File No. PCAOB 2012-01
Consists of 1348 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed rules, Auditing Standard No. 16, *Communications with Audit Committees* ("Auditing Standard No. 16"), related amendments to PCAOB standards and transitional amendments to AU sec. 380, *Communication with Audit Committees* ("AU sec. 380") (the "proposed rules"). The proposed rules changes are attached as Exhibit A to this rule filing. In addition, the Board is also requesting the SEC's approval, pursuant to Section 103(a)(3)(c) of the Act, of the application of Auditing Standard No. 16 to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934.[1/] See Exhibit 4.

(b) Auditing Standard No. 16 will supersede AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310"), and AU sec. 380.

(c) Not applicable.

[1/] Section 104 of the Jumpstart Our Business Startups Act provides that any additional rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation." As a result, Auditing Standard No. 16, which was adopted by the Board after April 5, 2012, is subject to a separate determination by the SEC regarding its applicability to audits of EGCs.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the SEC, at its open meeting on August 15, 2012. No other action by the Board is necessary for the filing of the proposed rules.

(b) Questions regarding this rule filing may be directed to Jennifer Rand, Deputy Chief Auditor (202-207-9206, randj@pcaobus.org), Jessica Watts, Associate Chief Auditor (202/207-9376, wattsj@pcaobus.org), Hasnat Ahmad, Assistant Chief Auditor (202/207-9349, ahmadh@pcaobus.org), Robert E. Burns, Associate General Counsel (202-207-9153, burnsr@pcaobus.org), or Nina Mojiri-Azad, Senior Assistant General Counsel (202-207-9035; mojiriazadn@pcaobus.org).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules Change

(a) Purpose

Section 103(a) of the Act directs the Board, by rule, to establish, among other things, "auditing and related attestation standards . . . to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by th[e] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors."

As discussed more fully in Exhibit 3, the Board adopted Auditing Standard No. 16, related amendments and transitional amendments to AU sec. 380 to improve the audit by enhancing communications between auditors and audit committees by establishing requirements that enhance the relevance, timeliness, and quality of the communications between the auditor and the audit committee.

The enhanced relevance, timeliness, and quality of communications should facilitate audit committees' financial reporting oversight, fostering improved financial reporting, thereby benefitting investors.

Auditing Standard No. 16 is intended to improve the audit[2/] by fostering constructive dialogue between the auditor and the audit committee about significant audit and financial statement matters. The standard requires the auditor to communicate certain matters regarding the audit and the financial statements to the audit committee, which should assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Effective two-way communication between the auditor and the audit committee on such relevant matters also will benefit the auditor in performing an effective audit.

Auditing Standard No. 16 encourages effective two-way communication between the auditor and the audit committee throughout the audit to assist both parties in understanding matters relevant to the audit. Communications that are tailored to the circumstances and informative, rather than "boiler-plate" or standardized, will enable the auditor and the audit committee to engage in a dialogue that is more likely to benefit both the audit committee, in conducting its oversight responsibilities, and the auditor, in conducting an effective audit. Effective communication between the auditor and the audit committee may

---

[2/] For the purpose of this proposed standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

involve many forms of communication, such as presentations, charts, written reports, or robust discussions.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

Not applicable

5. Board's Statement on Comments on the Proposed Rules Change Received from Members, Participants or Others

The Board released the proposed rules for public comment on March 29, 2010, 2010. See Exhibit 2(a)(A). The Board received 35 comment letters on the original proposed standard. See Exhibits 2(a)(B) and 2(a)(C). On September 21, 2010, the Board held a roundtable to obtain insight from additional stakeholders, including investors, audit committee members, auditors, and preparers. See Exhibits 2(a)(D). The Board reopened the public comment period on the original proposed standard to allow for interested parties to provide additional comments on the topics discussed at the roundtable. The Board received nine additional comment letters during this extended comment period. See Exhibits 2(a)(B) and 2(a)(C).

The Board considered the comments received relating to its initial proposed rules and at the roundtable and made changes to the initial proposed rules. As a result, the Board again sought public comment on the proposed rules on December 20, 2011. See Exhibit 2(a)(E). The Board received 39 written comment letters relating to its reproposal of the proposed rules. See Exhibits 2(a)(F) and 2(a)(G).

The Board has carefully considered all comments it has received. The Board's response to the comments it received and the changes made to the rules in response to the comments received are summarized in Exhibits 2(a)(E) and 3 to this filing.

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

Not applicable.

9. Exhibits

Exhibit A –	Text of the Proposed Rules.
Exhibit 1 –	Form of Notice of Proposed Rules for Publication in the Federal Register.
Exhibit 2(a)(A) –	PCAOB Release No. 2010-001 (March 29, 2010).
Exhibit 2(a)(B) –	Alphabetical List of Comments on the rules proposed in PCAOB Release No. 2010-001.
Exhibit 2(a)(C) –	Written comments on the rules proposed in PCAOB Release No. 2010-001.
Exhibit 2(a)(D) –	Transcript from Roundtable held on September 21, 2010.
Exhibit 2(a)(E) –	PCAOB Release No. 2011-008 (December 20, 2011).
Exhibit 2(a)(F) –	Alphabetical List of Comments on the rules proposed in PCAOB Release No. 2011-008.

Exhibit 2(a)(G) – Written comments on the rules proposed in PCAOB Release No. 2011-008.

Exhibit 3 – PCAOB Release No. 2012-004 (August 15, 2012)

Exhibit 4 – Request to Apply Auditing Standard No. 16 to Audits of Emerging Growth Companies

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

By:

Phoebe W. Brown
Secretary

August 28, 2012

Exhibit A – Text of the Proposed Rules

Below is Auditing Standard No. 16 and amendment to the Board's interim auditing standards.

Auditing Standard No. 16

Communications with Audit Committees

Introduction

1. This standard requires the auditor to communicate with the company's **audit committee**[1/] regarding certain matters related to the conduct of an audit[2/] and to obtain certain information from the audit committee relevant to the audit. This standard also requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee and to record that understanding in an engagement letter.

2. Other Public Company Accounting Oversight Board ("PCAOB") rules and standards identify additional matters to be communicated to a company's audit committee (see Appendix B). Various laws or regulations also require the auditor to communicate certain matters to the audit committee.[3/] The communication requirements of this standard do not modify or replace communications to the audit committee required by such other PCAOB rules and standards, and other laws or regulations. Nothing in this standard precludes the auditor from communicating other matters to the audit committee.

Objectives

3. The objectives of the auditor are to:

   a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

1/ Terms defined in Appendix A, *Definitions,* are set in **boldface type** the first time they appear.

2/ For purposes of this standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

3/ *See e.g.,* Section 10A(k) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j-1(k); Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07; and Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

Note: "Communicate to," as used in this standard, is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit.

Appointment and Retention

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

4. The auditor should discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

Establish an Understanding of the Terms of the Audit

5. The auditor should establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the following:

a. The objective of the audit;

b. The responsibilities of the auditor; and

c. The responsibilities of management.

6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually. The auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[4/] If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

[4/] Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

Note: Appendix C describes matters that the auditor should include in the engagement letter about the terms of the audit engagement.

7. If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept, continue, or perform the engagement.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

8. The auditor should inquire of the audit committee about whether it is aware of matters relevant to the audit,[5/] including, but not limited to, violations or possible violations of laws or regulations.[6/]

Overall Audit Strategy, Timing of the Audit, and Significant Risks

9. The auditor should communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit,[7/] and discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures.[8/]

Note: This overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures.

10. As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

[5/] In addition to this inquiry, paragraphs 5.f. and 54-57 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* describe the auditor's inquiries of the audit committee, or equivalent (or its chair) regarding the audit committee's knowledge of the risks of material misstatement, including fraud risks. These inquiries include, among other things, whether the audit committee is aware of tips or complaints regarding the company's financial reporting.

[6/] *See* AU sec. 317, *Illegal Acts by Clients*, for a description of the auditor's responsibilities when a possible illegal act is detected. For audits of issuers, *see also* Section 10A(b) of the Exchange Act, 15 U.S.C. § 78j-1(b), and Rule 10A-1 under the Exchange Act, 17 C.F.R. § 240.10A-1.

[7/] *See* paragraphs 8-9 of Auditing Standard No. 9, *Audit Planning,* for a description of the auditor's responsibilities for establishing an overall audit strategy.

[8/] Auditing Standard No. 12 requires the auditor to determine whether identified and assessed risks are significant risks. A significant risk is defined as a risk of material misstatement that requires special audit consideration.

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;[9/]

b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;[10/]

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;[11/]

d. The names, locations, and planned responsibilities[12/] of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

> Note: The term "other independent public accounting firms" in the context of this communication includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.

9/ *See* paragraph 16 of Auditing Standard No. 9 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

10/ *See* AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* which describes the auditor's responsibilities related to the work of internal auditors.

11/ *See* paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

12/ *See* paragraphs 8-14 of Auditing Standard No. 9, which discuss the auditor's responsibilities for determining the audit strategy, audit plan, and extent to which audit procedures should be performed at selected locations or business units involving multi-location engagements.

e. The basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.[13/]

11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.[14/]

Results of the Audit

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions

12. The auditor should communicate to the audit committee the following matters:

a. Significant accounting policies and practices.[15/]

(1) Management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and

(2) The effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

[13/] *See* AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, which discusses the professional judgments the auditor makes in deciding whether the auditor may serve as principal auditor.

[14/] *See* paragraph 15 of Auditing Standard No. 9, which discusses changes in audit strategy and the audit plan during the course of the audit.

[15/] *See, e.g.*, Financial Accounting Standards Board Accounting Standards Codification, Topic 235, Notes to Financial Statements, paragraph 235-10-50-1, which requires the entity to disclose a description of all significant accounting policies as an integral part of the financial statements, and paragraph 235-10-50-3, which describes what should be disclosed.

b. **Critical accounting policies and practices**. All critical accounting policies and practices to be used, including:[16/]

(1) The reasons certain policies and practices are considered critical; and

(2) How current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

Note: Critical accounting policies and practices, as defined in Appendix A, are a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. Critical accounting policies and practices are tailored to specific events in the current year, and the accounting policies and practices that are considered critical might change from year to year.

c. **Critical accounting estimates**.

(1) A description of the process management used to develop critical accounting estimates;[17/]

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;[18/] and

(3) Any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's

---

16/ *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(1) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(1).

17/ *See* AU sec. 342, *Auditing Accounting Estimates*, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

18/ *Id.*

reasons for the changes, and the effects of the changes on the financial statements.[19/]

d. Significant unusual transactions.

(1) Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature;[20/] and

(2) The policies and practices management used to account for significant unusual transactions.

Note: As part of its communications to the audit committee, management might communicate some or all of the matters in paragraph 12. If management communicates any of these matters, the auditor does not need to communicate them at the same level of detail as management, as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor should communicate any omitted or inadequately described matters to the audit committee.

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

13. The auditor should communicate to the audit committee the following matters:

a. Qualitative aspects of significant accounting policies and practices.

(1) The results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements;[21/] and

---

[19/] *Id.*

[20/] *See* paragraph 71.g. of Auditing Standard No. 12*.*

[21/] *See* paragraphs 24-27 of Auditing Standard No. 14, *Evaluating Audit Results*, which describe the auditor's responsibilities related to evaluating the qualitative aspects of the company's accounting practices.

(2) The results of the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management.[22]

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates.[23]

d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.[24]

e. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth.[25]

---

[22] *See* paragraph 27 of Auditing Standard No. 14.

[23] *See* AU sec. 342, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

[24] *See* paragraph .66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

[25] *See* paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Other PCAOB standards, such as AU sec. 334, *Related Parties,* and AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, describe the auditor's responsibilities related to evaluation of specific disclosures in financial statements.

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.[26/]

Other Information in Documents Containing Audited Financial Statements

14. When other information is presented in documents containing audited financial statements, the auditor should communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.[27/]

Difficult or Contentious Matters for which the Auditor Consulted

15. The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

Management Consultation with Other Accountants

16. When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, the auditor should communicate to the audit committee his or her views about such matters that were the subject of such consultation.

[26/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(2) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(2).

[27/] *See, e.g.*, AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.* In addition to AU sec. 550, discussion of the auditor's consideration of other information is included in AU sec. 558, *Required Supplementary Information,* and AU sec. 711, *Filings Under Federal Securities Statutes.*

Going Concern

17. The auditor should communicate to the audit committee, when applicable, the following matters relating to the auditor's evaluation of the company's ability to continue as a going concern:[28/]

a. If the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the conditions and events that the auditor identified that, when considered in the aggregate, indicate that there is substantial doubt;[29/]

b. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events;[30/]

c. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains:[31/]

[28/] *See* AU sec. 341 for the requirements regarding an auditor's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. Additionally, AU secs. 341.03a-c provide the auditor with an overview of the requirements for evaluating whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

[29/] *See* AU sec. 341.06, which provides examples of such conditions and events and AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

[30/] *See* AU sec. 341.08, which discusses the auditor's responsibilities related to the auditor's evaluation of management's plans.

[31/] *See* AU sec. 341.12, which describes the effects on the auditor's report. *See also* AU sec. 341.03c, which discusses the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

(1) The effects, if any, on the financial statements and the adequacy of the related disclosure;[32/] and

(2) The effects on the auditor's report.[33/]

Uncorrected and Corrected Misstatements

18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures[34/] that the auditor presented to management.[35/] The auditor should discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[36/] considered. The auditor also should communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

19. The auditor should communicate to the audit committee those corrected misstatements, other than those that are clearly trivial,[37/] related to accounts and

---

[32/] *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

[33/] *See* AU secs. 341.12-.16, which discuss the auditor's consideration of the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

[34/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include omission and presentation of inaccurate or incomplete disclosures.

[35/] *See* Section 13(i) of the Exchange Act, 15 U.S.C.§ 78m(i), which states, in part, that financial statements prepared in accordance with generally accepted accounting principles and filed with the Securities and Exchange Commission "shall reflect all material correcting adjustments that have been identified by a registered public accounting firm …."

[36/] Appendix B of Auditing Standard No. 14 discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

[37/] *See* paragraph 10 of Auditing Standard No. 14, which requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial.

disclosures that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

Material Written Communications

20. The auditor should communicate to the audit committee other material written communications between the auditor and management.[38/]

Departure from the Auditor's Standard Report

21. The auditor should communicate to the audit committee the following matters related to the auditor's report:

a. When the auditor expects to modify the opinion in the auditor's report, the reasons for the modification, and the wording of the report; and

b. When the auditor expects to include explanatory language or an explanatory paragraph in the auditor's report, the reasons for the explanatory language or paragraph, and the wording of the explanatory language or paragraph.

Disagreements with Management

22. The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information prior to the issuance of the auditor's report.

Difficulties Encountered in Performing the Audit

23. The auditor should communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

a. Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide

---

[38/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k) and Rule 2-07(a)(3) of Regulation S-X, 17 C.F.R. § 210.2-07 (a)(3).

information needed for the auditor to perform his or her audit procedures;

b. An unreasonably brief time within which to complete the audit;

c. Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;

d. Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and

e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

Note: Difficulties encountered by the auditor during the audit could represent a scope limitation,[39/] which may result in the auditor modifying the auditor's opinion or withdrawing from the engagement.

Other Matters

24. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.[40/]

Form and Documentation of Communications

25. The auditor should communicate to the audit committee the matters in this standard, either orally or in writing,[41/] unless otherwise specified in this standard. The auditor must document the communications in the work papers, whether such communications took place orally or in writing.[42/]

[39/] *See* paragraphs .22-.32 of AU sec. 508, *Reports on Audited Financial Statements,* for a discussion of scope limitations.

[40/] AU secs. 316.79-.81 and AU sec. 317.17 include specific communication requirements relating to fraud or illegal acts, respectively.

[41/] *See* paragraphs .07-.11 of AU sec. 532, *Restricting the Use of an Auditor's Report,* which apply to certain written reports on matters coming to the auditor's attention during the course of the audit.

[42/] Consistent with the requirements of Auditing Standard No. 3, *Audit Documentation*, the audit documentation should be in sufficient detail to enable

Note: If, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.

Timing

26. All audit committee communications required by this standard should be made in a timely manner and prior to the issuance of the auditor's report.[43/] The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.

Note: An auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit. The auditor, however, should communicate such matters to the audit committee prior to the issuance of the auditor's report.

APPENDIX A – Definitions

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Audit committee – A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the

---

an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of this standard.

[43/] Consistent with Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

accounting and financial reporting processes of the company and audits of the financial statements of the company.

A3. Critical accounting estimate – An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

A4. Critical accounting policies and practices – A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

APPENDIX B – Communications with Audit Committees Required by Other PCAOB Rules and Standards

This appendix identifies other PCAOB rules and standards related to the audit that require communication of specific matters between the auditor and the audit committee.

- Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist,* paragraphs 60, 62, and 64
- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* paragraphs 78-81, 91, C7, and C14
- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* paragraphs 5.f. and 54-57
- PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*
- PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting*
- PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* paragraphs .79-.81
- AU sec. 317, *Illegal Acts by Clients,* paragraphs .08, .17, and .20

- AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* paragraphs 4-7 and 9

- AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* paragraph .50

- AU sec. 333, *Management Representations*, paragraph .05

- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*, paragraphs .04 and .06

- AU sec. 711, *Filings Under Federal Securities Statutes*, paragraph .13

- AU sec. 722, *Interim Financial Information*, paragraphs .08-.09, .30-.31, and .33-.36

APPENDIX C – Matters Included in the Audit Engagement Letter

C1. The auditor should include the following matters in the engagement letter.[1/] The auditor's description of these matters will vary depending on whether the auditor is engaged in a financial statement audit or in an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

a. The objective of the audit is:

   1. Integrated audit: The expression of an opinion on both the effectiveness of internal control over financial reporting and the financial statements.

   2. Audit of financial statements: The expression of an opinion on the financial statements.

b. Auditor's responsibilities:

   1. The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

[1/] Certain matters should not be included in an engagement letter; for example, under Securities and Exchange Commission, *Section 602.02.f.i. of the Codification of Financial Reporting Policies*, indemnification provisions are not permissible for audits of issuers.

a. Integrated audit: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, an integrated audit is not designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

b. Audit of financial statements: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

2. An audit includes:

a. Integrated audit: In fulfillment of the responsibilities noted above, the auditor communicates:

1. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit, in writing.

2. To the audit committee: all significant deficiencies identified during the audit, in writing, and informs the audit committee when the auditor has informed management of all internal control deficiencies.

3. To management: all internal control deficiencies identified during the audit and not previously communicated in writing by the auditor or by others, including internal auditors or others within the company.

4. To the board of directors: any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, in writing.

b. Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed.[2/] An audit of financial statements is not designed to provide assurance on internal control or to identify internal control deficiencies. However, the auditor is responsible for communicating:

1. To the audit committee and management: all significant deficiencies and material weaknesses identified during the audit, in writing.

2. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion, in writing.

[2/] AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, provides direction on control deficiencies identified in an audit of financial statements.

c. Management's responsibilities:

1. Management is responsible for the company's financial statements, including disclosures.

2. Management is responsible for establishing and maintaining effective internal control over financial reporting.

3. Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities.

