

May 27, 2010

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

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

Dear Sir:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB or the "Board") *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards* (the "standard," "proposed standard" or "proposal").

The expansion of the audit committee's role in overseeing the integrity of the financial reporting process has contributed in a very positive way to the robustness of communications between auditors and audit committees since the passage of the Sarbanes-Oxley Act of 2002 (the Act). Our experience has been that audit committees are meeting more frequently and are more engaged in matters relevant to exercising effective oversight. We believe a well-informed audit committee is better able to execute its responsibilities, and accordingly, we support efforts aimed at improving communications between auditors and audit committees that are likely to result in the exchange of meaningful information that contributes to each party's role in promoting high quality financial reporting.

Overall, we believe the proposed standard represents an improvement in the Board's extant standards. In particular, we support:

- Incorporating SEC audit committee communication requirements arising from the Act so that required auditor communications regarding accounting matters are in a central location;
- Adapting the concept from International Standard on Auditing 260, *Communication with Those Charged with Governance* (ISA 260), that acknowledges the importance of effective two-way communications between the auditor and the audit committee to better achieve the objectives of the audit;
- Integrating the requirements for the auditor's appointment from interim standard AU 310, *Appointment of the Independent Auditor*, and
- Incorporating requirements that are reflective of best practices that have evolved over the past years in light of the increased frequency and depth of communications with audit committees.

In the remainder of our letter, we have organized our overall observations and concerns about the proposal into the following topical areas:

- Management's role in communicating with the audit committee
- Focusing communications on meaningful information
- Clarifying the objectives of the auditor
- Use of release text to interpret requirements
- Proposed amendment to interim standard AU 722, *Interim Financial Information*
- Intended users of the auditor's written communication

Finally, we have included other specific comments on the proposed standard in the Appendix to this letter. While we believe our role as auditors provides us with an important perspective, we also believe that the PCAOB should ensure that sufficient input is obtained from audit committee members about the types of communications they believe merit their attention in executing their oversight responsibilities.

Management's Role in Communicating with the Audit Committee

The Note to paragraph 12 acknowledges that management may communicate the matters identified in paragraph 12 regarding accounting policies, practices and estimates, in which case the auditor should determine whether all the matters were adequately described, and if not, the auditor should communicate any omitted or inadequately described matters to the audit committee.

Paragraph 5 of the Board's interim standard AU 380, *Communication With Audit Committees* (AU 380), which the proposed standard would supersede, has similar guidance; however, AU 380.05 acknowledges that management's communications may cover "certain of the matters specified in this section," i.e., they may extend to matters covered in AU 380 (and also in the proposed standard) which are beyond what is addressed in paragraph 12. We believe it is important for the proposed standard to acknowledge more broadly that management's communications also inform the audit committee and that, where the auditor can evaluate management's communications, the auditor may tailor the communications to the audit committee so that they are more appropriately focused on providing the auditor's perspective rather than supplanting or duplicating management's communications.

Matters in the proposed standard (beyond those identified in paragraph 12) about which we believe it is likely that management will have communicated to the audit committee include, for example, going concern uncertainties, complaints or concerns about accounting or auditing matters that were received through an entity's established protocols, and the critical accounting policies and practices that are the subject of paragraph 13(b). We do not intend that taking management's communications into account would in any way relieve the auditor of making required communications that only the auditor can make (e.g., an overview of the audit strategy, the auditor's evaluation of the quality, clarity, and completeness of the company's financial statements or the auditor's assessment of the entity's ability to continue as a going concern). We believe, however, that the interest of audit committees is not served by having duplicate communications from management and the auditor that potentially have the unintended consequence of distracting attention from more important matters.

Focusing Communications on Meaningful Information

We believe that several of the new requirements in the proposed standard, including those identified below, are too broad and therefore are likely to increase the communication of

information beyond that which merits the attention of the audit committee in all cases. We encourage the Board to modify these requirements to focus auditors on the provision of information that is tailored for each audit, such that it is meaningful to the audit committee in exercising its oversight of the financial reporting process.

