerned that requiring a significant number of new or expanded required communications, combined with an otherwise crowded audit committee agenda, could have a counter effect and unfortunately shift focus away from having meaningful dialogue about issues arising from the audit. Moreover, this approach may limit the auditor's opportunity to apply professional judgment in evaluating the relevance of the various items or required communications and instead promote a "check the box" mindset in order to demonstrate

auditor compliance with the requirements. Interim standard AU380.08 requires the auditor to determine that the audit committee is informed about the process used by management in formulating particularly sensitive estimates and about the basis for the auditor's conclusions regarding the reasonableness of those estimates. The current requirement permits the auditor to use professional judgment and expectations set in advance with the audit committee to determine the extent of information to be provided and discussed in order for the communication of sensitive accounting estimates to be effective.

Conversely, paragraph 12b of the proposed standard would require the auditor to communicate, for *each* critical accounting estimate, (1) a description of the process, (2) a description of management's significant assumptions that have a high degree of subjectivity, (3) a description of, and reasons for, changes to management's assumptions and (4) when critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various selections within the range would affect the company's financial statements. We are concerned that the expanded communication requirements may result in a significant increase in information provided to the audit committee at a level of detail that may detract from the effectiveness of the communications about critical accounting estimates and may result in significant increases in auditor effort without a corresponding benefit to the audit committee. Critical accounting estimates typically involve judgments around a number of assumptions - all of which can affect the range of possible outcomes. We also believe the requirement as drafted may result in auditors and management expending significant amounts of time reconciling views around the ranges associated with the corresponding estimates - even after the auditor and management have already concluded that the recorded amount is reasonable. Therefore, we recommend the Board consider whether allowing the auditor and audit committee to establish an understanding regarding the nature and extent of information to be provided to the audit committee to assist in its evaluation of the company's critical accounting estimates would more appropriately strike a balance between providing the audit committee with relevant information to inform its oversight and the effort associated with providing such information.

It is our view that paragraphs 12 and 13 should be revised to be consistent with interim standard AU380. We recommend the Board consider whether the new and expanded requirements that go beyond interim standard AU380 would better serve as guidelines or matters to consider rather than requirements, and therefore leave to the auditor's professional judgment to determine the nature and extent of additional communications that are appropriate in the circumstances of a particular audit.

Management's role in communications with the audit committee

Auditors, management, and audit committees have an individual and collective responsibility for fostering effective communication. While we agree with the Board's objective to refocus the auditing standard on communications between the auditor and audit committee, we believe the proposed standard could better reflect the important role of management in providing information to the audit committee. We believe the emphasis in the proposed standard on the auditor's responsibility to communicate each of the elements in paragraphs 12 and 13 combined with limited acknowledgment of the role of management in the communication process will result in written auditor communications that include significant information that is duplicative of that provided by management or already existing in the company's financial statement disclosures or management's discussion and analysis.

Establish a mutual understanding of the terms of the engagement

As stated in the release to the proposed standard, the Board has revised the interim standard to reflect the audit committee's role and responsibility for engaging and overseeing the auditor. We agree with the Board's requirement to document the understanding of the terms of the audit engagement with the audit committee given the committee's responsibility for appointment, compensation and retention of the auditor. In light of this change, we believe it would be appropriate for the responsibilities of the audit committee to also be outlined in the engagement letter in addition to those of management. While the auditing standards of the Board do not apply to audit committees, neither do they apply to management yet management's responsibilities are required elements of the written understanding with the client in current interim standard AU310.06 and in Appendix 3. We encourage the Board to discuss with the SEC the appropriateness of including the responsibilities of the audit committee as a component of the engagement letter. For example, the engagement letter might describe the responsibility of the audit committee to inform the auditor about matters that are relevant to the audit as implied through paragraph 8 of the proposed standard. We also recommend the Board describe in the appendix the important roles that management and the audit committee share in maintaining auditor independence.