4. Management is responsible for making all financial records and relevant information available to the auditor.

5. At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.

6. Management is responsible for adjusting the financial statements to correct material misstatements relating to accounts or disclosures and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

C2. In connection with a review of interim financial information, to confirm and document the understanding, the auditor should either: (a) document in the audit engagement letter the nature and objectives of the engagement to review interim financial information and the responsibilities of management and the auditor or (b) issue a separate engagement letter that addresses such matters.[3/]

[3/] Paragraphs .08-.09 of AU sec. 722, *Interim Financial Information*, discuss the auditor's responsibilities related to establishing an understanding with the audit committee in connection with a review of the company's interim financial information.

Amendments to PCAOB Standards

Auditing Standards

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, as amended, is amended as follows:

a. The following sentence is added at the end of paragraph 80:

This communication should be made in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

b. *The following sentence is added after the first sentence of paragraph 81:*

The auditor should communicate this information to the audit committee in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

Auditing Standard No. 9, *Audit Planning*

Auditing Standard No. 9, *Audit Planning*, is amended as follows:

a. Paragraph 6.c. is replaced with:

Establish an understanding of the terms of the audit engagement with the audit committee in accordance with Auditing Standard No. 16, *Communications with Audit Committees.*

b. Footnote 4 to paragraph 6 is deleted.

c. In footnote 7 to paragraph 9.a., the references to AU sec. 310 and AU sec. 380, *Communication with Audit Committees*, are replaced with a reference to Auditing Standard No. 16, *Communications with Audit Committees*.

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, is amended as follows:

The note to paragraph 5.d. is deleted.

AU sec. 310, "Appointment of the Independent Auditor"

SAS No. 1, "Codification of Auditing Standards and Procedures" section 310, "Appointment of the Independent Auditor" (AU sec. 310, "Appointment of the Independent Auditor"), as amended, is superseded.

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), as amended, is amended as follows:

a. The third sentence of paragraph .79 is replaced with:

> Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to the audit committee in a timely manner and prior to the issuance of the auditor's report.

b. The second sentence of paragraph .81 is replaced with:

> Such a communication may be a part of an overall communication to the audit committee of business and financial statement risks affecting the entity and/or in conjunction with the auditor communication about the qualitative aspects of the entity's accounting policies and practices (see paragraphs 12–13 of Auditing Standard No.16, *Communications with Audit Committees*). The auditor should communicate these matters to the audit committee in a timely manner and prior to the issuance of the auditor's report.

c. Within footnote 10 to paragraph .88, the reference to section 380, *Communication With Audit Committees*, is replaced with a reference to Auditing Standard No.16, *Communications with Audit Committees*.

AU sec. 317, "Illegal Acts by Clients"

SAS No. 54, "Illegal Acts by Clients" (AU sec. 317, "Illegal Acts by Clients"), as amended, is amended as follows:

a. The fourth sentence of paragraph .08 is replaced with:

> The auditor should make inquiries of management and the audit committee[1] concerning the client's compliance with laws and regulations and knowledge of violations or possible violations of laws or regulations.

b. Footnote 1 is added to paragraph .08 after the term "audit committee":

For this standard, audit committee is defined as a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, the person(s) who oversee the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.

c. The first sentence of paragraph .17 is replaced with:

The auditor should assure himself that the audit committee is adequately informed as soon as practicable and prior to the issuance of the auditor's report with respect to illegal acts that come to the auditor's attention.

d. Footnote 1 to paragraph .17 is deleted.

AU sec. 328, "Auditing Fair Value Measurements and Disclosures"

SAS No. 101, "Auditing Fair Value Measurements and Disclosures" (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), as amended, is amended as follows:

Paragraph .50 is replaced with:

Paragraphs 12-13 of Auditing Standard No. 16, *Communications with Audit Committees,* require the auditor to communicate to the audit committee matters related to critical accounting estimates, which may include fair value measurements.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows:

The following sentence is added as the last sentence of paragraph .05:

The auditor should provide a copy of the representation letter to the audit committee if management has not already provided the representation letter to the audit committee.

AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"

SAS No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), as amended, is amended as follows:

Paragraph .17A is added, along with the heading preceding this paragraph:

Communications with Audit Committees

Paragraph 17 of Auditing Standard No. 16, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the auditor's evaluation of a company's ability to continue as a going concern for a reasonable period of time.

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is superseded.

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380"

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380," is superseded.

AU sec. 532, "Restricting the Use of an Auditor's Report"

SAS No. 87, "Restricting the Use of an Auditor's Report (AU sec. 532, "Restricting the Use of an Auditor's Report"), as amended, is amended as follows:

In the second bullet point of paragraph .07, the reference to Section 380, *Communication With Audit Committees,* is replaced with a reference to Auditing Standard No. 16, *Communications with Audit Committees.*

AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"

SAS No. 8, "Other Information in Documents Containing Audited Financial Statements" (AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"), as amended, is amended as follows:

a. The sixth sentence of paragraph .04 is replaced with:

If the other information is not revised to eliminate the material inconsistency, he should communicate the material inconsistency to the audit committee and consider other actions, such as revising his report to include an explanatory paragraph describing the material inconsistency, withholding the use of his report in the document, and withdrawing from the engagement.

b. The second sentence of paragraph .06 is replaced with:

He should communicate the material misstatement of fact to the client and the audit committee, in writing, and consider consulting his legal counsel as to further appropriate action in the circumstances.

AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), as amended, is amended as follows:

The last sentence of paragraph .13 is replaced with:

In either case, the accountant should communicate the matter to the audit committee and also consider withholding his consent to the use of his report on the audited financial statements in the registration statement.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), as amended, is amended as follows:

a. The heading preceding paragraph .08, "Establishing an Understanding With the Client" is replaced with the heading, "Establishing an Understanding with the Audit Committee."

b. Paragraph .08 is replaced with:

The accountant should establish an understanding of the terms of an engagement to review interim financial information with the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee).[6] This understanding includes the objective of the review of interim financial information, the responsibilities of the accountant, and the responsibilities of management. Such an understanding reduces the risk that either the accountant or the audit committee may misinterpret the needs or expectations of the other party. The accountant should record this understanding of the terms of the engagement in an engagement letter and should provide the engagement letter to the audit committee. The accountant should have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the accountant should determine that the audit committee has acknowledged and agreed to the terms of the engagement. If the accountant believes he or she cannot establish an understanding of the terms of an engagement to review interim financial information with the audit committee, the accountant should decline to accept, continue, or perform the engagement.

c. Footnote 6 to paragraph .08 is replaced with:

See paragraph .16 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

d. In the first sentence of paragraph .09, the word "client" is replaced with the words "audit committee."

e. Paragraph .30 is replaced with:

If management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should communicate these matters to the audit committee as soon as practicable and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

f. The following sentence is added at the end of paragraph .33:

The accountant should communicate significant deficiencies or material weaknesses of which the accountant has become aware to the audit committee or those responsible for oversight of the company's financial reporting in a timely manner and prior to the registrant filing its periodic report with the SEC.

g. Paragraph .34 is replaced with:

When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Auditing Standard No. 16, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee in a timely manner and prior to the registrant filing its periodic report with the SEC. For example, the accountant should communicate a description of the process management used to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that management determined to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole.[23] As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, estimates, and significant unusual transactions described in paragraph 12 of Auditing Standard No. 16, *Communications with the Audit Committees*. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as the accountant (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the accountant considers critical. The accountant should communicate any omitted or inadequately described matters to the audit committee.

h. Footnote 23 to paragraph .34 is replaced with:

The schedule of uncorrected misstatements related to accounts and disclosures provided to the audit committee should be the same schedule that was included in or attached to the management representation letter that is described in paragraph .24(*k*) of this section.

i. The last two sentences of paragraph .35 are replaced with:

Therefore, any communication the accountant may make about the entity's accounting policies, practices, estimates, and significant unusual transactions as applied to its interim financial reporting, generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the qualitative aspects of the entity's accounting policies and practices that would be identified as a result of an audit.

j. Paragraph .36 is replaced with:

If the accountant has identified matters to be communicated to the audit committee, the accountant should communicate such matters to the audit committee, or at least its chair, in a timely manner and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

Transitional Amendments to AU sec. 380, Communication With Audit Committees

AU sec. 380*, Communication With Audit Committees*

SAS No. 61, "Communication With Audit Committees" *(*AU sec. 380*,* "Communication With Audit Committees"), as amended, is amended as follows:

a. The last sentence of paragraph .01 is replaced with:

> The communications required by this section are applicable to the audits of (i) issuers and (ii) brokers and dealers, as those terms are defined in the Sarbanes-Oxley Act of 2002, as amended.[2]

b. Footnote 2 to paragraph .01 is replaced with:

> *See* Sections 2(a)(7), 110(3), and 110(4) of the Sarbanes-Oxley Act of 2002.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-XXXXX; File No. PCAOB-2012-01)

[Date]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Funding

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), notice is hereby given that on August 28, 2012, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rules described in items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On August 15, 2012, the Board adopted Auditing Standard No. 16, *Communications with Audit Committees*, related amendments to its interim auditing standards, and transitional amendments to AU sec. 380, *Communication with Audit Committee* , (collectively, "the proposed rules"). The text of the proposed rules is set out below.

Auditing Standard No. 16

Communications with Audit Committees

Introduction

1. This standard requires the auditor to communicate with the company's **audit committee**[1/] regarding certain matters related to the conduct of an audit[2/]

[1/] Terms defined in Appendix A, *Definitions,* are set in **boldface type** the first time they appear.

and to obtain certain information from the audit committee relevant to the audit. This standard also requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee and to record that understanding in an engagement letter.

2. Other Public Company Accounting Oversight Board ("PCAOB") rules and standards identify additional matters to be communicated to a company's audit committee (see Appendix B). Various laws or regulations also require the auditor to communicate certain matters to the audit committee.[3/] The communication requirements of this standard do not modify or replace communications to the audit committee required by such other PCAOB rules and standards, and other laws or regulations. Nothing in this standard precludes the auditor from communicating other matters to the audit committee.

Objectives

3. The objectives of the auditor are to:

a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

Note: "Communicate to," as used in this standard, is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit.

[2/] For purposes of this standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

[3/] *See e.g.,* Section 10A(k) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j-1(k); Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07; and Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

Appointment and Retention

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

4. The auditor should discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

Establish an Understanding of the Terms of the Audit

5. The auditor should establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the following:

a. The objective of the audit;

b. The responsibilities of the auditor; and

c. The responsibilities of management.

6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually. The auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[4/] If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Note: Appendix C describes matters that the auditor should include in the engagement letter about the terms of the audit engagement.

7. If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept, continue, or perform the engagement.

[4/] Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

8. The auditor should inquire of the audit committee about whether it is aware of matters relevant to the audit,[5/] including, but not limited to, violations or possible violations of laws or regulations.[6/]

Overall Audit Strategy, Timing of the Audit, and Significant Risks

9. The auditor should communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit,[7/] and discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures.[8/]

> Note: This overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures.

10. As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;[9/]

[5/] In addition to this inquiry, paragraphs 5.f. and 54-57 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* describe the auditor's inquiries of the audit committee, or equivalent (or its chair) regarding the audit committee's knowledge of the risks of material misstatement, including fraud risks. These inquiries include, among other things, whether the audit committee is aware of tips or complaints regarding the company's financial reporting.

[6/] *See* AU sec. 317, *Illegal Acts by Clients*, for a description of the auditor's responsibilities when a possible illegal act is detected. For audits of issuers, *see also* Section 10A(b) of the Exchange Act, 15 U.S.C. § 78j-1(b), and Rule 10A-1 under the Exchange Act, 17 C.F.R. § 240.10A-1.

[7/] *See* paragraphs 8-9 of Auditing Standard No. 9, *Audit Planning,* for a description of the auditor's responsibilities for establishing an overall audit strategy.

[8/] Auditing Standard No. 12 requires the auditor to determine whether identified and assessed risks are significant risks. A significant risk is defined as a risk of material misstatement that requires special audit consideration.

[9/] *See* paragraph 16 of Auditing Standard No. 9 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to

b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;[10/]

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;[11/]

d. The names, locations, and planned responsibilities[12/] of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

> Note: The term "other independent public accounting firms" in the context of this communication includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.

---

perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

10/ *See* AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* which describes the auditor's responsibilities related to the work of internal auditors.

11/ *See* paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

12/ *See* paragraphs 8-14 of Auditing Standard No. 9, which discuss the auditor's responsibilities for determining the audit strategy, audit plan, and extent to which audit procedures should be performed at selected locations or business units involving multi-location engagements.

e. The basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.[13/]

11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.[14/]

Results of the Audit

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions

12. The auditor should communicate to the audit committee the following matters:

a. Significant accounting policies and practices.[15/]

(1) Management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and

(2) The effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

13/ *See* AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, which discusses the professional judgments the auditor makes in deciding whether the auditor may serve as principal auditor.

14/ *See* paragraph 15 of Auditing Standard No. 9, which discusses changes in audit strategy and the audit plan during the course of the audit.

15/ *See, e.g.*, Financial Accounting Standards Board Accounting Standards Codification, Topic 235, Notes to Financial Statements, paragraph 235-10-50-1, which requires the entity to disclose a description of all significant accounting policies as an integral part of the financial statements, and paragraph 235-10-50-3, which describes what should be disclosed.

b. **Critical accounting policies and practices**. All critical accounting policies and practices to be used, including:[16]

(1) The reasons certain policies and practices are considered critical; and

(2) How current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

Note: Critical accounting policies and practices, as defined in Appendix A, are a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. Critical accounting policies and practices are tailored to specific events in the current year, and the accounting policies and practices that are considered critical might change from year to year.

c. **Critical accounting estimates**.

(1) A description of the process management used to develop critical accounting estimates;[17]

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;[18] and

(3) Any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's

---

16/ *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(1) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(1).

17/ *See* AU sec. 342, *Auditing Accounting Estimates*, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

18/ *Id.*

reasons for the changes, and the effects of the changes on the financial statements.[19/]

d. Significant unusual transactions.

(1) Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature;[20/] and

(2) The policies and practices management used to account for significant unusual transactions.

Note: As part of its communications to the audit committee, management might communicate some or all of the matters in paragraph 12. If management communicates any of these matters, the auditor does not need to communicate them at the same level of detail as management, as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor should communicate any omitted or inadequately described matters to the audit committee.

19/ *Id.*

20/ *See* paragraph 71.g. of Auditing Standard No. 12.

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

13. The auditor should communicate to the audit committee the following matters:

a. Qualitative aspects of significant accounting policies and practices.

(1) The results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements;[21/] and

(2) The results of the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management.[22/]

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates.[23/]

d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.[24/]

e. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable

---

[21/] *See* paragraphs 24-27 of Auditing Standard No. 14, *Evaluating Audit Results*, which describe the auditor's responsibilities related to evaluating the qualitative aspects of the company's accounting practices.

[22/] *See* paragraph 27 of Auditing Standard No. 14.

[23/] *See* AU sec. 342, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

[24/] *See* paragraph .66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

financial reporting framework, including the auditor's 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, and the bases of amounts set forth.[25/]

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.[26/]

Other Information in Documents Containing Audited Financial Statements

14. When other information is presented in documents containing audited financial statements, the auditor should communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.[27/]

[25/] *See* paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Other PCAOB standards, such as AU sec. 334, *Related Parties,* and AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, describe the auditor's responsibilities related to evaluation of specific disclosures in financial statements.

[26/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(2) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(2).

[27/] *See, e.g.*, AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.* In addition to AU sec. 550, discussion of the auditor's consideration of other information is included in AU sec. 558, *Required Supplementary Information,* and AU sec. 711, *Filings Under Federal Securities Statutes.*

Difficult or Contentious Matters for which the Auditor Consulted

15. The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

Management Consultation with Other Accountants

16. When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, the auditor should communicate to the audit committee his or her views about such matters that were the subject of such consultation.

Going Concern

17. The auditor should communicate to the audit committee, when applicable, the following matters relating to the auditor's evaluation of the company's ability to continue as a going concern:[28/]

a. If the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the conditions and events that the auditor identified that, when considered in the aggregate, indicate that there is substantial doubt;[29/]

b. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the basis for the auditor's conclusion, including elements the auditor identified within management's plans

---

[28/] *See* AU sec. 341 for the requirements regarding an auditor's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. Additionally, AU secs. 341.03a-c provide the auditor with an overview of the requirements for evaluating whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

[29/] *See* AU sec. 341.06, which provides examples of such conditions and events and AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

that are significant to overcoming the adverse effects of the conditions and events;[30/]

c. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains:[31/]

(1) The effects, if any, on the financial statements and the adequacy of the related disclosure;[32/] and

(2) The effects on the auditor's report.[33/]

Uncorrected and Corrected Misstatements

18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures[34/] that the auditor presented to management.[35/] The auditor should discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected

---

[30/] *See* AU sec. 341.08, which discusses the auditor's responsibilities related to the auditor's evaluation of management's plans.

[31/] *See* AU sec. 341.12, which describes the effects on the auditor's report. *See also* AU sec. 341.03c, which discusses the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

[32/] *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

[33/] *See* AU secs. 341.12-.16, which discuss the auditor's consideration of the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

[34/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include omission and presentation of inaccurate or incomplete disclosures.

[35/] *See* Section 13(i) of the Exchange Act, 15 U.S.C.§ 78m(i), which states, in part, that financial statements prepared in accordance with generally accepted accounting principles and filed with the Securities and Exchange Commission "shall reflect all material correcting adjustments that have been identified by a registered public accounting firm …."

misstatements were immaterial, including the qualitative factors[36/] considered. The auditor also should communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

19. The auditor should communicate to the audit committee those corrected misstatements, other than those that are clearly trivial,[37/] related to accounts and disclosures that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

Material Written Communications

20. The auditor should communicate to the audit committee other material written communications between the auditor and management.[38/]

Departure from the Auditor's Standard Report

21. The auditor should communicate to the audit committee the following matters related to the auditor's report:

a. When the auditor expects to modify the opinion in the auditor's report, the reasons for the modification, and the wording of the report; and

b. When the auditor expects to include explanatory language or an explanatory paragraph in the auditor's report, the reasons for the explanatory language or paragraph, and the wording of the explanatory language or paragraph.

36/ Appendix B of Auditing Standard No. 14 discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

37/ *See* paragraph 10 of Auditing Standard No. 14, which requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial.

38/ *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k) and Rule 2-07(a)(3) of Regulation S-X, 17 C.F.R. § 210.2-07 (a)(3).

Disagreements with Management

22. The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information prior to the issuance of the auditor's report.

Difficulties Encountered in Performing the Audit

23. The auditor should communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

a. Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;

b. An unreasonably brief time within which to complete the audit;

c. Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;

d. Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and

e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

Note: Difficulties encountered by the auditor during the audit could represent a scope limitation,[39/] which may result in the auditor modifying the auditor's opinion or withdrawing from the engagement.

Other Matters

24. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come

---

[39/] *See* paragraphs .22-.32 of AU sec. 508, *Reports on Audited Financial Statements,* for a discussion of scope limitations.

to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.[40/]

Form and Documentation of Communications

25. The auditor should communicate to the audit committee the matters in this standard, either orally or in writing,[41/] unless otherwise specified in this standard. The auditor must document the communications in the work papers, whether such communications took place orally or in writing.[42/]

> Note: If, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.

Timing

26. All audit committee communications required by this standard should be made in a timely manner and prior to the issuance of the auditor's report.[43/] The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.

[40/] AU secs. 316.79-.81 and AU sec. 317.17 include specific communication requirements relating to fraud or illegal acts, respectively.