Consultations Outside the Engagement Team

Paragraph 13(f) requires the auditor to communicate to the audit committee "significant accounting matters for which the auditor has consulted outside the engagement team." We believe significant accounting matters that may trigger consultation outside the engagement team are already generally required to be communicated by paragraphs 12 and 13. The auditor's communications pursuant to those paragraphs would already be informed by the outcome of consultations where consultations had occurred. We believe, however, that the Board needs to make it clear that the intent of the requirement is not to communicate the mere fact that the engagement team may have consulted in one or more instances or the subject of all matters on which consultations have occurred, but rather to require auditors to consider accounting matters on which consultations have occurred to help identify potential significant accounting matters that merit the attention of the audit committee. Accordingly, to avoid the potential for inappropriate de facto conclusions that a matter is a significant accounting matter solely based upon a decision to consult outside the engagement team, we recommend clarifying paragraph 13(f) to require the communication of those significant accounting matters for which the auditor has consulted outside the engagement team that have not otherwise been communicated pursuant to the other requirements in paragraphs 12 and 13. We believe that the requirement, modified as we suggest, would capture the population of "complex transactions that may be high risk or controversial" that the Board identifies on page 11 of the release as being the significant accounting matters targeted by the requirement in paragraph 13(f). Alternatively, the requirement could be redrafted to communicate "complex transactions that may be high risk or controversial" without reference to consultations.

Use of Specialists

Paragraph 10(a) of the proposed standard requires the auditor to communicate to the audit committee "the auditor's determination of whether persons with specialized skill or knowledge are needed to apply the planned audit procedures or evaluate the audit results." We recommend that this communication focus on those specialists whose work, in the auditor's judgment, merits the attention of the audit committee given the nature of the specialist's involvement on a particular audit engagement and the relative complexity and significance of the relevant financial reporting issues. As such, we do not believe this requirement should encompass information technology or tax specialists without regard to the nature of the engagement and their involvement.

Principal Auditor Determination

Paragraph 10(e) requires the auditor to communicate "the basis for the auditor's determination that he or she can serve as principal auditor." In many circumstances this determination does not require significant consideration given the relative insignificance of the involvement of other auditors and, accordingly, is unlikely to merit the attention of the audit committee. We encourage the Board to limit this requirement to situations in which significant portions of the audit are performed by other auditors.

Critical Accounting Estimates

Paragraph 12(b)(iv) requires the auditor to communicate to the audit committee "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." Under existing auditing standards, when critical accounting estimates involve

consideration of a range of acceptable amounts rather than a point estimate, the auditor concludes whether the estimate recorded in the financial statements is reasonable by determining whether it falls within a range of acceptable amounts.

As drafted, the proposed requirement could result in the auditor performing procedures unnecessarily to determine the acceptability of management's entire range of estimates in order to comply with the communication requirement, even in circumstances in which it is clear that management's estimate is a reasonable one. While procedures to make this assessment may be appropriate in some circumstances, we do not believe that the quality of audit committee communications will be sufficiently enhanced in all cases by the proposed requirement. Furthermore, in some circumstances the communication could result in an inappropriate perception about the level of precision that can be attributed to an estimate. Accordingly, we encourage the Board to provide additional guidance that allows for the auditor's consideration of when the communication of such detail as implied by the requirement is likely to merit the attention of the audit committee. For example, factors that might contribute to a decision about whether this information merits the audit committee's attention could include the significance of the estimate, the degree of estimation uncertainty, the amounts by which the recorded amount differs from the amount best supported by the audit evidence, etc.

Departure from the Standard Auditor's Report

The auditor is required by paragraph 19 to communicate to the audit committee the reasons for a modification of the opinion in the auditor's report or the addition of an explanatory paragraph in the report. We believe there may be circumstances, for example, when the auditor has added an explanatory paragraph to the report for a mandatory change in accounting principle, in which the audit committee may find that such a required communication does not merit the committee's attention. We recommend replacing this requirement with a requirement to provide a draft of the audit report to the audit committee prior to the release of the report and to discuss any aspect of the report with the committee as deemed necessary by either the auditor or the audit committee.

Clarifying the Objectives of the Auditor

We recommend that the Board change the objective in paragraph 3(d) to "promoting effective two-way communication between the auditor and the audit committee" to be more consistent with ISA 260. We believe the ISA objective more appropriately reflects the desired outcome to be achieved. The Board's proposed objective, "evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit," is unnecessarily redundant with the requirement in paragraph 26. We agree with the requirement in paragraph 26, and believe that it provides appropriate direction to the auditor toward achieving the objective of promoting effective two-way communication.