Page 6 of the release and Appendix 3 indicate that the engagement letter is required to be "provided annually" to the audit committee; however, this requirement is not included in the standard itself. We do note that paragraph 25 of the proposed standard requires that all communications pursuant to the standard should be made annually. In addition, release question 3 asks whether it is appropriate for the proposed standard to require that an engagement letter "be prepared annually." As a result of these different descriptions, we are unclear of the Board's intent as to "providing" versus "preparing" the engagement letter and ask that it be clarified in the final standard.

We agree that communication of the terms of the engagement should be accomplished annually. However, we do not believe the auditing standard needs to specify the exact form of this communication. We do not believe that either preparing a new audit engagement letter or providing another copy of the existing engagement letter is essential to establishing a mutual understanding of the terms of the current year's engagement. We believe it would be more appropriate for auditors to determine the preference of the audit committee as to the nature and extent of the information or other communications to be provided to satisfy the requirement that the auditor and audit committee establish a mutual understanding of the terms of the audit. It is our experience that audit committee preferences as to the nature and extent of the communications vary. For example, the audit committee and the auditor might mutually conclude that there are no significant changes in the terms of the engagement from the prior year, and agree that the auditor could provide a copy or summary of the existing engagement letter to the audit committee as part of the annual communication.

Use of auditor communications by others

We believe it is important that the Board retain the provision from interim standard AU380.03 that requires, in situations where an auditor provides communications to audit committees in writing, the report indicate that it is intended solely for the use of the audit committee, board of directors or management, if appropriate, and that it is not intended to be and should not be used by anyone other than those specified parties. Communications between the auditor and audit committee should be

considered collectively for the audit committee's information or decision making purposes. For this reason, we are concerned that the absence of such a requirement may result in the unintended consequence of less candid discussions between the auditor and the audit committee due to the knowledge that the written information could be shared with other parties or result in another party inappropriately relying on the written information without the appropriate context.

Interim communication requirement

Appendix 2, page A2-4 (e.) details amendments to interim standard AU 722.34 to conform that standard to requirements in the proposed standard. As proposed, we believe this requirement may result in redundant and/or unnecessary auditor communications to the audit committee on an interim basis for ongoing issues that are communicated as part of the annual audit. In addition, given the limited scope of procedures performed as part of an interim review, we believe the auditor may be unable to provide the audit committee with observations at the same level of detail as compared to communications that are based on information obtained in conjunction with the annual audit. For these reasons, we believe the PCAOB should reconsider the auditor's interim communication requirements to the audit committee.

PCAOB standard setting process

We appreciate the insight provided by the Board in the release to the proposed standard and in Appendix 3, as they are helpful in understanding the Board's decision making process related to the guidance within the standard. However, it appears that in addition to providing insight into the Board's decision-making process, the Board is also attempting to interpret aspects of the standard in the release. We believe this increases the likelihood that the requirements of the standard will be interpreted differently, in that the release is not ultimately part of the final standard. For example, paragraph 10(d) of the proposed standard requires auditors to communicate the "roles, responsibilities, and locations of firms participating in the audit." The corresponding section within the release on page 9 makes clear that the PCAOB believes this communication should include participation of affiliated or network firms. We note that since this expectation is not explicit in the standard, it could be misunderstood or overlooked. We recommend the Board carefully consider the information provided in the release and Appendix 3 and modify the proposed standard as necessary so that the requirements are able to be interpreted consistently with the Board's intention.

We acknowledge the Board's efforts to consider the requirements of the relevant standards of the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants' Auditing Standards Board (ASB). The comparison in Appendix 3, outlining the significant difference in requirements between the Board's proposed standard and those of the relevant ISAs and SASs, is helpful in understanding and articulating the differences in the requirements among the (existing or proposed) standards. While we believe the Board has made significant progress in reducing the number of differences among the standards, we are concerned with some of the remaining differences. For example, and as described above, the Board's proposed standard would significantly expand the auditor's responsibilities regarding communication requirements relating to accounting policies and practices, and critical accounting estimates.