[41/] *See* paragraphs .07-.11 of AU sec. 532, *Restricting the Use of an Auditor's Report,* which apply to certain written reports on matters coming to the auditor's attention during the course of the audit.

[42/] Consistent with the requirements of Auditing Standard No. 3, *Audit Documentation*, the audit documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of this standard.

[43/] Consistent with Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

> Note: An auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit. The auditor, however, should communicate such matters to the audit committee prior to the issuance of the auditor's report.

APPENDIX A – Definitions

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Audit committee – A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

A3. Critical accounting estimate – An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

A4. Critical accounting policies and practices – A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

APPENDIX B – Communications with Audit Committees Required by Other PCAOB Rules and Standards

This appendix identifies other PCAOB rules and standards related to the audit that require communication of specific matters between the auditor and the audit committee.

- Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist,* paragraphs 60, 62, and 64

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* paragraphs 78-81, 91, C7, and C14

- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* paragraphs 5.f. and 54-57

- PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*

- PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting*

- PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*

- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* paragraphs .79-.81

- AU sec. 317, *Illegal Acts by Clients,* paragraphs .08, .17, and .20

- AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* paragraphs 4-7 and 9

- AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* paragraph .50

- AU sec. 333, *Management Representations*, paragraph .05

- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*, paragraphs .04 and .06

- AU sec. 711, *Filings Under Federal Securities Statutes*, paragraph .13

- AU sec. 722, *Interim Financial Information*, paragraphs .08-.09, .30-.31, and .33-.36

APPENDIX C – Matters Included in the Audit Engagement Letter

C1. The auditor should include the following matters in the engagement letter.[1/] The auditor's description of these matters will vary depending on whether the auditor is engaged in a financial statement audit or in an audit of internal

---

[1/] Certain matters should not be included in an engagement letter; for example, under Securities and Exchange Commission, *Section 602.02.f.i. of the Codification of Financial Reporting Policies*, indemnification provisions are not permissible for audits of issuers.

control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

a. The objective of the audit is:

1. Integrated audit: The expression of an opinion on both the effectiveness of internal control over financial reporting and the financial statements.

2. Audit of financial statements: The expression of an opinion on the financial statements.

b. Auditor's responsibilities:

1. The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

a. Integrated audit: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, an integrated audit is not designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

b. Audit of financial statements: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

2. An audit includes:

a. Integrated audit: In fulfillment of the responsibilities noted above, the auditor communicates:

1. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit, in writing.

2. To the audit committee: all significant deficiencies identified during the audit, in writing, and informs the audit committee when the auditor has informed management of all internal control deficiencies.

3. To management: all internal control deficiencies identified during the audit and not previously communicated in writing by the auditor or by others, including internal auditors or others within the company.

4. To the board of directors: any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, in writing.

b. Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed.[2/] An audit of financial statements is not designed to provide assurance on internal control or to identify internal

[2/] AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, provides direction on control deficiencies identified in an audit of financial statements.

control deficiencies. However, the auditor is responsible for communicating:

1. To the audit committee and management: all significant deficiencies and material weaknesses identified during the audit, in writing.

2. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion, in writing.

c. Management's responsibilities:

1. Management is responsible for the company's financial statements, including disclosures.

2. Management is responsible for establishing and maintaining effective internal control over financial reporting.

3. Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities.

4. Management is responsible for making all financial records and relevant information available to the auditor.

5. At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.

6. Management is responsible for adjusting the financial statements to correct material misstatements relating to accounts or disclosures and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

C2. In connection with a review of interim financial information, to confirm and document the understanding, the auditor should either: (a) document in the audit engagement letter the nature and objectives of the engagement to review interim financial information and the responsibilities of management and the auditor or (b) issue a separate engagement letter that addresses such matters.[3/]

Amendments to PCAOB Standards

Auditing Standards

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, as amended, is amended as follows:

a. The following sentence is added at the end of paragraph 80:

   This communication should be made in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

b. *The following sentence is added after the first sentence of paragraph 81:*

   The auditor should communicate this information to the audit committee in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

Auditing Standard No. 9, *Audit Planning*

Auditing Standard No. 9, *Audit Planning*, is amended as follows:

a. Paragraph 6.c. is replaced with:

   Establish an understanding of the terms of the audit engagement with the audit committee in accordance with Auditing Standard No. 16, *Communications with Audit Committees.*

b. Footnote 4 to paragraph 6 is deleted.

c. In footnote 7 to paragraph 9.a., the references to AU sec. 310 and AU sec. 380, *Communication with Audit Committees*, are replaced

---

[3/] Paragraphs .08-.09 of AU sec. 722, *Interim Financial Information*, discuss the auditor's responsibilities related to establishing an understanding with the audit committee in connection with a review of the company's interim financial information.

with a reference to Auditing Standard No. 16, *Communications with Audit Committees*.

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, is amended as follows:

The note to paragraph 5.d. is deleted.

AU sec. 310, "Appointment of the Independent Auditor"

SAS No. 1, "Codification of Auditing Standards and Procedures" section 310, "Appointment of the Independent Auditor" (AU sec. 310, "Appointment of the Independent Auditor"), as amended, is superseded.

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), as amended, is amended as follows:

a. The third sentence of paragraph .79 is replaced with:

   Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to the audit committee in a timely manner and prior to the issuance of the auditor's report.

b. The second sentence of paragraph .81 is replaced with:

   Such a communication may be a part of an overall communication to the audit committee of business and financial statement risks affecting the entity and/or in conjunction with the auditor communication about the qualitative aspects of the entity's accounting policies and practices (see paragraphs 12–13 of Auditing Standard No.16, *Communications with Audit Committees*). The auditor should communicate these matters to the audit committee in a timely manner and prior to the issuance of the auditor's report.

c. Within footnote 10 to paragraph .88, the reference to section 380, *Communication With Audit Committees*, is replaced with a reference to Auditing Standard No.16, *Communications with Audit Committees*.

AU sec. 317, "Illegal Acts by Clients"

SAS No. 54, "Illegal Acts by Clients" (AU sec. 317, "Illegal Acts by Clients"), as amended, is amended as follows:

a. The fourth sentence of paragraph .08 is replaced with:

> The auditor should make inquiries of management and the audit committee[1] concerning the client's compliance with laws and regulations and knowledge of violations or possible violations of laws or regulations.

b. Footnote 1 is added to paragraph .08 after the term "audit committee":

> For this standard, audit committee is defined as a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, the person(s) who oversee the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.

c. The first sentence of paragraph .17 is replaced with:

> The auditor should assure himself that the audit committee is adequately informed as soon as practicable and prior to the issuance of the auditor's report with respect to illegal acts that come to the auditor's attention.

d. Footnote 1 to paragraph .17 is deleted.

AU sec. 328, "Auditing Fair Value Measurements and Disclosures"

SAS No. 101, "Auditing Fair Value Measurements and Disclosures" (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), as amended, is amended as follows:

Paragraph .50 is replaced with:

Paragraphs 12-13 of Auditing Standard No. 16, *Communications with Audit Committees,* require the auditor to communicate to the audit committee matters related to critical accounting estimates, which may include fair value measurements.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows:

The following sentence is added as the last sentence of paragraph .05:

The auditor should provide a copy of the representation letter to the audit committee if management has not already provided the representation letter to the audit committee.

AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"

SAS No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), as amended, is amended as follows:

Paragraph .17A is added, along with the heading preceding this paragraph:

Communications with Audit Committees

Paragraph 17 of Auditing Standard No. 16, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the auditor's evaluation of a company's ability to continue as a going concern for a reasonable period of time.

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is superseded.

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380"

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380," is superseded.

AU sec. 532, "Restricting the Use of an Auditor's Report"

SAS No. 87, "Restricting the Use of an Auditor's Report (AU sec. 532, "Restricting the Use of an Auditor's Report"), as amended, is amended as follows:

In the second bullet point of paragraph .07, the reference to Section 380, *Communication With Audit Committees,* is replaced with a reference to Auditing Standard No. 16, *Communications with Audit Committees.*

AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"

SAS No. 8, "Other Information in Documents Containing Audited Financial Statements" (AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"), as amended, is amended as follows:

a. The sixth sentence of paragraph .04 is replaced with:

If the other information is not revised to eliminate the material inconsistency, he should communicate the material inconsistency to the audit committee and consider other actions, such as revising his report to include an explanatory paragraph describing the material inconsistency, withholding the use of his report in the document, and withdrawing from the engagement.

b. The second sentence of paragraph .06 is replaced with:

He should communicate the material misstatement of fact to the client and the audit committee, in writing, and consider consulting his legal counsel as to further appropriate action in the circumstances.

AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), as amended, is amended as follows:

The last sentence of paragraph .13 is replaced with:

In either case, the accountant should communicate the matter to the audit committee and also consider withholding his consent to the use of his report on the audited financial statements in the registration statement.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), as amended, is amended as follows:

a. The heading preceding paragraph .08, "Establishing an Understanding With the Client" is replaced with the heading, "Establishing an Understanding with the Audit Committee."

b. Paragraph .08 is replaced with:

The accountant should establish an understanding of the terms of an engagement to review interim financial information with the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee).[6] This understanding includes the objective of the review of interim financial information, the responsibilities of the accountant, and the responsibilities of management. Such an understanding reduces the risk that either the accountant or the audit committee may misinterpret the needs or expectations of the other party. The accountant should record this understanding of the terms of the engagement in an engagement letter and should provide the engagement letter to the audit committee. The accountant should have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the accountant should determine that the audit committee has acknowledged and agreed to the terms of the engagement. If the accountant believes he or she cannot establish an understanding of the terms of an engagement to review interim financial information with the audit committee, the accountant should decline to accept, continue, or perform the engagement.

c. Footnote 6 to paragraph .08 is replaced with:

See paragraph .16 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

d. In the first sentence of paragraph .09, the word "client" is replaced with the words "audit committee."

e. Paragraph .30 is replaced with:

If management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should communicate these matters to the audit committee as soon as practicable and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

f. The following sentence is added at the end of paragraph .33:

The accountant should communicate significant deficiencies or material weaknesses of which the accountant has become aware to the audit committee or those responsible for oversight of the company's financial reporting in a timely manner and prior to the registrant filing its periodic report with the SEC.

g. Paragraph .34 is replaced with:

When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Auditing Standard No. 16, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee in a timely manner and prior to the registrant filing its periodic report with the SEC. For example, the accountant should communicate a description of the process management used to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that management determined to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole.[23] As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, estimates, and significant unusual transactions described in paragraph 12 of Auditing Standard No. 16, *Communications with the Audit Committees*. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as the accountant (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the accountant considers critical. The accountant should communicate any omitted or inadequately described matters to the audit committee.

h. Footnote 23 to paragraph .34 is replaced with:

The schedule of uncorrected misstatements related to accounts and disclosures provided to the audit committee should be the same schedule that was included in or attached to the management representation letter that is described in paragraph .24(*k*) of this section.

i. The last two sentences of paragraph .35 are replaced with:

Therefore, any communication the accountant may make about the entity's accounting policies, practices, estimates, and significant unusual transactions as applied to its interim financial reporting, generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the qualitative aspects of the entity's accounting policies and practices that would be identified as a result of an audit.

j. Paragraph .36 is replaced with:

If the accountant has identified matters to be communicated to the audit committee, the accountant should communicate such matters to the audit committee, or at least its chair, in a timely manner and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

Transitional Amendments to AU sec. 380, Communication With Audit Committees

AU sec. 380, *Communication With Audit Committees*

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is amended as follows:

a. The last sentence of paragraph .01 is replaced with:

The communications required by this section are applicable to the audits of (i) issuers and (ii) brokers and dealers, as those terms are defined in the Sarbanes-Oxley Act of 2002, as amended.[2]

b. Footnote 2 to paragraph .01 is replaced with:

See Sections 2(a)(7), 110(3), and 110(4) of the Sarbanes-Oxley Act of 2002.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. The Board is also requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, for application to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"). The Board's request is set forth in section D.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Section 103(a) of the Sarbanes-Oxley Act directs the Board, by rule, to establish, among other things, "auditing and related attestation standards . . . to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by th[e] [Sarbanes-Oxley] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." The Board adopted Auditing Standard No. 16, *Communications with Audit Committees* (the "standard"), and related amendments to improve the audit by enhancing communications between auditors and audit committees.

As discussed more fully in Exhibit 3, the Board adopted Auditing Standard No. 16 because it believes that the standard is in the public interest because the standard establishes requirements that enhance the relevance, timeliness, and quality of the communications between the auditor and the audit committee. The enhanced relevance, timeliness, and quality of communications should facilitate audit committees' financial reporting oversight, fostering improved financial reporting, thereby benefitting investors.

With the passage of the Sarbanes-Oxley Act and the establishment of the PCAOB, Congress acknowledged that auditors play an important role in protecting the interests of investors by preparing and issuing informative, accurate, and independent audit reports.[1/] The audit committee[2/] also plays an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to a company's shareholders and others to

---

1/ *See* Section 101(a) of the Sarbanes-Oxley Act, 15 U.S.C. § 7211(a); Senate Report No. 107-206, at 5-6 (July 3, 2002).

2/ The term "audit committee," as defined in Auditing Standard No. 16, is a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to a company, the entire board of directors of the company. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

oversee the integrity of a company's accounting and financial reporting processes and audits. The audit committee, among other things, serves as the board of director's principal interface with the company's auditors and facilitates communications between the company's board of directors, its management, and its independent auditors on significant accounting issues and policies. The roles of auditors and audit committees are critical to the efficiency and integrity of the capital markets.

Both the auditor and the audit committee benefit from a meaningful exchange of information regarding significant risks of material misstatement in the financial statements and other matters that may affect the integrity of the company's financial reports. Communications between the auditor and the audit committee allow the audit committee to be well-informed about accounting and disclosure matters, including the auditor's evaluation of matters that are significant to the financial statements, and to be better able to carry out its oversight role. Communications with the audit committee provide auditors with a forum separate from management to discuss matters about the audit and the company's financial reporting process.

Auditing Standard No. 16 is aligned with the requirements of the Sarbanes-Oxley Act. For many public companies, the Sarbanes-Oxley Act served to strengthen and expand the role of the audit committee in the financial reporting process. For example, the Sarbanes-Oxley Act requires that audit committee members of listed companies be independent and that audit committees be responsible for the appointment, compensation, and oversight of the work of the external auditor for the purpose of preparing or issuing an audit report or related work.[3/] These requirements place the audit committee at the center of the relationship between management of a public company and its auditor.

Auditing Standard No. 16 is intended to improve the audit[4/] by fostering constructive dialogue between the auditor and the audit committee about significant audit and financial statement matters. The standard requires the auditor to communicate certain matters regarding the audit and the financial statements to the audit committee, which should assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Effective two-way communication between the auditor and the audit committee on such relevant matters also will benefit the auditor in performing an effective audit.

Auditing Standard No. 16 encourages effective two-way communication between the auditor and the audit committee throughout the audit to assist both parties in understanding matters relevant to the audit. Communications that are tailored to the circumstances and informative, rather than "boiler-plate" or

---

3/ *See* Section 301 of the Sarbanes-Oxley Act and Section 10A(m)(2) of the Exchange Act, 15 U.S.C. § 78j-1(m)(2).

4/ For purposes of this release and standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

standardized, will enable the auditor and the audit committee to engage in a dialogue that is more likely to benefit both the audit committee, in conducting its oversight responsibilities, and the auditor, in conducting an effective audit. Effective communication between the auditor and the audit committee may involve many forms of communication, such as presentations, charts, written reports, or robust discussions.

AU sec. 380, which became effective in January 1989, indicated that audit committee communications are incidental to the audit and are not required to occur prior to the issuance of the auditor's report. In contrast, Auditing Standard No. 16 recognizes the importance of the auditor's communications with the audit committee in today's business and regulatory environment; therefore, Auditing Standard No. 16 requires the auditor to communicate the audit strategy and results of the audit to the audit committee in a timely manner and prior to the issuance of the auditor's report to provide an opportunity for the audit committee and the auditor to take appropriate action to address the matters communicated.

Timely communications with the audit committee help the auditor improve the audit by, among other things (i) informing the audit committee, which has responsibility for the oversight of financial reporting, about significant matters related to the audit and the financial statements, (ii) enabling the auditor to obtain the audit committee's insights and information about transactions and events, (iii) enabling the auditor to learn about complaints regarding accounting or auditing matters, and (iv) assisting the auditor in gaining a better understanding of the company and its control environment.

Auditing Standard No. 16 generally links the new communication requirements to the results of related audit performance requirements in other PCAOB standards, or the conduct of the audit. The standard does not otherwise impose new performance requirements, other than communications. Because other PCAOB standards already require the auditor to perform procedures underlying the communications required in Auditing Standard No. 16, and the standard primarily requires communication of the results of the auditor's procedures, the Board does not anticipate a significant increase in cost as a result of the implementation of the standard.

Some of the matters to be communicated under Auditing Standard No. 16 relate specifically to matters involving management's preparation of the company's financial statements. In many companies, management might communicate these matters or take the lead on communicating these matters to the audit committee. The PCAOB does not have the authority to require management to communicate to the audit committee. Additionally, certain communications by the auditor are mandated by federal securities laws and Commission rules.[5/] Therefore, Auditing Standard No. 16 establishes required communications by the auditor to the audit committee but, at the same time,

---

[5/] *See e.g.,* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k); SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"), 17 C.F.R. § 210.2-07; and Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

clearly recognizes and acknowledges that management might communicate to the audit committee certain matters related to the company's financial statements. In such circumstances, the auditor does not need to communicate those matters at the same level of detail as management, as long as certain conditions are met, as specified in the standard.

Auditing Standard No. 16 is scalable for audits of companies of various sizes and complexities. A company's size and complexity might affect the risks of misstatements, the audit strategy, and other significant matters that warrant the attention of the audit committee. Based on the specific company's circumstances, the standard requires communications only to the extent that the matters are relevant to the audit of the financial statements of the company or of internal control over financial reporting. For example, an auditor of a smaller, less complex company with fewer difficult auditing or financial reporting issues may have fewer matters to communicate than the auditor of a larger, more complex company.

The proposed rules also amend the Board's interim standards including superseding interim standards AU sec. 380, *Communication With Audit Committees*, and AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310").

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Sarbanes-Oxley Act.

B. Board's Statement on Burden on Competition

Not applicable.

C. Board's Statement on Comments on the Proposed Rules Change Received from Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2010-001 (March 29, 2010). The Board received 35 comment letters. On September 21, 2010, the Board held a roundtable to obtain insight from additional stakeholders, including investors, audit committee members, auditors, and preparers. The Board reopened the public comment period on the original proposed rules to allow for interested parties to provide additional comments on the topics discussed at the roundtable. The Board received nine additional comment letters during this extended comment period.

The Board considered the comments received relating to its initial proposed rules and at the roundtable and made changes to the initial proposed rules. As a result, the Board again sought public comment on the proposed rules on December 20, 2011. The Board received 39 written comment letters relating to its reproposal of the proposed rules.

The Board has carefully considered all comments received. The Board's response to the comments it received and the changes made to the rules in response to the comments received are discussed below.

Overview of Auditing Standard No. 16

Auditing Standard No. 16 provides a definition of audit committee, retains or enhances existing communication requirements, incorporates certain SEC auditor communication requirements to audit committees, and adds new communication requirements that are generally linked to performance requirements in other PCAOB standards.