We also recommend that the Board add as an objective "obtaining from those charged with governance information relevant to the audit" which is also an objective in ISA 260. The objectives in paragraphs (a) through (c) all address information that the auditor *provides to* the audit committee. We believe that it is also important to include an objective for the auditor to *obtain from* the audit committee information relevant to the audit to emphasize the importance of two-way communications between the auditor and the audit committee. Furthermore, the objective we recommend is supported by the requirement in paragraph 8 to inquire of the audit committee whether it is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters.

Use of Release Text to Interpret Requirements

It is important that guidance considered necessary to understand the requirements of the standard be included in the standard. We have identified release text related to the following requirements that we believe either should be incorporated into the standard or addressed differently in the release text when the Board issues a final standard to avoid confusion in practice and to encourage consistent application of the standard by auditors.

Significant Issues Discussed with Management Prior to the Auditor's Appointment or Retention

Paragraph 4 requires the auditor to 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."

We believe this requirement, which is incorporated from AU 380, is appropriate and provides clear direction to the auditor as drafted. The release text on page 18, however, states that "in determining what information to communicate to the audit committee, 'retention' is not meant to limit this communication to discussions that occur shortly before re-appointment, but could include discussions occurring throughout the auditor's relationship with the company." In our view, this interpretive commentary could inappropriately change the nature of the requirement. The proposed standard contains numerous requirements to communicate significant issues, including those related to the application of accounting principles and auditing standards, to the audit committee. What is unique about the requirement in paragraph 4 is its linkage of "significant issues discussed with management" and "in connection with the appointment or retention of the auditor." Contrary to what is stated in the release text, limiting this communication to discussions that occur in the context of re-appointment is integral to the intent of the requirement and, accordingly, we encourage the Board to clarify that in the release text of the final standard when it is issued.

Firms Participating in the Audit

Paragraph 10(d) requires the auditor to communicate to the audit committee "the roles, responsibilities, and locations of firms participating in the audit."

On page 9 of the release, the Board states that "auditors may use affiliated or network firms, outsourcing arrangements, or non-affiliated firms." We recommend that this clarifying guidance be incorporated into paragraph 10(d).

Critical Accounting Policies and Practices

The Note to paragraph 13(b), which is intended to distinguish between critical accounting policies and practices and significant accounting policies and practices, states that "those accounting policies and practices considered to be critical might change from year to year."

Page 11 of the release text provides as an example that "a significant merger or acquisition may result in the related accounting policy being considered critical in the year in which the transaction occurs, but not in subsequent years." We believe the Note to paragraph 13(b) would be enhanced by adding this example.

Other Matters

Paragraph 22 requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the financial reporting process. We recommend incorporating the phrase "other than those matters previously reported to the auditor

by the audit committee" from page 15 of the release into the second sentence of this paragraph, and also providing guidance acknowledging that management may already have communicated such matters to the audit committee. Our suggested changes are shown below.

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. This communication includes when the auditor is aware of complaints or concerns raised regarding accounting or auditing matters ***other than those matters previously reported to the auditor by the audit committee or that the auditor has determined were previously communicated to the audit committee by management.***

Proposed Amendment to Interim Standard AU 722, *Interim Financial Information*

We recommend the PCAOB reconsider the interim auditor communication requirements to the audit committee created by the proposed replacement of paragraph 34 of AU 722, *Interim Financial Information*, in Appendix 2 of the proposal. These requirements 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. Furthermore, given the nature of the procedures performed as part of an interim review, we believe that it is inappropriate to suggest that auditors should 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 performance of an audit.

Intended Users of the Auditor's Written Communication

Although we acknowledge that paragraph 11 of interim standard AU 532, *Restricting the Use of an Auditor's Report*, requires the restriction of by-product reports, including reports issued pursuant to AU 380, we recommend that the Board carry forward in the proposed standard the requirement in AU 380.03 that, when the auditor communicates in writing, the report should indicate that it is intended solely for the information and use of the audit committee or the board of directors and, if appropriate, management, and is not intended to be and should not be used by anyone other than these specified parties. Alternatively, the Board could make reference to AU 532 in the proposed standard. We believe that the kind of robust, substantive communications with the audit committee that the Board intends are facilitated by restricting the use of the auditor's written communication because doing so reduces the risk that such communications will be inappropriately used and relied upon by parties who may not have the appropriate context to understand them.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Michael J. Gallagher (973-236-4328) or Brian R. Richson (973-236-5615) regarding our submission.