In addition, as previously stated in other comments to the Board, although the differences between the proposed standard and those of the ISAs and SASs included in Appendix 3 are intended to be helpful to auditors in understanding the intent of the Board, we believe that providing such a high level view of the differences does not provide the complete or necessary detail for the auditor to bridge any differences between standard setters. We believe that it is important for the Board to consider providing additional insight into how auditor performance is expected to change as a result of the proposed standard. This might be accomplished with tabular comparisons and analyses to allow auditors the additional visibility into the Board's thought process in developing the PCAOB standards, and enhancing auditors' understanding, implementation, and consistent execution of the standards on all audits they perform.

Specific comments

Significant issues discussed with management prior to the auditor's appointment or retention

Paragraph 4 of the proposed standard requires the auditor discuss with the audit committee any significant issues discussed with management in connection with the appointment or retention of the auditor, including *any* discussions regarding the application of accounting principles and auditing standards. Nearly all discussions with management are related to accounting and auditing matters (e.g., gaining an understanding of the company's accounting policies and processes, discussing with management the expected timing and coordination of the audits). Therefore, we believe communications with the audit committee should be limited to *significant* discussions with management regarding the application of accounting principles and auditing standards. We recommend the Board replace the term "any" with "significant" to clarify this requirement.

Overview of the audit strategy and timing of the audit

Paragraph 10a of the proposed standard requires the auditor to communicate the auditor's determination of whether persons with specialized skill or knowledge are needed to assist in execution of the audit. We suggest the Board clarify the context of "specialized skill" as to whether the requirement is meant to apply to persons within the audit firm, outside specialists that have been engaged by the audit firm, or both.

Auditor evaluation of the quality of the company's financial reporting

Paragraph 12a (ii) requires auditor communication of "the anticipated application by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting." We recommend the auditor's communication requirements in this paragraph be written consistent with the requirements of SEC Staff Accounting Bulletin No. 74 for management.

Paragraph 12a (iii) of the proposed standard requires the auditor to communicate the methods used by management to account for significant *and* unusual transactions. We would like to highlight to the Board that as worded the requirement would set a new threshold for such communications. Interim standard AU380.07 requires the auditor to determine whether the audit committee is informed about methods used to account for significant unusual transactions. In addition, PCAOB Staff Audit Practice

Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions* uses terminology that is consistent with interim standard AU380.07. We recommend that the Board use terminology within the proposal that is consistent with existing PCAOB standards and guidance.

In paragraphs 13a and 13b, the Board has proposed communication requirements related to both a company's significant accounting policies and practices and critical accounting policies and practices. Interim standard AU380.07 requires the auditor to communicate certain information related to *significant accounting policies*. Rule 2-07(1) of Regulation S-X requires the auditor to communicate *all critical accounting policies and practices*. We recommend the PCAOB utilize terminology within the proposal that is consistent with existing PCAOB standards and guidance.

Paragraph 13b (iii) of the proposed standard would require the auditor to communicate how current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical. We recommend the Board clarify and provide guidance for the auditor's consideration of "anticipated future events" that may affect the assessment of whether certain policies and practices are considered critical. The proposed requirement appears to be incremental to the requirements of Rule 2-07 of Regulation S-X. Without additional guidance related to how an auditor should anticipate future events and evaluate the company's current policies or practices, we are concerned that auditors, management and audit committees may spend efforts debating matters that may not ultimately provide information that is meaningful or relevant to the audit committee's oversight. Such communications could also potentially detract from discussion of other more significant matters related to the current year's financial statements.

Paragraph 13(f) of the proposed standard would require the auditor to communicate significant accounting matters for which the auditor consulted outside the engagement team. We perceive there may be variance among firms as to when and how such consultations outside the engagement team should occur. For this reason, we believe such a requirement would result in significant variation in communications from audit to audit, and may actually cause confusion among audit committee members in that regard.

Management consultation with others

Release question 12 inquires whether the requirement of paragraph 15 of the proposed standard should be expanded to require the auditor to communicate his or her views on management's consultations with non-accountants such as consultants or law firms on accounting or auditing matters. Because these communications may not be relevant to the audit and therefore will not provide benefit to the audit committee's oversight, we do not believe the proposed standard should be expanded to include management consultations with non-accountants.