For audits of issuers, Auditing Standard No. 16 incorporates the Sarbanes-Oxley Act's definition of audit committee as a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, then the audit committee is the entire board of directors of the company. For audits of nonissuers, the definition of audit committee contained in Auditing Standard No. 16 provides that if no audit committee or board of directors (or equivalent body) exists with respect to the company, then the audit committee is the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

AU sec. 310 requires the auditor to establish an understanding with the client regarding the services to be performed. Auditing Standard No. 16 requires the auditor to establish the understanding of the terms of the audit engagement with the audit committee. This requirement aligns the auditing standard with the provision of the Sarbanes-Oxley Act that requires the audit committee of listed companies to be responsible for the appointment of the external auditor.[6/]

Additionally, Auditing Standard No. 16 requires the auditor to record the terms of the engagement in an engagement letter and to have the engagement letter executed by the appropriate party or parties on behalf of the company and determine that the audit committee has acknowledged and agreed to the terms. These requirements are an expansion of the requirement in AU sec. 310 for the auditor to document the understanding in the working papers, preferably through a written communication with the client.

Auditing Standard No. 16 retains many of the communication requirements in AU sec. 380 and also incorporates the SEC communication requirements.[7/] The standard improves the current communication requirements of AU sec. 380 by requiring the communications with the audit committee to occur before the issuance of the audit report. Additionally, the standard enhances certain existing auditor communication requirements by requiring the auditor to communicate:

- Certain matters regarding the company's accounting policies, practices, and estimates;

6/ *See* Section 301 of the Sarbanes-Oxley Act, and Sections 10A(m)(2) of the Exchange Act, 15 U.S.C. § 78j-1(m)(2).

7/ *See* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k) and SEC Rule 2-07(a)(1)-(3).

- The auditor's evaluation of the quality of the company's financial reporting;
- Information related to significant unusual transactions, including the business rationale for such transactions; and
- The auditor's views regarding significant accounting or auditing matters when the auditor is aware that management consulted with other accountants about such matters and the auditor has identified a concern regarding these matters.

Auditing Standard No. 16 expands the inquiries of the audit committee required by Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* which requires the auditor to inquire of the audit committee regarding the matters important to the identification and assessment of risks of material misstatement and fraud risks. The additional inquiries in Auditing Standard No. 16 address whether the audit committee is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations.

Additionally, Auditing Standard No. 16 adds new communication requirements that provide the audit committee with additional information about significant aspects of the audit. These communications are generally linked to the results of the audit procedures or the conduct of the audit. Under Auditing Standard No. 16 the auditor would be required to communicate:

- An overview of the overall audit strategy, including timing of the audit, significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks;
- Information about the nature and extent of specialized skill or knowledge needed in the audit, the extent of the planned use of internal auditors, company personnel or other third parties, and other independent public accounting firms, or other persons not employed by the auditor that are involved in the audit;
- The basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit will be performed by other auditors;
- Situations in which the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting;
- Difficult or contentious matters for which the auditor consulted outside the engagement team;
- The auditor's evaluation of going concern;
- Departure from the auditor's standard report; and
- Other matters arising from the audit that are significant to the oversight of the company's financial reporting process, including

complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit.

In addition to the communication requirements included in Auditing Standard No. 16, other PCAOB standards and rules that require the auditor to communicate specific matters to the audit committee are referenced in Appendix B to Auditing Standard No. 16.

While the standard establishes certain requirements regarding auditor communications to the audit committee, Auditing Standard No. 16 does not preclude the auditor from providing additional information to the audit committee. Nor does the standard preclude the auditor from responding to audit committee requests for additional information from the auditor.

Definition of Audit Committee (Paragraph A-2 of Auditing Standard No. 16)

Auditing Standard No. 16 defines an audit committee as a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company. This definition largely incorporates the definition of "audit committee" from the Sarbanes-Oxley Act.[8/] The parenthetical phrase "or equivalent body" after the term "committee" clarifies that entities with bodies performing a function similar to that of an audit committee would fit within this category.

[8/] Section 2(a)(3) of the Sarbanes-Oxley Act, 15 U.S.C. § 7201.

The standard modifies the Sarbanes-Oxley Act's version of the definition of an audit committee as it relates to audits of nonissuers. Specifically, for audits of nonissuers, Auditing Standard No. 16 states that, if no such committee or board of directors (or equivalent body) exists with respect to the company, the audit committee would be considered the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company. This modification was made to recognize that some nonissuers, including brokers and dealers, may have governance structures that do not include boards of directors or audit committees. In those cases, the auditor would identify those persons at the nonissuer company who oversee the company's accounting and financial reporting processes and audits. This modification is meant to indicate that senior persons in an oversight role in such circumstances would be the recipients of the auditor communications.

Using the definition of "audit committee," the auditor would identify the bodies or persons that oversee the company's accounting, auditing, and financial reporting processes to find the appropriate recipient of the communications under the standard.[9/] For issuers, the definition is the same as the definition included in the Sarbanes-Oxley Act.[10/] For nonissuers, the definition contains three

9/ The Board's proposed definition is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, or an entity's governing documents regarding the establishment, approval, or ratification of board of directors or audit committees, or the delegation of responsibilities of such a committee or board.

10/ Section 2(a)(3) of the Sarbanes-Oxley Act, 15 U.S.C. § 7201.

categories of bodies or persons. The first two categories (audit committee and the entire board of directors of the company) are the same as those included in the definition of audit committee for an issuer. The third category covers situations in which the company does not have an audit committee, board of directors, or equivalent body, such as certain non-public brokers and dealers. The parenthetical phrase "or equivalent body" after the term "board of directors" clarifies that entities with bodies performing a function similar to that of a corporate board of directors would fit within this category.

The reproposed standard required the auditor to communicate to those persons designated to oversee the financial reporting processes of the company in situations in which a nonissuer does not have an audit committee, board of directors, or equivalent body. Some commenters indicated that, for certain nonissuers, the person designated to oversee the accounting and financial reporting processes of the company could be the chief financial officer, in which case the communication would be made to the person preparing the financial statements. Therefore, commenters suggested that the auditor should make relevant communications to the chief executive officer, or equivalent officer of the company.

Some commenters suggested that the standard should clarify to whom the auditor should communicate when the company is a subsidiary of another entity. Auditing Standard No. 16 does not require communication outside the governance structure of the audited entity because the standard designates the appropriate party to receive the auditor communications within the audited entity. If directed by the audit client, or if the auditor otherwise deems it appropriate, the auditor could also communicate to a parent company audit committee or equivalent body.

Objectives (Paragraph 3 of Auditing Standard No. 16)

Auditing Standard No. 16 states that the objectives of the auditor are to (a) communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee; (b) obtain information from the audit committee relevant to the audit; (c) communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and (d) provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process. The objectives of the standard are intended to highlight the overall context for the requirements in the standard.

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention (Paragraph 4 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards. This requirement was retained from AU sec. 380.[11/]

This requirement is included in the standard because the audit committee might ask management for its views concerning the appointment or retention of the auditor. Management's views might be influenced by the interaction between the auditor and management and the auditor's evaluations and conclusions regarding the application of accounting principles or auditing standards.

Some commenters suggested that these discussions should include a robust fee discussion or a discussion about the results of the auditor's considerations during the client acceptance and continuance process, such as the auditor's views of the entity's accounting and financial reporting practices or management's integrity. The standard was not revised to include such additional matters because the requirement in the standard specifically addresses the auditor's discussions with management related to accounting and auditing matters in connection with the appointment or retention of the auditor. However, Auditing Standard No. 16 requires the auditor to communicate any matters arising from the audit to the audit committee that the auditor believes are significant to the audit committee's oversight of the company's financial reporting process.[12/]

[11/] AU sec. 380.15.

[12/] Paragraph 24 of Auditing Standard No. 16.

<u>Establish an Understanding of the Terms of the Audit (Paragraphs 5-7 of Auditing Standard No. 16)</u>

Auditing Standard No. 16 includes a specific requirement for the auditor to establish an understanding of the terms of the audit engagement with the audit committee. Having a mutually clear understanding of the terms of the engagement, including the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management in connection with the audit, should benefit both the auditor and the audit committee.

The requirement in Auditing Standard No. 16 is similar to the requirement in AU sec. 310, *Appointment of the Independent Auditor* ("AU sec 310"), which requires the auditor to establish an understanding with the client regarding the services to be performed. However, Auditing Standard No. 16 more specifically requires that the understanding be with the audit committee due to the audit committee's financial reporting and audit oversight role, rather than with the "client," which could be understood to mean others besides the audit committee in certain circumstances.

Auditing Standard No. 16 also requires the auditor to record the understanding of the terms of the audit engagement in an engagement letter. Appendix C of Auditing Standard No. 16 describes matters that should be included in an engagement letter, including the objective of the audit and the responsibilities of the auditor and management. This is an expansion of the requirement in AU sec. 310, which requires the auditor to document the understanding of the engagement in the working papers, preferably through a written communication with the client.

Some commenters indicated that the engagement letter should describe the responsibilities of the audit committee related to the audit. The Board considered this suggestion and did not change the standard to include the responsibilities of the audit committee, as those responsibilities are governed by the rules of other organizations, such as the Commission and the national securities exchanges.[13/] However, the standard does not prohibit the auditor from including other matters in the engagement letter, as agreed upon by the auditor and the audit committee, so long as those matters are not in violation of other standards or rules, for example, independence requirements.

Auditing Standard No. 16 requires the auditor to provide the engagement letter to the audit committee annually. Additionally, the auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[14/] The standard also states that if the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor also should determine that the audit committee has acknowledged and agreed to the terms of the engagement. This acknowledgment may be obtained

---

13/ *See, e.g.,* New York Stock Exchange, Listed Company Manual at Section 303A.07, Audit Committee Additional Requirements.

14/ Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

in a variety of ways, such as obtaining the audit committee members' signatures, or its chair's signature on behalf of the audit committee, or obtaining another form of acknowledgement and agreement by the audit committee regarding the terms of the audit engagement. Obtaining this acknowledgement reduces the risk that either the auditor or the audit committee might misinterpret the needs or expectations of the other party. An acknowledgement by the audit committee, the signatures of the audit committee members, or the signature of its chair on behalf of the audit committee on the engagement letter is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, applicable exchange requirements, or the company's governing documents, regarding the authority or lack of authority of the audit committee to enter into any contract or agreement with the auditor.

Several commenters suggested that the standard should specify that the engagement letter should be executed by management in addition to the audit committee or by management alone, along with a representation that it has the authority to do so on behalf of the audit committee. The Board considered these comments and decided that, absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter. Therefore, the standard does not specify the party that should execute the engagement letter on behalf of the company.

Some commenters suggested that the standard should indicate that the audit committee's acknowledgement can be either written or oral. Other commenters suggested that the audit committee's acknowledgement should be written, either evidenced by a signature on the engagement letter or in the audit committee's minutes, to avoid the potential for subsequent misunderstandings of whether the audit committee's acknowledgement has been obtained.

The Board considered these comments and determined that the audit committee's acknowledgement may be provided in writing, such as a signed engagement letter or through the minutes of the audit committee meeting, or orally. The primary focus of this requirement is that the auditor receives acknowledgment and agreement from the audit committee rather than the method the audit committee uses to provide that acknowledgement; therefore, a change to the standard was not warranted. The reproposed standard did not specify the form of acknowledgment and, therefore, the standard was not revised. However, the auditor could request that the audit committee acknowledge the terms of the audit engagement in writing. If the audit committee's acknowledgement is received orally, in accordance with paragraph 25 of Auditing Standard No. 16, the auditor is required to document the acknowledgement in the auditor's work papers.

Obtaining Information Relevant to the Audit (Paragraph 8 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to inquire of the audit committee about whether it is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations. This inquiry contributes to a two-way dialogue between the auditor and the audit committee concerning matters relevant to the audit. This inquiry would complement the requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks, in accordance with Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.[15/] This requirement is included in the standard because, in addition to the inquiries required as part of the risk assessment procedures, audit committees may be aware of other matters relevant to the auditor in performing audit procedures.

Auditing Standard No. 16 does not include the reference to "complaints or concerns received by the audit committee regarding financial reporting matters" previously included in the reproposed standard. This change is not intended to signal a change in the scope of this communication between the audit committee and the auditor. Rather, the Board notes that such inquiry by the auditor of the audit committee is already included in paragraph 56.b(3) of Auditing Standard No. 12, which requires the auditor to inquire of the audit committee about tips or complaints regarding the company's financial reporting.[16/] Since the inquiry in the reproposed standard was similar to the inquiries in Auditing Standard No. 12,

---

[15/] *See* paragraph 5.f. and 54-57 of Auditing Standard No. 12.

[16/] Auditing Standard No. 12 also includes inquiries regarding the audit committee's views about fraud risks, its knowledge of fraud, and the audit committee's response to tips or complaints regarding the company's financial reporting, and how the audit committee exercises oversight of the company's assessment of fraud risks. *See* paragraphs 56.b(1)-(4) of Auditing Standard No. 12.

Auditing Standard No. 16 was revised to remove the inquiry regarding complaints or concerns.

Auditing Standard No. 16 does not provide specific timing for these inquiries to be made. Depending on the circumstances of the audit, it may be appropriate for the auditor to conduct such inquiries of the audit committee at the outset of the audit and/or at other various stages of the audit. For example, the auditor may want to conduct these inquiries early in the audit to consider any information received from the audit committee in designing the nature, timing, and extent of audit procedures. In other circumstances, as the audit progresses, an auditor may want to inquire of the audit committee as to whether any additional matters or concerns relevant to the audit have come to the attention of the audit committee not previously discussed with the auditor.

The reproposed standard required the auditor to inquire of the audit committee about "whether it is aware of matters that might be relevant to the audit." One commenter raised concerns about this provision of the reproposed standard as being "too broad and overreaching," which could obscure information that is truly relevant to the audit. Other commenters suggested that the inquiries of the audit committee should be expanded to include other matters, such as the audit committee's awareness of significant changes in company conditions or activities.

After considering the comments received on the scope of the information to be communicated under this provision, the term "might be" was excluded from this paragraph of the standard. The deletion of the term "might be" is appropriate to avoid an overly broad interpretation of the standard to require discussion of matters that may not be directly connected to the audit.

Although the Board did not revise the requirement to list all the matters of which the auditor could inquire in this provision, the requirement in the standard is not meant to be limited only to matters that are related to violations or possible violations of laws. The Board did not consider it practical to revise the requirement in an attempt to list all the matters of which the auditor could inquire in this provision. Such matters can and should vary from audit to audit. Rather, the inclusion of such matters was meant to serve only as an example of a matter that the auditor should discuss with the audit committee.

The same commenter who objected to the breadth of the inquiry also raised concerns related to the audit committee providing information to the auditor about violations or possible violations of laws or regulations and complaints or concerns received regarding financial reporting matters contained in the reproposed standard. The commenter indicated that the audit committee's communication of such information could cause the information to lose its confidentiality status with potential significant harmful consequences to the company, such as reducing the candor and chilling communications between management, employees, and the audit committee. The commenter also indicated that if the audit committee discloses information covered by privileged attorney-client communications or attorney work product to the auditor as part of this communication, the company may face a risk that a court may later deem the company to have waived the protection of such privilege or work product doctrine.

The Board did not change the requirement to exclude inquiries regarding violations or possible violations of laws or regulations that are relevant to the audit. Limiting the scope of information that the audit committee might provide to the auditor could severely affect the auditor's ability to conduct an effective audit.

The purpose of this requirement is to enable the auditor to have the information necessary to conduct the audit to support the auditor's opinion on the company's financial statements. Due to the audit committee's oversight responsibilities, it is appropriate for the auditor to ask the audit committee for information relevant to the audit, including matters related to violations or possible violations of laws or regulations. Without such inquiry, the auditor may not have information that could influence the performance of the audit.

The same commenter also indicated that if the audit committee provides information relevant to the audit, the audit committee's role would change fundamentally from overseeing the accounting and financial reporting process of the company and audits of financial statements to becoming the original source of information for the auditor and guarantor of the accuracy and completeness of the financial statements, a role that historically has been that of management. It is possible, that in some situations, the communication from the audit committee is the first instance in which a matter is brought to the attention of the auditor.

For example, in some situations the audit committee may have unique insight into management's performance. By providing the opportunity for the audit committee to discuss information with the auditor, the standard enables the auditor to obtain the audit committee's perspective on matters which may be different from management's perspective.

Overall Audit Strategy, Timing of the Audit, and Significant Risks (Paragraphs 9-11 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and to discuss with the audit committee the significant risks[17/] identified during the auditor's risk assessment procedures. Under this requirement, the auditor communicates to the audit committee the results of audit procedures performed in accordance with other PCAOB standards, such as Auditing Standard No. 9, *Audit Planning,* which requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan. As part of the auditor's risk assessment process, the auditor is required to identify and assess the risk of material misstatement, including significant risks.[18/]

The timing of communications related to the audit strategy may vary from audit to audit based on the facts and circumstances. However, early

---

17/ *See* paragraph A5 of Auditing Standard No. 12, which defines significant risk as a risk of material misstatement that requires special audit consideration.

18/ *See* paragraphs 59, 70, and 71 of the Auditing Standard No. 12.

communication of these matters might enable the audit committee to understand the auditor's views regarding risk and thereby provide an opportunity for the audit committee to communicate insights regarding additional risks that the auditor did not identify and allow the auditor to more effectively incorporate the additional risks into the audit strategy.

Some commenters indicated that the requirement for the auditor to communicate the audit strategy might result in the audit committee second guessing the auditor's strategy and the scope of the audit. These commenters suggested that the standard should emphasize that the auditor should not disclose details about the audit strategy that would allow management or the audit committee to take steps that could reduce the effectiveness of the audit strategy. Another commenter suggested the standard should require the auditor to provide specific details about the type and timing of procedures. Auditing Standard No. 16 includes a note, which indicates that the overview of the audit strategy is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures. Communicating certain details might reduce the effectiveness of those audit procedures. The Board considers that the language in Auditing Standard No. 16 strikes the appropriate balance; therefore, the standard was not revised.

Some commenters suggested that significant risks should be communicated throughout the audit rather than communicating just those significant risks identified during the auditor's risk assessment procedures. It is not the intent of the standard for the auditor to communicate only the significant risks that are identified during the auditor's risk assessment procedures. Paragraph 11 of Auditing Standard No. 16 requires the auditor to communicate significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

A commenter suggested that the communication of risks be expanded to include business risks and the auditor's views of the company's internal controls, in addition to the significant risks of material misstatement to the financial statements. As part of obtaining an understanding of the company and its environment, Auditing Standard No. 12 requires the auditor to obtain an understanding of the company's objectives, strategies, and related business risks that could reasonably be expected to result in risks of material misstatement.[19/] Under Auditing Standard No. 16, the auditor is required to communicate significant risks to the audit committee. If the auditor determines that a business risk results in a significant risk of material misstatement, the auditor should communicate the significant risk to the audit committee. Additionally, under Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* and AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* the auditor is required to communicate to the audit committee material

---

[19/] *See* paragraph 14 of Auditing Standard No. 12.

weaknesses and significant deficiencies in internal control over financial reporting identified during the audit.[20/] Therefore, the standard was not revised.

Auditing Standard No. 16 also requires communications regarding others involved in the audit, such as persons with specialized skill or knowledge, internal audit, and other firms or persons performing audit procedures. Communications of others involved in the audit might be important for an audit committee to understand as part of the audit committee's oversight of the financial reporting process.