Sincerely,



Attachment

Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards

This appendix provides additional comments on specific requirements in the proposed standard for the Board's consideration.

Obtaining Information Related to the Audit

Paragraph 8 requires the auditor to inquire of the audit committee whether it is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. We recommend that the Board expand footnote 5 to paragraph 8 to include a reference to Rule 10A-3(b)(3) under the Securities Exchange Act of 1934, which requires the audit committee to establish procedures for the receipt of complaints or concerns raised regarding accounting and auditing matters. We also suggest including a reference to paragraph 51 of the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, which would require the auditor to make inquiries of the audit committee, among others, "who might reasonably be expected to have information that is important to the identification and assessment of risks of material misstatement," which would encompass risks of material misstatement due to error as well as fraud.

Accounting Policies, Practices, and Estimates

Paragraph 12(a)(ii) requires the auditor to communicate "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 adding a note that management is already required to disclose this information pursuant to Securities and Exchange Commission Codification of Staff Accounting Bulletins, Topic 11.M., *Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period*. Also, since Topic 11.M. only addresses accounting standards, we encourage the Board to clarify what the reference to "regulatory pronouncements" in paragraph 12(a)(ii) is intended to encompass.

We also recommend editing the following subparagraphs of paragraph 12 as shown below to clarify these requirements to communicate certain matters regarding accounting policies, practices, and estimates to the audit committee.

- 12. a. iii.** The methods used by management to account for significant ~~and~~ unusual transactions;
- 12. b. iii.** Any significant changes to assumptions or processes made by management to **develop** the critical accounting estimates in the year under audit, a description of **management's** the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes;

Auditor's Evaluation of the Quality of the Company's Financial Reporting

We recommend adding a footnote reference at paragraph 13(e) to Rule 2-07(a)(2) of Regulation S-X.

Corrected and Uncorrected Misstatements

We recommend adding a footnote reference at paragraph 17 to Rule 2-07(a)(3) of Regulation S-X.

Two-Way Communications Have Not Been Adequate

When the auditor determines that the two-way communications have not been adequate, paragraph 27, consistent with ISA 260, requires the auditor to evaluate the effects, if any, on the auditor's assessment of the risks of material misstatement and on the auditor's ability to obtain sufficient appropriate audit evidence, and requires the auditor to take appropriate action. We recommend that the PCAOB, when finalizing its proposed Risk Assessment standards, include appropriate cross-references (for example, at paragraph 36 of the Proposed Auditing Standard *Evaluating Audit Results*) to this requirement.

In addition, the Note to paragraph 27 is not clear as drafted. We recommend that the Note be clarified to state that the auditor's determination that the two-way communications have not been adequate may be a factor the auditor considers in assessing whether the board of directors or audit committee has exercised appropriate oversight over financial reporting and internal control as part of the auditor's evaluation of the control environment pursuant to paragraph 25 of Auditing Standard 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5) and pursuant to the guidance in paragraph 5 of AU 325, *Communications About Control Deficiencies in an Audit of Financial Statements*.

We suggest the PCAOB include footnote references to paragraphs 26-28 of this proposed standard at paragraph 25 of AS 5 and at AU 325.05.

Appendix C - Matters Communicated in the Audit Engagement Letter

Appendix C identifies matters that the auditor is required to include in the engagement letter. Paragraphs C1(b)(2)(a) and C1(b)(2)(b) identify in detail the various communications about control deficiencies that the auditor is required to make in an integrated audit and in an audit of financial statements, respectively. We question why the Board has included only communications about control deficiencies as part of the required content of the engagement letter given the nature and extent of other communications that are required both in the proposed standard and also in other PCAOB standards and rules as identified in Appendix B of the proposed standard. We recommend that the Board either delete these two paragraphs from the required content of the engagement letter or add some other relevant communications, for example, communications about the auditor's independence; the audit strategy including significant risks identified; the auditor's evaluation of the quality of the company's financial reporting; and uncorrected misstatements.