Going concern

Paragraph 16a requires the auditor to communicate to the audit committee conditions or events that indicate there *could* be substantial doubt about the company's ability to continue as a going concern and the conditions and events that mitigated the auditor's doubt (to the extent that those concerns were mitigated). We are concerned that using the threshold "could" may result in the auditor communicating his or her consideration in situations where the auditor does not have a significant

doubt about the company's ability to continue as a going concern. Because the question of whether or not timely communications were made about going concern is often raised in litigation, we believe it is important that the description of matters that are required to be communicated in the proposed standard reflect the requirements in auditing standards that address going concern matters. We note that paragraph 23 of ISA 570, *Going Concern*, provides additional guidance regarding when to communicate the auditor's concern and the nature of such communications. We recommend the PCAOB consider utilizing the language in ISA 570 to describe the auditor's obligations to communicate matters related to the consideration of a company's ability to continue as a going concern.

We do not believe the requirements included in paragraphs 16(a) and 16(b) adequately describe that the considerations related to an auditor's evaluation of a company's ability to continue as a going concern are initially made by management and then evaluated by the auditor (e.g., assessment of the conditions and events, management's plans to overcome the conditions and events, effect on the financial statements, etc.). We recommend the PCAOB consider reflecting management's responsibility for its assessment in both paragraphs 16(a) and 16(b).

Corrected and uncorrected misstatements

The second sentence of paragraph 18 requires auditors to "communicate those corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications such corrected misstatements might have on the financial reporting process." We recommend the Board provide more specificity with regard to "implications" that corrected misstatements might have on the financial reporting process. For example, if the Board is referring to the implications that the corrected misstatements might have on the system of internal control over financial reporting, we suggest adding a cross-reference to applicable sections of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and AU325 of the Board's interim standards, *Communications About Control Deficiencies in an Audit of Financial Statements*.

The note to paragraph 18 also includes requirements to communicate the effect uncorrected misstatements could have on the financial statements in future periods. Because this requirement is similar to the second requirement in paragraph 18, we are unsure what, if any, importance should be assigned to this requirement being set off in a note. In addition, it appears the requirement within the note to paragraph 18 is inconsistent with SEC Staff Accounting Bulletins No. 99 and 108.

Release question 15 inquires whether the proposed standard should require all corrected misstatements, including those detected by management, to be communicated to the audit committee. While the audit committee may benefit from this information, we are concerned that such a requirement would be impractical. Management may identify a number of adjustments to its financial statements as part of the routine financial statement close process and correct the financial statements accordingly. Absent a clear definition of what constitutes a "misstatement" for the purpose of such communication, which does not exist today, we believe establishing such a requirement for auditors would likely result in auditors expending significant efforts to identify adjustments that were previously identified by the company's internal controls and established financial close process and to determine whether such adjustments represented "correct misstatements." We also do not believe auditors generally will have knowledge of all such adjustments

due to the nature of the company's financial statement close process and the timing of the auditor's procedures.

Other matters

The communication requirements of paragraph 22 include complaints or concerns raised regarding accounting or auditing matters of which the auditor is aware. We believe this requirement, without the clarification in footnote 24 is vague and may be difficult for the auditor to satisfy. We recommend the Board revise paragraph 22 to include the clarification from footnote 24 to make the Board's intent with the requirement clearer. For example, paragraph 22 and footnote 24 might be amended as follows:

22. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the financial reporting process, including ~~This communication includes~~ when the auditor is aware of complaints or concerns raised regarding accounting or auditing matters that may indicate the existence of fraud or illegal acts.

24. Paragraphs .79-.82 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, and paragraph .17 of AU sec. 317, *Illegal Acts by Clients*, ~~include specific communication requirements relating to fraud or illegal acts.~~

Release question 16 regarding paragraph 23 asks whether the proposed standard should require that all or just certain matters be communicated to the audit committee in writing. We believe that the current requirement strikes the appropriate balance by allowing the auditor to tailor his or her communications with the audit committee to the particular facts and circumstances and therefore, do not believe that a requirement for all communications to be in writing is appropriate.