Specialized Skill or Knowledge (Paragraph 10.a. of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee the nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks. This requirement is designed for the auditor to communicate the determination the auditor is required to make as part of developing the audit strategy in Auditing Standard No. 9.[21/] Many audit firms have employees with specialized skill or knowledge that the engagement team can utilize. However, other firms might not have such in-house expertise. The

---

[20/] *See* paragraphs 78 and 80 of Auditing Standard No. 5 and paragraph 4 of AU sec. 325.

[21/] *See* paragraph 16 of Auditing Standard No. 9 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

focus of this requirement is on the communication about the need for specialized skill or knowledge, regardless of whether the specialist is from within the firm or outside the firm.

Internal Audit (Paragraphs 10.b. and 10.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements, including when internal audit provides direct assistance to the auditor. In addition, Auditing Standard No. 16 requires the auditor to communicate the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting.

Auditing Standard No. 9 requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan, including the nature, timing, and extent of resources necessary to perform the engagement.[22/] Other standards, including AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* and Auditing Standard No. 5, provide additional requirements and impose limits on the use of internal audit staff. The requirement in Auditing Standard No. 16 is to communicate to the audit committee the extent

---

[22/] *See* paragraphs 8-9 of Auditing Standard No. 9.

to which the auditor plans to use the work of the company's internal auditors and others as determined in the audit plan.

Other Firms or Persons Performing Audit Procedures (Paragraph 10.d. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit. The standard includes a note stating the term "other independent public accounting firms" includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.

In planning and performing the audit, the auditor determines whether to use other auditors or other persons to perform audit procedures at individual client locations, business units, or to perform work related to specific audit areas or procedures. Those other auditors might be affiliated firms, non-affiliated firms, or other persons not employed by the auditor.

The note to Auditing Standard No. 16 was revised from the reproposed standard to clarify that the communication regarding other independent public accounting firms is not based on the type of relationship the auditor otherwise has with the other firms. Rather, the requirement for the auditor to communicate the names, locations, and planned responsibilities of other independent public accounting firms and other persons is to provide information to the audit committee regarding the parties involved in the audit. This requirement also might facilitate a discussion of how the work of other parties would affect the audit.

The reproposed standard also required the auditor to communicate to the audit committee the "planned roles" of others involved in the audit and the "scope of audit procedures." One commenter suggested that the requirement to communicate the "scope of audit procedures" should be clarified in the standard. Another commenter suggested that the communication should be expanded to be more robust when other participants are used to audit foreign components of a company. Auditing Standard No. 10, *Supervision of the Audit Engagement,* requires the auditor to inform engagement team members of their responsibilities[23/] and AU sec. 543, *Part of Audit Performed by Other Independent Auditors,* discusses situations in which the auditor uses the work and reports of other independent auditors who have audited financial statements of one or more subsidiaries, divisions, branches, components or investments included in the financial statements.[24/] To align with these requirements, the standard was revised to require the auditor to communicate only the "planned responsibilities" of other participants involved in the audit, the requirements to communicate the "planned roles" of others involved in the audit and the "scope of audit procedures" were removed from the standard, and the standard was not expanded to include other considerations.

[23/] *See* paragraph 5.a. of Auditing Standard No. 10.

[24/] *See* AU sec. 543.01.

Many commenters suggested that the standard provide a threshold for determining when to make communications regarding others involved in the audit, such as when another auditor performs procedures related to a percentage of the company's total assets or addresses significant risks. Others suggested that the communication include only non-affiliated accounting firms. The standard was not revised because audit committees have oversight of the entire audit engagement, which includes work performed by other auditors. The audit committee should be aware of all the participants in the audit. This communication regarding other participants in the audit would enable the audit committee to inquire or otherwise determine, for example, whether the other participants are registered with the Board and are subject to PCAOB inspections and whether they have disciplinary history with the Board or other regulators.

This communication requirement is intended to be scalable. For example, the amount of detail the auditor generally would communicate to the audit committee regarding the participation of other auditors would be greater for participants that perform a significant portion of the audit or that perform procedures related to significant risks.

Principal Auditor (Paragraph 10.e. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors. This communication requirement is based on the auditor's determination that the auditor can serve as the principal auditor in accordance with AU sec. 543. This communication would enable the audit committee to evaluate the extent of work performed by the principal auditor in relation to work performed by other auditors.

The reproposed standard included a note to describe situations where such communications would be required. The Board determined that this note was not necessary because AU sec. 543, governs the determination of whether the auditor can serve as the principal auditor.

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions (Paragraph 12 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the company's accounting policies and practices, estimates, and significant unusual transactions. However, the standard recognizes that management also might make communications to the audit committee regarding these matters and that the auditor might not need to communicate the information at the same level of detail as management as long as the auditor meets certain criteria specified in the standard. In such circumstances, the auditor should communicate any omitted or inadequately described matters to the audit committee.

Accounting Policies and Practices (Paragraphs 12.a. and 12.b. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain information regarding the company's significant accounting policies and practices and also critical accounting policies and practices.

The standard uses the terms "significant accounting policies and practices" and "critical accounting policies and practices." The Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") and the International Accounting Standards Board, require that companies disclose a description of all significant accounting policies as an integral part of the financial statements.[25/] For example, the FASB ASC recognizes that an entity's description of its significant accounting policies is an integral part of the financial statements.[26/] Additionally, the term "significant accounting policies and practices" is consistent with the term used in AU sec. 380 and understood in practice and, therefore, has not been separately defined.

The definition of "critical accounting policies and practices" in Auditing Standard No. 16 is based on the SEC's description of the term "critical

---

[25/] *See* FASB ASC, Topic 235, Notes to Financial Statements, section 235-10-50. As part of this disclosure, the entity is required to disclose accounting policies and to describe the accounting principles followed by the entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations. Additionally, *see* paragraph 117 of International Accounting Standard 1, *Presentation of Financial Statements,* which requires the entity to disclose the summary of significant accounting policies, including the measurement basis used in preparing the financial statements and other accounting policies that are relevant to understanding the financial statements.

[26/] *See* FASB ASC paragraphs 235-10-50-1 through 235-10-50-6.

accounting policies and practices" as a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.[27/] The selection of significant accounting policies and practices involves a broader range of transactions and events over time, while the selection of critical accounting policies and practices is tailored to specific events in the current year. Therefore, critical accounting policies and practices might be viewed as a subset of significant accounting policies and practices.

Significant Accounting Policies and Practices (Paragraph 12.a. of Auditing Standard No. 16)

Auditing Standard No. 16 generally retains the requirements from AU sec. 380 related to communication of the company's significant accounting policies and practices, including:

- Management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and
- The effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which

---

[27/] See SEC, Strengthening the Commission's Requirements Regarding Auditor Independence, Securities Act Release No. 8183 (Jan. 28, 2003).

there is a lack of authoritative guidance or consensus, or diversity in practice.

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to significant accounting policies and practices, whereas, AU sec. 380 required the auditor only to determine that the audit committee was "informed." This change in wording is intended to indicate that the auditor should make these communications, rather than determine that the audit committee was informed, as required in AU sec. 380. However, the note to paragraph 12 of Auditing Standard No. 16 acknowledges that such communications may be made by management, and if the auditor meets certain conditions, these communications need not be duplicated by the auditor.

Some commenters suggested that it was unclear whether the communication of the initial selection of, or changes in, significant accounting policies or the application of such policies in the current period would require communication annually if there is no change. Another commenter indicated that the auditor may not be in a position to provide information on areas for which there is diversity in practice because the auditor may not be knowledgeable of accounting practices used by other entities.

Auditing Standard No. 16 was not revised in response to these comments. The standard indicates that the auditor should communicate to the audit committee the initial selection in the current period of significant accounting policies. The standard also indicates that the auditor should communicate to the audit committee changes in those policies or changes in the application of those policies in the current period if they differ from those policies that management previously utilized or how they were previously applied.

Additionally, the auditor's responsibility to communicate the effect of significant accounting policies includes (i) controversial areas or (ii) areas for which there is lack of authoritative guidance or consensus, or diversity in practice. The auditor should be aware of diversity in practice related to significant accounting policies and practices used by the company because Auditing Standard No. 12 requires the auditor to evaluate whether the company's selection of and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and accounting principles used in the relevant industry.[28/] Based on this evaluation, the auditor should be in a position to make such communication.

Critical Accounting Policies and Practices (Paragraph 12.b. of Auditing Standard No. 16)

Auditing Standard No. 16 incorporates the Exchange Act requirement for the auditor to communicate to the audit committee all critical accounting policies and practices to be used.[29/] Auditing Standard No. 16 also requires the auditor to communicate the reasons certain accounting policies and practices are

---

[28/] Paragraph 12 of Auditing Standard No. 12.

[29/] Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), requires the auditor to report this information to the audit committee. *See also* SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"), 17 C.F.R. § 210.2-07.

considered critical and how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.[30/]

Some commenters recommended deleting the requirement for the auditor to communicate how anticipated future events might affect the determination of whether certain policies and practices are considered critical since the auditor cannot predict the future. The standard retains the SEC requirement regarding communication of anticipated future events related to critical accounting policies and practices, as this is a component of the required communication the SEC identified in adopting SEC Rule 2-07.[31/] The standard notes that critical accounting policies and practices are tailored to specific events in the current year and that the accounting policies and practices that are considered critical might change from year to year. For example, a significant merger or acquisition may result in the related accounting policy being considered critical in the current year in which the related transaction occurs, but not in subsequent years. Auditing Standard No. 16 is aligned with the SEC requirement, therefore the standard was not revised.

[30/] *See* Securities Act Release No. 8183, which describes the SEC's expectations regarding the discussion related to critical accounting policies and practices. In this release, the SEC indicated that it anticipated that the discussion of accounting policies and practices would include how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

[31/] *Id.*

Critical Accounting Estimates (Paragraph 12.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the following matters related to critical accounting estimates:

(1) A description of the process management used to develop critical accounting estimates;

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and

(3) Any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.

As the term "critical accounting estimate" implies, the communication is not designed to encompass a long list of accounting estimates resulting from the application of accounting policies that cover a substantial number of line items in the company's financial statements. Rather, Auditing Standard No. 16 defines the term "critical accounting estimate" as an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

The definition of "critical accounting estimate" is based on SEC interpretive guidance in connection with management's discussion and analysis ("MD&A") of the company's financial condition and results of operations.[32/] The alignment of the term critical accounting estimates in PCAOB standards with the same term in the SEC's interpretive guidance allows auditors to use the same concept under SEC requirements and PCAOB standards when communicating matters to the audit committee. The term critical accounting estimate is used to help focus the communication to the audit committee on those estimates that might be subject to a higher risk of material misstatement, such as certain fair value estimates. The definition of a critical accounting estimate is intended to replace the term "particularly sensitive" in AU sec. 380.[33/]

The requirement to communicate the process management used to develop critical accounting estimates is adapted from the requirement in AU sec. 380 related to particularly sensitive accounting estimates.[34/] Additionally, the communication requirements are designed to communicate the results of the auditor's performance requirements under AU sec. 342, *Auditing Accounting*

[32/] *See* SEC, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (Dec. 19, 2003).

[33/] *See* AU sec. 380.08, which stated in part, "[c]ertain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments."

[34/] AU sec. 380.08.

Estimates, which requires the auditor to evaluate the reasonableness of accounting estimates. In evaluating the reasonableness of the accounting estimate, AU sec. 342 also requires the auditor to obtain an understanding of how management developed the estimate.[35/] AU sec. 342 also states that in evaluating the reasonableness of an estimate, the auditor normally concentrates on key factors and assumptions that are (a) significant to the accounting estimate, (b) sensitive to variations, (c) deviations from historical patterns, and (d) subjective and susceptible to misstatement and bias.[36/]

One commenter suggested that the communication requirement also include how management subsequently monitors critical accounting estimates and, 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. Although these requirements are not included in Auditing Standard No. 16, the Board notes that the SEC has stated that management should disclose the company's critical accounting estimates in MD&A.[37/] According to the related SEC release, management's discussion should present, among other matters, the company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time and

---

35/ *See* AU sec. 342.10.

36/ *See* AU Sec. 342.09.

37/ *See* Securities Act Release No. 8350.

analyze an estimate's specific sensitivity to change based on other outcomes that are reasonably likely to occur and would have a material effect.[38/] The commenter's concerns, therefore, may be addressed through a company's MD&A disclosures.

AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires the auditor to read the other information, such as MD&A in documents containing audited financial statements, and consider whether the information, or the manner of its presentation, is materially inconsistent with information in the financial statements or is a material misstatement of fact.[39/] Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee the results of such procedures. Accordingly, no change was made to the standard.

Significant Unusual Transactions (Paragraph 12.d. of Auditing Standard No. 16)

Auditing Standard No. 16 includes requirements for the auditor to communicate to the audit committee (1) significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature;[40/] and (2) the policies and practices management used to account for significant unusual transactions.

[38/] *Id.*

[39/] AU secs. 550.04-.05.

[40/] *See* paragraph 71.g. of Auditing Standard No. 12.

Communication of significant unusual transactions would enable the audit committee to gain the auditor's insight into those transactions and to take any appropriate action.

The requirement in the standard for the auditor to communicate the policies and practices management used to account for significant unusual transactions is similar to the requirement in AU sec. 380.[41/] Under Auditing Standard No. 16, such communication also would include the identification of significant unusual transactions.

The reproposed standard required the auditor to communicate significant unusual transactions, of which the auditor is aware, that are outside the normal course of business for the company or otherwise appear to be unusual due to their timing, size, or nature. Many commenters indicated that management also might communicate matters related to significant unusual transactions to the audit committee and that the standard should acknowledge that management might make the communications related to significant unusual transactions. The standard was revised to recognize that management might make these communications to the audit committee and that, in those situations, the auditor might not need to communicate the information at the same level of detail as management as long as certain criteria specified in the standard are met. However, the auditor should communicate any omitted or inadequately described matters to the audit committee.

[41/] AU sec. 380.07.

Additionally, some commenters suggested that the communication should be limited to significant unusual transactions that are considered significant risks. While a significant unusual transaction might also be considered a significant risk, this communication provides the audit committee with additional information regarding the significant unusual transactions and the policies and practices management used to account for such transactions, even if such transactions do not constitute significant risks. Significant unusual transactions, at times, have been considered to be a contributing factor in attempts to mislead investors about a company's financial condition. Therefore, providing the audit committee with information regarding significant unusual transactions could benefit the audit committee in its oversight of the financial reporting process.

Some commenters suggested that the standard include a definition of the term "significant unusual transactions." Auditing Standard No. 16 describes significant unusual transactions as significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature, which is consistent with the description of this term in other PCAOB standards, such as Auditing Standard No. 12.[42/] Therefore, the standard was not revised to further define significant unusual transactions.

[42/] Paragraph 71.g. of Auditing Standard No. 12.

Consideration of Communications Made by Management (Note to Paragraph 12 of Auditing Standard No. 16)

Auditing Standard No. 16 retains the substance of the communication requirements in AU sec. 380 regarding accounting policies, practices, and estimates. The requirement in the standard for the auditor to communicate critical accounting policies and practices is consistent with Section 10A(k) of the Exchange Act, which requires auditors of issuers to report all critical accounting policies and practices to the issuer's audit committee.[43/] In addition, Auditing Standard No. 16 includes a new requirement related to the communication of significant unusual transactions.

Many commenters suggested that the standard should recognize that management has the primary responsibility for reporting to the audit committee and that the auditor's responsibility should be to confirm that management has appropriately communicated. No change was made in response to this comment because, similar to AU sec. 380, Auditing Standard No. 16 acknowledges that management also may be communicating certain matters related to the financial reporting process to the audit committee. The Board recognizes that management as well as the auditor might discuss accounting policies, practices, estimates, and significant unusual transactions with the audit committee and that it would not be cost-effective or practical for the audit committee to listen to essentially the same presentation twice. Therefore, Auditing Standard No. 16 indicates that, in situations in which management communicates matters in

---

43/ *See also* SEC Rule 2-07.

paragraph 12, the auditor's communication requirement under the standard would be met if the auditor: (1) participates in management's discussion with the audit committee,[44/] (2) affirmatively confirms to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identifies for the audit committee those accounting policies and practices that the auditor considers critical. In addition, the auditor should communicate any omitted or inadequately described matters to the audit committee.

In situations in which management makes those communications to the audit committee, in order to satisfy the communication requirement in Auditing Standard No. 16, the auditor would be required to participate during discussions between management and the audit committee regarding accounting policies, practices, estimates, and significant unusual transactions, which may include discussions of the importance of critical accounting policies, practices or estimates, or the difficult, subjective, or complex nature of the judgment involved in significant unusual transactions, or the selection or application of accounting policies, practices, or estimates. If the auditor to identifies the accounting policies and practices that the auditor considers critical to the portrayal of the company's financial condition and results and affirmatively confirms that management has adequately communicated the accounting policies, practices, estimates, and significant unusual transactions to the audit committee in a meeting in which the

[44/] The auditor's participation in management's discussion with the audit committee could be satisfied in person or via audio or video conference.

auditor participated the auditor would be deemed to satisfy the requirement for the auditor to report all critical accounting policies and practices to the audit committee, without the need for the auditor to repeat management's presentation on the same topic.

Conversely, if the auditor (1) did not participate in management's meeting with the audit committee in which communication regarding accounting policies, practices, estimates, and significant unusual transactions occurred, (2) did not affirmatively confirm that accounting policies, practices, estimates, and significant unusual transactions had been discussed adequately by management, or (3) with respect to critical accounting policies and practices, did not identify those accounting policies and practices that the auditor considers critical, then the auditor would be required to communicate to the audit committee the matters described in paragraph 12 of Auditing Standard No. 16, regardless of any management communication regarding those matters.

Auditor's Evaluation of the Quality of the Company's Financial Reporting (Paragraph 13 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate certain matters to the audit committee regarding the auditor's views of the audit and the financial statements as described below.

Qualitative Aspects of Significant Accounting Policies and Practices (Paragraph 13.a. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements. This requirement is similar to certain communication requirements that have been superseded. AU sec. 380 required the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the company's accounting principles.[45/] Additionally, AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* required the auditor to consider whether matters related to management bias should be communicated to the audit committee.[46/]

The requirement in Auditing Standard No. 16 is designed for the auditor to communicate the results of the auditor's procedures under Auditing Standard No. 14, *Evaluating Audit Results,* which requires the auditor to, among other things, evaluate the qualitative aspects of the company's accounting practices,[47/] including potential bias in management's judgments about the amounts and disclosures in the financial statements.[48/]

45/ AU sec. 380.11.

46/ Following the original proposal of this standard, AU sec. 9312 was superseded when the Board adopted the risk assessment standards. The performance requirement of AU sec. 9312, however, was substantially included in the risk assessment standards.

47/ *See* paragraphs 24-27 of Auditing Standard No. 14.

48/ *Id*.

Additionally, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the results of the auditor's evaluation of the differences between (i) estimates best supported by audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management. This communication is designed for the auditor to discuss the results of the auditor's evaluation of these matters as required under Auditing Standard No. 14.[49/] Linking the communication requirements with performance requirements in Auditing Standard No. 14 provides context regarding the matters to be communicated.

Some commenters suggested that the standard should retain the requirement in AU sec. 380 for the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles. Auditing Standard No. 16 modifies the requirement from AU sec. 380 by requiring the auditor to communicate to the audit committee the results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, while linking the communication requirement to the performance requirement in Auditing Standard No. 14. Therefore, no change was made in response to these comments.

[49/] *See* paragraph 27 of Auditing Standard No. 14.

Assessment of Critical Accounting Policies and Practices (Paragraph 13.b. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosures of those policies and practices proposed by the auditor that management did not make. This requirement is based on the Exchange Act's requirement that the auditor report to the audit committee all critical accounting policies and practices.[50/] In the release adopting the SEC's related rule, the SEC indicated that it anticipated that the auditor's communications to the audit committee regarding critical accounting policies would include an assessment of management's disclosures along with any significant proposed modifications by the auditor that were not included in those disclosures.[51/]

Conclusions Regarding Critical Accounting Estimates (Paragraph 13.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates. This requirement is similar to a requirement in AU sec. 380.[52/] This requirement is designed to require the auditor to communicate the

---

50/ *See* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k); and SEC Rule 2-07.

51/ *See* Securities Act Release No. 8183.

52/ *See* AU sec. 380.08.

results of the auditor's procedures regarding critical accounting estimates under PCAOB standards, such as AU sec. 342.[53] Communicating these results will provide the audit committee with the auditor's assessment of the critical accounting estimates based on the auditor's procedures.

Significant Unusual Transactions (Paragraph 13.d. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's understanding of the business rationale for significant unusual transactions. This communication requirement is aligned with the performance requirement in AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* which requires the auditor to gain an understanding of the business rationale regarding significant transactions that are outside the normal course of business or that otherwise appear unusual.[54] This communication would provide the audit committee with an opportunity to receive the auditor's perspective of such transactions.

In a separate rulemaking project, the Board has proposed amendments to AU sec. 316 that would require the auditor to design and perform procedures to obtain an understanding of the business purpose (or lack thereof) of each significant unusual transaction and evaluate whether the business purpose (or the lack thereof) indicates that the significant unusual transaction may have been

---

53/ *See* AU secs. 342.04, 09-.10.

54/ *See* AU sec. 316.66.

entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.[55/] If, at the conclusion of that rulemaking project, the Board adopts the proposed amendments to AU sec. 316, the Board will consider, as appropriate, amending Auditing Standard No. 16 to align the communication with any new performance requirements.

Financial Statement Presentation (Paragraph 13.e. of Auditing of Auditing Standard No. 16)

Similar to AU sec. 380.11, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth. This communication requirement relates to the auditor's evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, as required by Auditing Standard No. 14.[56/]

[55/] *Proposed Auditing Standard - Related Parties*, *Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions*, *and Other Proposed Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2012-001 (Feb. 28, 2012).

[56/] See paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibility relating to the evaluation of whether the financial

Some commenters suggested that the standard should retain the requirement in AU sec. 380 for the auditor to discuss with the audit committee the auditor's views about the clarity and completeness of the company's financial statements and disclosures. However, commenters on the original proposed standard indicated it was not clear what was meant by the clarity and completeness of the company's financial statements and related disclosures. Commenters also expressed concern as to what should be included in the communications to the audit committee. The communication requirement in Auditing Standard No. 16 avoids possible confusion regarding the meaning of the phrase "clarity and completeness" by linking it to the auditor performance requirements included in Auditing Standard No. 14 for the auditor to evaluate the presentation of the financial statements, including disclosures. The performance requirements in Auditing Standard No. 14[57/] provide context regarding the matters to be communicated under Auditing Standard No. 16.

New Accounting Pronouncements (Paragraph 13.f. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and

---

statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

57/ *Id.*

might have a significant effect on future financial reporting. This requirement is based on the situations in which, as a result of the auditor's procedures, the auditor has identified a concern regarding the anticipated application of a new accounting pronouncement. Auditing Standard No. 16 does not require the auditor to perform additional procedures to identify such concerns.

Some commenters noted that management generally discloses in the financial statements the potential effects of adoption of new accounting standards and that this auditor communication to the audit committee should be related to the auditor's evaluation of management's disclosures related to new accounting pronouncements. The intent of the required communication to the audit committee is not meant to provide an additional evaluation of management's disclosures. Rather, the intent is to inform the audit committee when the auditor "has identified a concern" regarding the planned implementation of a new accounting pronouncement or whether management has devoted adequate resources to prepare its accounting and disclosure processes, and other financial reporting systems, for the timely implementation of the new accounting pronouncement. This communication might inform the audit committee's oversight of the company's financial reporting process. Requiring the discussion of such matters is intended to allow the audit committee to properly consider the auditor's concerns regarding future financial statements. Accordingly, no change to the standard was made.

Alternative Accounting Treatments (Paragraph 13.g. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate all alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor. This requirement is consistent with Section 10A(k) of the Exchange Act and with SEC Rule 2-07, which requires the auditor to report to the audit committee all alternative treatments that are related to material items, were discussed with management, and are permissible under the applicable financial reporting framework.[58/]

Other Information in Documents Containing Audited Financial Statements (Paragraph 14 of Auditing Standard No. 16)

Auditing Standard No. 16 retains the requirement from AU sec. 380.12 for the auditor to communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for other information presented in documents containing audited financial statements, any related procedures performed, and the results of such procedures. Such other information would include documents described in AU sec. 550, AU sec. 558, *Required Supplementary Information,* and AU sec. 711, *Filings Under Federal Securities Statutes*.

[58/] *See* SEC Rule 2-07, Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Securities Act Release No. 8183.

The auditor's responsibility under AU sec. 550 requires the auditor to read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, in the financial statements.[59/] One commenter suggested that Auditing Standard No. 16 should also include a requirement to communicate any identified material inconsistencies or misstatements of facts, including the auditor's response to such matters.

Auditing Standard No. 16 requires the auditor to communicate the results of the auditor's procedures related to other information in documents containing audited financial statements, which would require the auditor to communicate identified inconsistencies or misstatements of facts to the audit committee. The Board is amending AU sec. 550 to require the auditor to communicate to the audit committee the material inconsistency between the other information and the financial statements in situations in which the information is not revised to eliminate the material inconsistency. The Board also is amending AU sec. 550 to require the auditor to communicate to the client and the audit committee, in writing, a material misstatement of fact in the other information. Thus, it was not necessary to revise the standard in response to commenters.

[59/] *See generally*, AU secs. 550.04-.07, which require that the auditor read the information and consider whether it is materially inconsistent with information in the financial statements or whether it contains any material misstatements of fact.

Difficult or Contentious Matters for which the Auditor Consulted (Paragraph 15 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process. The required communications of difficult or contentious matters are based on the results of the procedures the auditor performed regarding such matters during the course of the audit and do not require the performance of new or additional procedures.

Many matters that arise during an audit can be complex or unusual, and the auditor might consult on such matters with the firm's national office, industry specialists, or external parties. Difficult or contentious issues can arise in various stages of the audit, including in the auditor's evaluation of management's judgments, estimates, accounting policies, or assessment of identified control deficiencies. Difficult or contentious issues generally are the critical matters that concern the auditor when he or she is making the final assessment of whether the financial statements are presented fairly.

A difficult issue might not always be synonymous with a contentious issue. Rather, a difficult issue might be a matter that requires consultation. A contentious issue might be a matter that not only requires consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management. Audit committees might better appreciate the importance of difficult or contentious matters if they are aware that such consultations took place.

During the course of the audit difficult or contentious issues might arise for which the auditor did not consult, but which the auditor believes are relevant to the audit committee's oversight of the financial reporting process. Auditing Standard No. 16 does not preclude the auditor from communicating to the audit committee difficult or contentious matters for which the auditor did not consult outside the engagement team.

Some commenters suggested that the standard should define difficult or contentious matters. The term "difficult or contentious matter" is used in Auditing Standard No. 7, *Engagement Quality Review.* Therefore, the term "difficult or contentious matter" is not defined in this standard.

Some commenters suggested that the standard should exclude the discussions between the auditor and the engagement quality reviewer from communications to the audit committee regarding consultation outside the engagement team on difficult or contentious matters. The communication to the audit committee in Auditing Standard No. 16 focuses on the difficult or contentious matters on which the auditor consulted, not on the parties involved in the consultation. Therefore, the standard was not revised.

Management Consultation with Other Accountants (Paragraph 16 of Auditing Standard No. 16)

When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's views about such matters that were the subject of such consultation. This requirement is similar to a requirement in AU sec. 380.[60/] Communicating matters that were the subject of consultations only when the auditor has identified a concern about those matters should allow the audit committee to focus its efforts on important accounting and auditing issues.

Some commenters suggested that communicating management consultations with other accountants should be management's responsibility and that the standard should clarify that the auditor should comment only on what management has communicated regarding such consultations. The standard does not impose a communication requirement on management. The requirement in Auditing Standard No. 16 is specifically related to the auditor's responsibilities when management has consulted with other accountants and only when the auditor has a concern regarding the accounting and auditing matters that were the subject of management's consultations. Therefore, Auditing Standard No. 16 was not revised.

As part of the comment process, the Board asked whether the requirement to communicate about consultations should be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms. Some commenters suggested that communication

---

[60/] AU sec. 380.14.

regarding management's consultations with non-accountants should be required, while others suggested that communication about these consultations should be made at the auditor's discretion depending on the facts or circumstances and the significance of the consultation to the financial statements. However, many commenters indicated that this communication should not be expanded to include consultations with non-accountants, as the auditors would not be in position to know about all management consultations with non-accountants. Some commenters indicated that this requirement could result in the auditor expending significant effort to identify and evaluate management's consultations with non-accountants. After consideration of these comments, the standard was not revised to require the auditor to communicate management's consultation with non-accountants.

Going Concern (Paragraph 17 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the auditor's evaluation of the company's ability to continue as a going concern. The communication requirements in Auditing Standard No. 16 are based on the auditor's performance requirements under AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, which requires the auditor to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.[61] The auditor's communication to the audit committee regarding the auditor's evaluation of the company's ability to continue as a going concern can serve to further inform the audit committee, in certain circumstances, regarding difficult conditions and events that the company is encountering.

Auditing Standard No. 16 requires the auditor to communicate the conditions and events the auditor identified that, when considered in the aggregate, lead the auditor to believe that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. Information about such conditions and events is obtained from the application of auditing procedures planned and performed to achieve audit objectives that are related to management's assertions in the financial statements.[62] Examples of such conditions and events include, but are not limited to, negative trends, other indications of possible financial difficulties, internal matters, or external matters that have occurred.[63]

61/ *See* AU sec. 341.06, which provides examples of such conditions and events and AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

62/ *See* AU sec. 341.02.

63/ *See* AU sec. 341.06, which provides examples of such conditions and events.

Under AU sec. 341, if after considering the identified conditions and events, in the aggregate, the auditor believes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider management's plans for dealing with the adverse effects of the conditions and events.[64/] Additionally, the auditor should obtain information about the plans and consider whether it is likely that the adverse effects will be mitigated for a reasonable period of time, and that such plans can be effectively implemented.[65/] Auditing Standard No. 16 requires that if the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the auditor should communicate to the audit committee the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events.[66/]

Under AU sec. 341, if the auditor concludes that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph to reflect

---

[64/] *See* AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

[65/] *See* AU sec. 341.03b.

[66/] *See* AU sec. 341.08, which discusses the auditor's responsibilities related to the auditor's evaluation of management's plans.

the auditor's conclusion that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.[67/] Additionally, Auditing Standard No. 16 requires that if the auditor concludes that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains,[68/] the auditor should communicate to the audit committee: (1) the effects, if any, on the financial statements and the adequacy of the related disclosure;[69/] and (2) the effects on the auditor's report.[70/]

The reproposed standard required the auditor to communicate the conditions and events the auditor identified that, when considered in the aggregate, indicate that there "could be" substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. Some commenters suggested that the threshold for communication to the audit committee should be when the auditor believes there "is" substantial doubt about the company's ability to continue as a going concern, rather than when there "could be" substantial doubt. Those commenters suggested that threshold

---

[67/] *See* AU sec. 341.12.

[68/] *See* AU sec. 341.03c, which discusses the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

[69/] *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

[70/] *See* AU secs. 341.12-.16, which discuss the auditor's consideration of the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

because, under AU sec. 341, the auditor is required to consider management's plans for addressing the adverse effects of the events and conditions when the auditor believes there "is" substantial doubt.

Auditing Standard No. 16 was revised to require the threshold for the auditor's initial communication to the audit committee to be when the auditor "believes there is" substantial doubt about the company's ability to continue as a going concern. This aligns more closely the communication requirement about the conditions and events with the other communication requirements in paragraph 17 of Auditing Standard No. 16. Under paragraph 17 of Auditing Standard No. 16 the auditor is required to communicate conditions and events, along with the auditor's conclusion regarding whether either management's plans alleviate the adverse effects of the conditions and events (item b) or substantial doubt remains (item c).

Uncorrected and Corrected Misstatements (Paragraphs 18-19 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to provide the audit committee with the schedule of uncorrected misstatements[71/] relating to accounts and disclosures that was presented to management. Several commenters indicated that audit committees would not find value in information presented at the same level of detail as presented to management, and that the auditor, therefore, should provide a summary of misstatements to the audit committee.

[71/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include both omissions and the presentation of inaccurate or incomplete disclosures.

The Board decided to retain the requirement because presenting a schedule that shows only a summary of the uncorrected misstatements rather than the individual misstatements might not be informative for the audit committee. In addition, the requirement in Auditing Standard No. 16 is not a significant change from AU sec. 380.10, which required the presentation to the audit committee of a schedule of uncorrected misstatements.

The schedule of uncorrected misstatements required by Auditing Standard No. 16 is similar to the summary of uncorrected misstatements included in or attached to the management representation letter.[72/] Additionally, the Exchange Act and SEC Rule 2-07 require the auditor to provide to the audit committee other material written communications between the auditor and management, which would include the schedule of unadjusted audit differences and a listing of adjustments and reclassifications not recorded, if any.[73/]

Auditing Standard No. 14 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial, and to communicate those to management on a timely basis.[74/] According to Auditing Standard No. 14, a misstatement may relate to a difference between the amount, classification, presentation, or disclosure of a reported financial

---

72/ *See* paragraph .06g of AU sec. 333, *Management Representation*.

73/ *See* Section 10A(k)(3) of the Exchange Act, 15 U.S.C. § 78j-1(k)(3), SEC Rule 2-07(a)(3) and Securities Act Release No. 8183.

74/ *See* paragraphs 10 and 15 of Auditing Standard No. 14.

statement item and the amount, classification, presentation, or disclosure that should be reported in conformity with the applicable financial reporting framework.[75/] The requirement in Auditing Standard No. 16 to communicate misstatements related to accounts and disclosures relates only to those misstatements that the auditor has accumulated throughout the audit that are not clearly trivial and have been reported to management.

Auditing Standard No. 16 also requires the auditor to discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[76/] considered. In addition, the auditor also should communicate to the audit committee that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

Auditing Standard No. 16 also requires the auditor to communicate those corrected misstatements, other than those that are clearly trivial, related to accounts and disclosures that might not have been detected except through the

---

[75/] *See* paragraph A2 of Auditing Standard No. 14.

[76/] *See* Appendix B of Auditing Standard No. 14, which discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

auditing procedures performed and discuss with the audit committee the implications that such corrected misstatements might have on the financial reporting process.

One commenter suggested that the standard should require the auditor to communicate management's adjusting entries recorded at the end of the period or other entries to reconcile accounts. The release accompanying the original proposed standard included a question that asked whether all corrected misstatements, including those detected by management, should be communicated to the audit committee. Many commenters responding to the question were not supportive of the auditor communicating misstatements detected by management or management's period-end adjusting entries, because the auditor may not have knowledge of all such adjustments due to the nature of a company's financial statement close process and the timing of the auditor's procedures. Commenters suggested that such a requirement would likely result in the auditor expending significant effort to identify misstatements or adjusting entries that the company's internal controls previously identified in the financial close process. Accordingly, the standard does not include a requirement for the auditor to communicate misstatements detected by management.

Some commenters suggested that the standard should be revised to require the auditor to communicate only corrected misstatements that individually or in the aggregate could be significant to the company's financial statements. As noted previously, Auditing Standard No. 14 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial. The misstatements the auditor accumulated and management corrected are those that are other than clearly trivial and could be significant to the company's financial statements, either quantitatively or qualitatively. Auditing Standard No. 16 also requires the auditor to communicate those corrected misstatements that might not have been detected except through the auditing procedures performed. The intent of this requirement is to inform the audit committee of misstatements, which might have certain implications on the company's financial reporting process, that were detected only through audit procedures. Therefore, Auditing Standard No. 16 was not revised.

Another commenter suggested that the standard should specifically require the auditor to request management to correct the uncorrected misstatements. The Board did not make this change because management has its own legal responsibilities in relation to the preparation and maintenance of the company's books, records, and financial statements. Section 13(i) of the Exchange Act requires the financial statements filed with the SEC to reflect all material correcting adjustments identified by the auditor.[77/]

Material Written Communication (Paragraph 20 of Auditing Standard No. 16)

Auditing Standard No. 16 incorporates the Exchange Act's requirement for the auditor to communicate other material written communications between the

[77/] Section 13(i) of the Exchange Act, 15 U.S.C. § 78j-1(m)(i).

auditor and management to the audit committee.[78/] This requirement is intended to capture other possible material written communications that might occur but are not addressed by requirements in the standard or by other PCAOB standards, such as the management representation letter.[79/]

Departure from the Auditor's Standard Report (Paragraph 21 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee when the auditor expects to modify the opinion in the auditor's report or include explanatory language or an explanatory paragraph in the auditor's report.[80/] The auditor is required to communicate the reasons for and the wording of the modification, explanatory language, or explanatory paragraph. The requirement is intended to provide the basis for a discussion between the auditor and the audit committee in those circumstances in which the auditor expects to add explanatory language or modify the opinion in the auditor's standard report.

As part of overseeing the audit and the financial reporting process, it might be important for the audit committee to understand the reasons an auditor adds explanatory language or modifies the opinion in the auditor's standard report.

[78/] Section 10A(k)(3) of the Exchange Act, 15 U.S.C. § 78j-1(k)(3), requires the auditor to report this information to the audit committee; *see also* SEC Rule 2-07.

[79/] *See* Securities Act Release No. 8183 for a discussion of the substance of other material written communications.

[80/] *See* paragraphs .11-.74 and .76 of AU sec. 508, *Reports on Audited Financial Statements*.

Such communication enables the audit committee to be aware of the nature of any specific matters that the auditor expects to highlight in the auditor's report. In addition, these communications provide the audit committee with an opportunity to obtain further clarification from the auditor about the modification. This communication also provides the audit committee with an opportunity to provide the auditor with further information and explanations regarding the matters that are expected to be included in the auditor's report.

Disagreements with Management (Paragraph 22 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. This requirement is retained from AU sec. 380.13.

Examples of disagreements might include disagreements with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report. For purposes of Auditing Standard No. 16, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional, relevant facts or information prior to the issuance of the auditor's report.

One commenter suggested that disagreements that are satisfactorily resolved should not be communicated to the audit committee unless the auditor determines that these matters warrant the audit committee's attention. As noted previously, this communication requirement is not new. As part of conducting the oversight of the audit and the financial reporting process, it might be important for the audit committee to know the areas of tension between the auditor and management regarding matters that could be significant to the company's financial statements, such as accounting principles and practices, financial statement disclosures, auditing scope or procedures, or similar matters. Accordingly, no change was made in response to this comment. Additionally, SEC Form 8-K requires that a registrant report certain disagreements between management and the auditor, whether or not such disagreements are satisfactorily resolved, when there is a change in the auditor.[81/] The requirement in Auditing Standard No. 16 provides the audit committee with information regarding important matters that might need to be reported subsequently in an SEC filing.

[81/] *See e.g.,* Exchange Act Form 8-K, Item 4.01. *See also* Item 304(a)(1)(iv) of Regulation S-K, 17 C.F.R. § 229.304(a)(1)(iv), and Instructions 4 and 5 to that item, which require disclosure of disagreements, or differences of opinion, at the "decision-making level," that, if not resolved to the auditor's satisfaction, would have caused the auditor to make reference to the subject matter of the disagreement in connection with his or her report.

<u>Difficulties Encountered in Performing the Audit (Paragraph 23 of Auditing Standard No. 16)</u>

Auditing Standard No. 16 includes the requirement from AU sec. 380.16 for the auditor to communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

- Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;
- An unreasonably brief time within which to complete the audit;
- Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;
- Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and
- Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

Other Matters (Paragraph 24 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters. Communication of the other matters is based on the results of audit procedures or the conduct of the audit and does not require the auditor to perform new or additional procedures beyond the communication itself.

The Sarbanes-Oxley Act requires that audit committees of listed companies establish procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting control, or auditing matters, and for the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.[82/]

Auditing Standard No. 12 requires the auditor to inquire of the audit committee regarding tips or complaints received by the audit committee regarding financial reporting matters. The auditor might become aware of complaints or concerns regarding financial reporting matters that were not received through the audit committee's process, and, therefore, are unknown to the audit committee. The audit committee might be better able to exercise its oversight activities if the auditor informed the audit committee of these matters.

[82/] *See* Section 301 of the Sarbanes-Oxley Act, and Section 10A(m)(4) of the Exchange Act, 15 U.S.C. § 78j-1(m)(4).

Paragraph 24 of Auditing Standard No. 16 requires the auditor to communicate these matters to the audit committee.

AU sec. 380 required the auditor to ensure that the audit committee receives additional information regarding the scope and results of the audit that may assist the audit committee in overseeing the financial reporting and disclosure process. Auditing Standard No. 16 enhances the requirement in AU sec. 380 for the auditor to communicate to the audit committee the results of the audit procedures regarding the accounting or auditing matters that have been the subject of complaints or concerns.

The standard acknowledges that there might be other matters known to the auditor that may be beneficial to the audit committee's oversight of the financial reporting process. This communication could provide the audit committee with an opportunity to better understand management's intentions regarding such matters.

Several commenters suggested that Auditing Standard No. 16 should require the auditor to communicate to the audit committee the results of PCAOB inspection findings and any necessary remediation by the audit firm. With respect to inspections, the Sarbanes-Oxley Act restricts what the Board may publicly disclose,[83/] and the Sarbanes-Oxley Act makes no exception for disclosure to an

---

[83/] *See* Section 104(g)(2) of the Sarbanes-Oxley Act (providing that the Board shall make inspection reports available to the public in appropriate audit committee even if a Board inspection has reviewed an audit of the financial statements overseen by that audit committee. The Board cannot compel a firm to disclose nonpublic inspection information to an audit committee. This need not prevent an audit committee from discussing inspection results with its auditor. The Board encourages firms to communicate effectively with audit committees about inspection matters. The Sarbanes-Oxley Act does not restrict a firm from disclosing to an audit committee nonpublic information regarding PCAOB inspections (including quality control deficiencies and the firm's remediation of those deficiencies) or PCAOB disciplinary matters.[84/]

Form and Documentation of Communications (Paragraph 25 of Auditing Standard No. 16)

Auditing Standard No. 16 retains from AU sec. 380 the ability for auditors to communicate to the audit committee either orally or in writing, unless otherwise specified in the standard. Some commenters suggested that the standard should require all communications to be in writing, while other commenters indicated that the standard should continue to provide flexibility in the manner of communication.

Auditing Standard No. 16 was not revised to require all communications to be in writing. The Board's intention is to promote effective two-way

---

detail "subject to," among other things, the broad disclosure restrictions of Section 105(b)(5)(A)).

[84/] *See Information for Audit Committees About the PCAOB Inspection Process*, PCAOB Release No. 2012-003 (Aug. 1, 2012).

communication between the auditor and the audit committee, whether through presentations, written reports, or interactive discussions. Written communications might provide the auditor with a basis to lead an active two-way discussion with the audit committee.

In addition, the form of communication may depend on the nature of the matter to be communicated. For example, written information often makes it easier for the audit committee to understand highly complex information (for example, information about critical accounting estimates). However, having a dialogue on key matters often is an important factor in effective communications between the auditor and the audit committee.

Auditing Standard No. 16 also requires the auditor to document the communications in the work papers, whether such communication took place orally or in writing. The standard further requires the auditor to include a copy of or a summary of management's communications provided to the audit committee in the audit documentation if, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management.

Timing (Paragraph 26 of Auditing Standard No. 16)

The Board considers communications with audit committees to be an integral part of the audit process. AU sec. 380 stated that audit committee communications are incidental to the audit and are not required to occur before the issuance of the auditor's report on the entity's financial statements so long as the communications occur on a timely basis.[85/] Auditing Standard No. 16 requires the auditor to communicate the matters required by the standard in a timely manner and prior to the issuance of the auditor's report. This requirement aligns the timing of communications with SEC Rule 2-07, which requires the auditor to communicate matters to the audit committee prior to the filing of the auditor's report with the SEC.[86/] The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up actions needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.

The reproposed standard specified that all communications be made in a timely manner and prior to the issuance of the auditor's report, unless other timing requirements are specified by PCAOB rules or standards or the rules or regulations of the SEC. One commenter suggested that the "rules and regulations of the SEC" should be modified to the "federal securities laws," since timing of certain communications to the audit committee also is specified in securities laws. The standard was updated to reference "securities laws."[87/]

[85/] AU sec. 380.04.

[86/] *See* SEC Rule 2-07.

[87/] The term "securities laws" is defined in section 2(a)(15) of the Sarbanes-Oxley Act, 15 U.S.C. § 7201, to mean the provisions of law referred to

Commenters generally agreed that audit committee communications should occur in a timely manner and prior to the issuance of the auditor's report. Some commenters suggested that the standard should specify the timing of the communication about certain matters, such as during planning or prior to the earnings release.

Auditing Standard No. 16 does not emphasize the specific timing of certain communications because the appropriate timing might vary depending on the circumstances. As noted in the standard, the appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and any corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws. However, in all events, the timing of the communication should be prior to the issuance of the auditor's report.

Providing communications required by Auditing Standard No. 16 to the audit committee in a timely manner and prior to the issuance of the auditor's report will allow the audit committee and the auditor the opportunity to take any action they may deem appropriate to address the matters communicated prior to the issuance of the auditor's report.

---

section 3(a)(47) of the Exchange Act, 15 U.S.C. § 78c(a)(47), as amended by the Sarbanes-Oxley Act, and includes the rules, regulations, and orders issued by the SEC thereunder.

The reproposed standard noted that an auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit; however, the auditor should communicate such matters to the full audit committee prior to the issuance of the auditor's report. Several commenters suggested that the auditor's responsibility to subsequently communicate to the "full" audit committee was an unnecessary burden and that the word "full" should be deleted to allow the auditor to communicate to the audit committee when a quorum is present. The standard was revised accordingly to eliminate the word "full."

Adequacy of the Two-Way Communication Process

The original proposed standard included a requirement for the auditor to evaluate whether the two-way communication between the auditor and the audit committee was adequate to support the objectives of the audit. The requirement was included to emphasize that effective two-way communication is beneficial to achieving the objectives of the audit.

Many commenters on the original proposed standard noted that an evaluation of the adequacy of the two-way communications can only be effective if both parties are involved in the evaluation. These commenters also suggested that if only the auditor evaluates the effectiveness based on his or her understanding of what was communicated, that evaluation would not provide information about the audit committee's understanding of that communication. In response to commenters, the Board removed this requirement in the reproposed standard.

Some commenters on the reproposed standard indicated that the Board should reinstate the requirement for the auditor to evaluate the adequacy of the two-way communication between the auditor and the audit committee to encourage the auditor to determine whether there is effective two-way communication. Additionally, some commenters suggested that the standard should be revised to change certain requirements for the auditor to communicate "with" the audit committee instead of "to" the audit committee in situations in which two-way discussion would be appropriate for the auditor to obtain information on particular matters relevant to the audit.

The note in paragraph 3 of Auditing Standard No. 16 states that the requirement for the auditor to "communicate to" the audit committee is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit. The importance of effective two-way communications remains in the standard; therefore, no change was considered necessary.

In addition, as part of understanding the company's control environment in Auditing Standard No. 12, the auditor assesses whether the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control.[88/] Other PCAOB standards require that, in an audit of financial statements, if the auditor becomes aware, or in an integrated audit, if the auditor concludes that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that information in writing to the board of directors.[89/] Not including a requirement for the auditor to evaluate the adequacy of a two-way communication in this standard does not change the auditor's responsibility for assessing the audit committee's effectiveness under existing PCAOB standards.

Amendments to PCAOB Standards

With the adoption of Auditing Standard No. 16, the Board adopted related communication requirements to other PCAOB standards. These amendments were made to the following standards, among others:

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*;
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*;
- AU sec. 317, *Illegal Acts by Clients*;

[88/] *See* paragraphs 23-24 of Auditing Standard No. 12.

[89/] *See* paragraph 79 of Auditing Standard No. 5 and paragraph 5 of AU sec. 325.

- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*; and
- AU sec. 722, *Interim Financial Information*.

The Board is amending AU sec. 722 to be consistent with Auditing Standard No. 16. Some commenters suggested that the amendments to AU sec. 722 should clarify that the accountant ("accountant" is the term used in AU sec. 722) is not required to repeat communications that were made as part of the annual audit. Other commenters suggested that the amendments to AU sec. 722 should become effective for interim periods following the first annual period in which Auditing Standard No. 16 becomes effective and that, otherwise, implementing the amendments prior to the first annual communication under Auditing Standard No. 16 would likely result in unnecessarily expanding the communication requirements related to the auditor's review of interim information.

The objective of a review of interim financial information pursuant to AU sec. 722 is to provide the accountant with a basis for communicating whether the accountant is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.[90/] Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim

---

[90/] AU sec. 722.07.

financial information to be reported.[91/] A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit.[92/]

AU sec. 722.18 requires the accountant to make inquiries of members of management who have responsibility for financial and accounting matters, including but not limited to, matters concerning unusual or complex situations that may have an effect on the interim financial information. Examples of situations about which the accountant would ordinarily inquire of management include, among other things, significant, unusual, or infrequently occurring transactions; application of new accounting principles; changes in accounting principles or the methods of applying them; and trends and developments affecting accounting estimates.[93/]

An amendment to AU sec. 722 states that when conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Auditing Standard No. 16, as they relate to interim financial information, have been identified.[94/] This requirement is similar to the

---

[91/] AU sec. 722.15.

[92/] AU sec. 722.07.

[93/] AU sec. 722.55.

[94/] Amendment to AU sec. 722.34.

current requirement for the accountant to refer to AU sec. 380 for matters to communicate to the audit committee when conducting an interim review.[95/]

Additionally, the amendments to AU sec. 722 recognize that management might communicate some or all of the matters related to the company's accounting policies, practices, estimates, and significant unusual transactions described in paragraph 12 of Auditing Standard No. 16. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as certain criteria are met. However, any omitted or inadequately described matters should be communicated to the audit committee.

The amendment to AU sec. 722.35 also indicates that any communication the accountant may make about the entity's accounting policies, practices, estimates, and significant unusual transactions as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. The amendments to AU sec. 722 do not require that the communications to the audit committee repeat the annual communications but, rather, that the communication be related to the accountant's findings while performing the interim review procedures.

[95/] *Id*.

The Board determined not to defer the effective date for quarterly reviews as suggested by some commenters. Deferral of the effective date would result in AU sec. 380 continuing to apply to communications relevant to quarterly reviews, while Auditing Standard No. 16 simultaneously would require communications relating to the annual audit. Auditing Standard No. 16 requires timely communications of matters in connection with the annual audit to be made throughout the year under audit. These communications would, therefore, be made at or near the time that related communications are required in connection with quarterly reviews. Applying Auditing Standard No. 16 for the annual audit and AU sec. 380 for quarterly reviews could cause some degree of complexity because auditors would be required to apply two different standards when communicating important information to the audit committee. Therefore, the Board is making Auditing Standard No. 16 effective for quarterly reviews of fiscal years beginning on or after December 15, 2012.

In addition to avoiding having two co-existing and differing standards, implementing Auditing Standard No. 16 in the first quarter of 2013 should benefit audit committees by providing for the communication of significant information during the most current period. Also, and as discussed above, the objective of a review of interim financial information differs significantly from that of an audit, and any communication the accountant would make pertaining to interim financial reporting would be limited, as discussed in AU sec. 722, to matters the accountant considered when conducting the review of interim financial information.

The proposed amendments to other PCAOB standards accompanying the reproposed standard included an amendment to AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents.* This amendment would have required the auditor to communicate to the audit committee material misstatements if the client did not agree to revise the accompanying information. This amendment was removed from the amendments accompanying Auditing Standard No. 16 because the Board has proposed to supersede AU sec. 551 as part of its standard-setting project related to auditing supplemental information.[96/]

QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice,* states that to minimize the risk of misunderstandings regarding the nature, scope, and limitations of services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services.[97/] To align with Auditing Standard No. 16, the reproposed standard proposed an amendment to QC sec. 20 to change "client" to "audit committee." One commenter indicated that QC sec. 20 applies to attest engagements as well as to audit engagements. This commenter suggested that

---

[96/] *See Proposed Auditing Standard, Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards.* PCAOB Release No. 2011-005 (July 12, 2011).

[97/] QC sec. 20.16.

instead of replacing "client" with "audit committee," a clarifying footnote be added to the word "client" to indicate that with respect to a financial statement audit or an audit of internal control over financial reporting, the auditor is required to establish an understanding of the terms of the audit engagement with the audit committee. The Board considered this comment and decided not to amend QC sec. 20 at this time. Changes to the Board's quality control standards will be considered as part of the Board's quality control standard-setting project.

Audits of Brokers and Dealers

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[98/] gave the Board oversight of the audits of brokers and dealers registered with the SEC. In September 2010, the Commission issued interpretive guidance clarifying that the references in Commission rules and staff guidance and in the federal securities laws to generally accepted auditing standards ("GAAS") or to specific standards under GAAS, as they relate to nonissuer brokers or dealers, should continue to be understood to mean the auditing and attestation standards established by the American Institute of Certified Public Accountants ("AICPA"), but noted that it intended to revisit this interpretation in connection with a SEC rulemaking project to update the audit and attestation requirements for brokers and dealers in light

[98/] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

of the Dodd-Frank Act.[99/] On June 15, 2011, the SEC proposed to amend its rules, including SEC Rule 17a-5 under the Exchange Act, to require, among other things, that audits of brokers' and dealers' financial statements and examinations of reports regarding compliance with SEC requirements be performed in accordance with the standards of the PCAOB.[100/]

If the SEC adopts its proposed amendments to SEC Rule 17a-5 or provides other direction that auditors of brokers and dealers are to comply with PCAOB professional standards, the Board's auditing, attestation, quality control, and, where applicable, independence standards would then apply to audits of brokers and dealers as required by Section 17 of the Exchange Act and SEC Rule 17a-5.[101/]

Further, if the SEC adopts its proposed amendments to SEC Rule 17a-5 or provides other direction that auditors of brokers and dealers are to comply with PCAOB standards, prior to the effective date of Auditing Standard No. 16,[102/] the Board's interim standard, AU sec. 380, would be in effect for audits of brokers

---

[99/] SEC, *Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers*, Exchange Act Release No. 62991 (Sept. 24, 2010).

[100/] SEC, *Broker-Dealer Reports,* Exchange Act Release No. 64676 (June 15, 2011).

[101/] 17 C.F.R. § 240.17a-5.

[102/] As noted in this release, the Board anticipates that Auditing Standard No. 16 will be effective, subject to SEC approval, for audits of fiscal years beginning on or after December 15, 2012.

and dealers conducted for periods prior to the effective date of Auditing Standard No. 16. The Board's interim standard, AU sec. 380, which was last amended in 1999, indicates that it is not applicable to the audit of a broker or dealer if the broker or dealer does not have an audit committee[103/] or is registered with the SEC only because of Section 15(a) of the Exchange Act.[104/] Conversely, the auditor communication requirements under GAAS, which are contained in Statement on Auditing Standards ("SAS") 114, *The Auditor's Communication With Those Charged With Governance,* which was issued by the Auditing Standards Board ("ASB") of the AICPA in 2006, are applicable to audits of all brokers and dealers.[105/] Because of this difference in the applicability of the

---

[103/] AU sec. 380.01 states that the communications required by AU sec. 380 are applicable to entities that either have an audit committee or that have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee (such as a finance committee or budget committee).

[104/] *See* AU sec. 380.01, which states that the communications required by the standard "are applicable to . . . all Securities and Exchange Commission (SEC) engagements." As noted in footnote 2 to AU sec. 380.01, the audits of brokers and dealers do not fall within an SEC engagement as defined in AU sec. 380 if the broker or dealer is registered only because of Section 15(a) of the Exchange Act.

[105/] *See* paragraph 1 of SAS 114 which states "[t]his statement . . . establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements," and section 5.129 of the *AICPA Audit & Accounting Guide: Brokers and Dealers in Securities* (July 2010), which states, in part: "AU section 380, *The Auditor's Communication with Those Charged with Governance* … has been updated for the issuance of SAS No. 114…. AU 380 is applicable to all broker-dealers being audited under GAAS, regardless of their governance structure or size."

auditor communication standards to the audits of brokers and dealers, there could be a gap in required audit committee communications if the SEC amendments to SEC Rule 17a-5 are adopted and become effective prior to the effective date of Auditing Standard No. 16. To eliminate this gap, the Board is amending AU sec. 380 to delete the current exception for audits of brokers and dealers that do not have an audit committee or are registered with the SEC only because of Section 15(a) of the Exchange Act. The transitional amendment would eliminate the above-referenced gap in audit committee communications by making the communication requirements in AU sec. 380 applicable to audits of issuers and brokers and dealers, as those terms are defined in the Sarbanes-Oxley Act, prior to the effective date of Auditing Standard No. 16.

If PCAOB standards are applicable to audits of brokers and dealers prior to the effective date of Auditing Standard No. 16, the communication requirements under Auditing Standard No. 16 would be applicable to the audits of brokers and dealers upon the effective date of the standard.

The release accompanying the reproposed standard posed a question about whether the standard should apply to the audits of all brokers and dealers. Many commenters supported the requirement for the standard to apply to the audits of all brokers and dealers. However, some commenters suggested that it may not be practicable to communicate the matters in the standard because they may not be applicable to all brokers and dealers due to the varying size and nature of the brokers and dealers as well as the difference in their governance structures. Some commenters suggested that these brokers and dealers may not have an audit committee, board of directors, or equivalent body, or that the individual designated to oversee the financial reporting process and audits of the company might be the same person preparing the financial statements. They suggested, therefore, that the standard should apply only to certain types of brokers and dealers, such as carrying brokers or dealers. Other commenters suggested that the standard should not be applicable to the audits of brokers and dealers.

The Board acknowledges that there are smaller, less complex brokers and dealers that do not have an audit committee, board of directors, or equivalent body, but that communicating matters about the audit and the financial statements to those overseeing the financial reporting process is important. The governance structure of brokers and dealers does not change the value of the information regarding the audit or the company's financial statements.

Therefore, as discussed in this release, the definition of audit committee was revised for audits of nonissuers to recognize that if no such committee or board of directors (or equivalent body) exists with respect to the company, the communication should be made to the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

The release accompanying the reproposed standard posed a question about whether there are any communication requirements specific to the audits of all brokers and dealers that should be added to the standard. Some commenters suggested that the standard should require additional communication to the audit committee related to the additional attestation reporting to be required for brokers and dealers as proposed in pending SEC amendments to its Rule 17a-5.[106/] Once the amendments to Rule 17a-5 are adopted in final form, the Board may consider adding requirements for communication to the audit committee pertaining to such matters.

Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act"), any rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs (as defined in Section 3(a)(80) of the Exchange Act) unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."[107/] Auditing Standard No. 16 is the first auditing standard adopted by the Board subsequent to enactment of the JOBS Act and accordingly is subject to a separate determination by the SEC regarding its applicability to audits of EGCs.

106/ SEC, *Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers*, Exchange Act Release No. 62991 (Sept. 24, 2010).

107/ Pub. L. No. 112-106, 126 STAT. 306 (April 5, 2012). *See* Section 103(a)(3)(C) of the Sarbanes-Oxley Act, 15 U.S.C. § 7213 (a)(3)(C), as added by Section 104 of the JOBS Act.

The Board is also requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, for application to audits of EGCs, as that term is defined in Section 3(a)(80) of the Exchange Act. The Board's request is set forth in section D.

Effective Date

The Board anticipates that the transitional amendments to AU sec. 380 will be effective, subject to SEC approval, for the periods that PCAOB standards become applicable to audits of brokers and dealers, as designated by the SEC upon adoption of its amendments to SEC Rule 17a-5, if such periods precede the effective date of Auditing Standard No. 16.

The Board anticipates that Auditing Standard No. 16 and related amendments, included will be effective, subject to SEC approval, for audits of fiscal years beginning on or after December 15, 2012.

Comparison of the Objectives and Requirements of Auditing Standard No. 16, Communications with Audit Committees, to the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants

In developing its original proposed standard, the Board took into account, among other things, the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and the ASB of the AICPA. The release accompanying the initial proposed standard and reproposed standard included a comparison of the objectives and requirements of the initial proposed standard and reproposed standards to the analogous standards of the IAASB and ASB.

The following discussion compares certain significant differences between the objectives and requirements of Auditing Standard No. 16 and the analogous standards of the IAASB and ASB of the American Institute of Certified Public Accountants.

The analogous IAASB standards are:

- International Standard on Auditing ("ISA") 210, *Agreeing the Terms of Audit Engagements*, and
- ISA 260, *Communication with Those Charged with Governance*.

The analogous ASB standards[108/] are:

- AU-C Section 210, *Terms of Engagement*, and
- AU-C Section 260, *The Auditor's Communication With Those Charged with Governance*.

Other standards of the IAASB and the ASB, respectively, were considered in this comparison to the extent that they include comparable requirements, including:

108/ In October 2011, the ASB issued Statement on Auditing Standards ("SAS") No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which contains the Preface to Codification of Statements on Auditing Standards, *Principles Underlying an Audit Conducted in Accordance with Generally Accepted Auditing Standards*, and 39 clarified SASs. SAS 122 identifies the section within the AICPA codification with "AU-C" section numbers. *See* http://www.aicpa.org/RESEARCH/STANDARDS/AUDITATTEST/Pages/audit%20and%20attest%20standards.aspx

- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*,
- ISA 450, *Evaluation of Misstatements Identified during the Audit*,
- ISA 570, *Going Concern,*
- ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),*
- ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,*
- AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*,
- AU-C Section 450, *Evaluation of Misstatements Identified During the Audit,*
- AU-C Section 600, *Using the Work of Others – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),*
- SAS 118, *Other Information in Documents Containing Audited Financial Statements*, and
- SAS 126, *The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern* (Redrafted).

The information presented does not cover the application and explanatory material in the IAASB standards or ASB standards.[109/]

This discussion is provided for informational purposes only. It is not a summary of or a substitute for Auditing Standard No. 16 itself. This comparison may not represent the views of the IAASB or ASB regarding the interpretation of their standards.

Objectives

PCAOB

Auditing Standard No. 16 supersedes AU sec. 310 and AU sec. 380. Given the responsibility of many audit committees for the appointment and retention of the auditor, Auditing Standard No. 16 combines the requirements from the Board's standards, AU secs. 310 and 380, into one auditing standard.

Auditing Standard No. 16 includes four objectives for the auditor, which reflect both the appointment and retention of the auditor as well as the overall communication responsibilities. The objectives of the auditor are to:

[109/] Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,* indicates that the application and other explanatory material section of the ISAs "does not in itself impose a requirement," but "is relevant to the proper application of the requirements of an ISA." Paragraph A63 of AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards,* states that although application and other explanatory material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

IAASB and ASB

ISA 210 and AU-C Section 210 both include an objective to establish whether the preconditions for an audit are present. Auditing Standard No. 16 does not include this objective, because some of the related requirements in the ISA and SAS are not applicable to audits performed under PCAOB standards, such as determining whether the financial reporting framework is acceptable. For audits performed under PCAOB standards, 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.

Both ISA 260 and AU-C Section 260 include an objective for the auditor to promote effective two-way communication between the auditor and those charged with governance. Although Auditing Standard No. 16 does not include a similar objective, the standard encourages effective two-way communication between the auditor and the audit committee. As stated in Auditing Standard No.

16, "communicate to," is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit.

Appointment and Retention

Significant Issues Discussed with Management In Connection with the Auditor's Appointment or Retention

PCAOB

Auditing Standard No. 16 requires the auditor to discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

IAASB and ASB

ISA 210 and AU-C Section 210 do not include a similar requirement.

Establish an Understanding of the Terms of the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the objective of the audit, the responsibilities of the auditor, and the responsibilities of management. Paragraph 6 of Auditing Standard No. 16 requires the auditor to record the understanding of the terms in an engagement letter and provide the engagement letter to the audit committee annually. In addition, paragraph 6 of

Auditing Standard No. 16 includes a requirement for the auditor to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Additionally, Auditing Standard No. 16 requires the auditor to decline to accept, continue, or perform the engagement if the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee.

IAASB and ASB

ISA 210 and AU-C Section 210 require the auditor to agree on the terms of the audit engagement with management and, where appropriate, those charged with governance.

ISA 210 and AU-C Section 210 require the engagement letter to be in writing, although there is no requirement that the engagement letter be given to the audit committee or that it be signed by the audit committee, or its chair on behalf of the audit committee, or that it otherwise be acknowledged by the audit committee. Additionally, ISA 210 states that for recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. Accordingly, ISA 210 permits the auditor to not send a new audit engagement letter or other written agreement each period.

AU-C Section 210 requires the auditor to assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented.

Both ISA 210 and AU-C Section 210 also establish requirements for the auditor to determine whether the preconditions for an audit exist. Auditing Standard No. 16 does not include similar requirements, as these requirements were either not applicable to audits performed under PCAOB standards or were addressed through the requirements in Auditing Standard No. 16 for establishing an understanding of the terms of the audit engagement with the audit committee.

ISA 210 requires the auditor to determine whether there are any conflicts between the financial reporting standards and additional requirements supplemented by law or regulation. AU-C Section 210 does not include similar requirements. Auditing Standard No. 16 also does not include similar requirements as they are not relevant to the audits performed under PCAOB standards.

ISA 210 and AU-C Section 210 also include requirements regarding limitation of scope prior to audit engagement acceptance, other factors affecting audit engagement acceptance, and acceptance of a change in the terms of the audit engagement. Auditing Standard No. 16 does not include such requirements as they are not applicable to audits performed under PCAOB standards.

AU-C Section 210 also includes requirements regarding initial audits and re-audits. Auditing Standard No. 16 does not include similar requirements, although similar requirements are included in the Board's standard, AU sec. 315, *Communications Between Predecessor and Successor Auditors*.

Additionally, ISA 260 and AU-C Section 260 include a requirement for the auditor to communicate with those charged with governance the form, timing, and expected general content of communications. Auditing Standard No. 16 does not include this requirement; however, Auditing Standard No. 16 does not preclude the auditor from communicating these matters to the audit committee.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to inquire of the audit committee about whether it is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations. This requirement complements the requirement in Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* for the auditor to make inquiries of the audit committee, or equivalent (or its chair) about risks of material misstatement, including inquiries related to fraud risks.[110/]

IAASB and ASB

[110/] Paragraphs 5.f. and 54-57 of Auditing Standard No. 12.

ISA 260 and the AU-C Section 260 do not contain a similar requirement for the auditor to inquire of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations. However, ISA 240 and AU-C Section 240 require the auditor to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity.

Overall Audit Strategy, Significant Risks, and Timing of the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures. As part of communicating the overall audit strategy, paragraph 10 of Auditing Standard No. 16 requires the auditor to communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;

b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;

d. The names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

e. The basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.

In addition, Auditing Standard No. 16 requires the auditor to communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

IAASB and ASB

ISA 260 and AU-C Section 260 require the auditor to communicate an overview of the planned scope and timing of the audit. However, ISA 260 and AU-C Section 260 do not require the auditor to communicate significant changes to the planned scope and timing of the audit. Further, ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks, the auditor's use of the work of internal auditors, or the auditor's use of the work of other company personnel and third parties working under the direction of management or the audit committee.

ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit.

However, ISA 600 and AU-C Section 600, include requirements for the auditor to communicate certain matters to those charged with governance including: an overview of the type of work to be performed on the financial information of the components; an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components; instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work; any limitation on the group audit; and fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or other where the fraud resulted in a material misstatement of the group financial statements. In addition, AU-C Section 600 also includes a requirement for the auditor to communicate the basis for the decision to make reference to the audit of a component auditor in the auditor's report on the group financial statements.

Results of the Audit

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions
PCAOB

Auditing Standard No. 16 requires the auditor to communicate certain matters relating to accounting policies and practices, estimates, and significant unusual transactions. However, Auditing Standard No. 16 acknowledges that if management communicates matters related to accounting policies and practices, estimates, and significant unusual transactions to the audit committee, the auditor does not need to communicate these matters at the same level of detail as management as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the auditor considers critical. In addition, the auditor is required to communicate any omitted or inadequately described matters to the audit committee.

Matters to be communicated include:

a. Significant accounting policies and practices – (1) management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and (2) the effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

b. All critical accounting policies and practices to be used, including: (1) the reasons certain policies and practices are considered critical; and (2) how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

c. Critical accounting estimates – (1) a description of the process management used to develop critical accounting estimates; (2) management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and (3) any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.

d. Significant unusual transactions – (1) significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature; and (2) the policies and practices management used to account for significant unusual transactions.

IAASB

ISA 260 requires the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. AU-C Section 260 also provides that, when applicable, the auditor should determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The ISAs and the AU-Cs do not include a similar requirement for communicating significant unusual transactions.

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

PCAOB

Auditing Standard No. 16 requires the auditor to communicate the following matters to the audit committee:

a. Qualitative aspects of significant accounting policies and practices.

1) The results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements; and

2) The results of the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management.

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates.

d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.

e. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth.

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.

IAASB

ISA 260 requires the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. The ISA provides that, when applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity.

The ISAs do not include a similar requirement for communicating the auditor's understanding of the business rationale for significant unusual transactions.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable the auditor should:

a. Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity, and

b. Determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The AU-Cs do not include a similar requirement for communicating the auditor's understanding of the business rationale for significant unusual transactions.

Other Information in Documents Containing Audited Financial Statements

PCAOB

When other information is presented in documents containing audited financial statements, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.

AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires that if the auditor identifies a material inconsistency in the other information presented in documents containing audited financial statements, and the other information is not revised by management to eliminate the material inconsistency, the auditor should communicate the material inconsistency to the audit committee. The auditor should also consider other actions, such as revising the audit report to include an explanatory paragraph describing the material inconsistency, as described in paragraph .11 of AU sec. 508, *Reports on Audited Financial Statements*, withholding the use of the report in the document, and withdrawing from the engagement. The auditor should also communicate a material misstatement of fact to the client and the audit committee, if the material misstatement of fact is not corrected.

IAASB

ISA 720 requires that if the auditor identifies a material inconsistency in the other information in documents containing audited financial statements and revision of the other information is necessary and management refuses to make the revision, then the auditor shall communicate this matter to those charged with governance and (a) include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; or (b) withhold the auditor's report; or (c) withdraw from the engagement, where withdrawal is possible under applicable law or regulation. ISA 720 also requires the auditor to notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action if there is a material misstatement of fact in the other information which management refuses to correct.

ASB

SAS 118 contains similar requirements to those in Auditing Standard No. 16.

Difficult or Contentious Matters for which the Auditor Consulted

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

IAASB and ASB

ISA 260 and AU-C Section 260 do not include a similar requirement.

Management Consultation with Other Accountants

PCAOB

When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, Auditing Standard No. 16 requires the auditor to communicate to the audit committee his or her views about such matters that were the subject of such consultation.

IAASB

ISA 260 does not include a similar requirement.

ASB

AU-C Section 260 requires the auditor to communicate to those charged with governance the auditor's views about matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultations occurred.

Going Concern

PCAOB

Paragraph 17 of Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee, when applicable, certain matters relating to the auditor's evaluation of the company's ability to continue as a going concern. These matters include (a) If the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the conditions and events that the auditor identified that, when considered in the aggregate, indicate that there is substantial doubt; (b) If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events; (c) if the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains, the effects, if any, on the financial statements and the adequacy of the related disclosure and the effects on the auditor's report.

IAASB

ISA 570 requires the auditor to communicate events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. This communication includes whether the events or conditions constitute a material uncertainty; whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and the adequacy of related disclosures in the financial statements.

ASB

SAS 126 requires the auditor to communicate with those charged with governance the nature of the conditions or events identified, the possible effects on the financial statements and the adequacy of related disclosures in the financial statements, and the effects on the auditor's report if, after considering identified conditions or events in the aggregate and after considering management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains.

Uncorrected and Corrected Misstatements

PCAOB

Auditing Standard No. 16 requires the auditor to provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that the auditor presented to management. Auditing Standard No. 16 also requires the auditor to discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors considered. Additionally, Auditing Standard No. 16 requires the auditor to communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated. Auditing Standard No. 16 also requires the auditor to communicate to the audit committee those corrected misstatements, other than those that are clearly trivial, related to accounts and disclosures that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

IAASB and ASB

ISA 450 and AU-C Section 260 include requirements for the auditor to communicate uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. The auditor's communication shall identify the material uncorrected misstatements individually. Additionally, under ISA 450 and the AU-C Section 260, the auditor is required to communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

ISA 450 and AU-C Section 450 require the auditor to request that uncorrected misstatements be corrected. Auditing Standard No. 16 does not require the auditor to make this request, because under SEC rules the financial statements are required to reflect all material correcting adjustments identified by the auditor.

ISA 450 does not include a requirement for the auditor to communicate corrected misstatements to those charged with governance. AU-C Section 260 requires the auditor to communicate material, corrected misstatements that were brought to the attention of management as a result of audit procedures.

Material Written Communication

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee other material written communications between the auditor and management.

IAASB and ASB

ISA 260 and AU-C Section 260 require the auditor to communicate to those charged with governance written representations the auditor is requesting.

Disagreements with Management

PCAOB

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Auditing Standard No. 16 also states that disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information prior to the issuance of the auditor's report.

IAASB

The ISAs do not include a similar requirement.

ASB

AU-C Section 260 requires the auditor to communicate disagreements with management, if any.

Other Matters

PCAOB

Auditing Standard No. 16 includes a requirement for 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. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.

IAASB and ASB

ISA 260 and AU-C Section 260 include a similar requirement for the auditor to communicate other matters to those charged with governance that, in the auditor's professional judgment, are significant and relevant to the oversight of the financial reporting process.

Form and Documentation of Communications

PCAOB

Auditing Standard No. 16 requires the auditor to communicate the matters in the standard to the audit committee, either orally or in writing, unless otherwise specified in Auditing Standard No. 16. In addition, the standard also requires the auditor to document the communications in the work papers whether such communications took place orally or in writing. Auditing Standard No. 16 also requires the auditor to include a copy of or a summary of management's communication provided to the audit committee in the audit documentation, if as part of its communications to the audit committee, management communicated some or all of the matters related to accounting policies and practices, estimates, significant unusual transactions, or uncorrected misstatements to the audit committee, and, as a result, the auditor did not communicate these matters at the same level of detail as management.

IAASB

ISA 260 requires the auditor to communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate. Written communication need not include all matters that arose during the course of the audit.

ASB

AU-C Section 260 requires the auditor to communicate in writing with those charged with governance significant findings or issues from the audit if, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved.

Timing

PCAOB

Auditing Standard No. 16 requires the communications to the audit committee to be made in a timely manner and prior to the issuance of the auditor's report.[111/]

IAASB and ASB

ISA 260 and AU-C Section 260 require that the auditor should communicate with those charged with governance on a timely basis.

D. Request to Apply Auditing Standard No. 16 to Audits of Emerging Growth Companies

Introduction and Statutory Background

On August 15, 2012, the Board adopted Auditing Standard No. 16 (Auditing Standard No. 16 may also be referred to as "the new standard" in this section)[112/] pursuant to the Board's authority under the Sarbanes-Oxley Act .[113/]

[111/] Auditing Standard No. 16 includes the following exception for registered investment companies – Consistent with SEC Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update, in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

[112/] *Communications with Audit Committees*, PCAOB Release No. 2012-004 (Aug. 15, 2012).

[113/] Pub. L. No. 107-204. Pursuant to Section 101 of the Sarbanes-Oxley Act, the mission of the Board is to oversee the audit of companies that are

Auditing Standard No. 16 requires auditors to communicate certain significant audit and financial statement matters to the audit committee of the company[114/] under audit. Among other things, the required communications include such matters as: (i) the company's critical accounting practices; (ii) significant risks identified by the auditor's risk assessment procedures; (iii) the company's significant unusual transactions; and (iv) when applicable, the auditor's evaluation of the company's ability to continue as a going concern. Communications may be made orally or in writing, but should be made in a timely manner and prior to the issuance of the auditor's report.

In the Board's view, the adoption of Auditing Standard No. 16 is in the public interest and contributes to investor protection because it establishes requirements that enhance the relevance, timeliness, and quality of communications between auditors and audit committees. The enhanced relevance, timeliness, and quality of communications should improve the audit

---

subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. Section 103 of the Sarbanes-Oxley Act authorizes the Board to adopt auditing standards for use in public company audits "as required by this Act or the rules of the [Securities and Exchange] Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." In addition, Section 982 of the Dodd-Frank Act of 2010 expanded the authority of the PCAOB to oversee the audits of registered brokers and dealers, as defined in the Exchange Act. *See* Pub. L. No. 111-203.

[114/] The term "company" as used in this section is intended to refer to companies whose audits are required to be performed in accordance with PCAOB standards.

and facilitate audit committees' financial reporting oversight, fostering improved financial reporting. The Board's adopting release dated August 15, 2012, discusses the record developed by the Board in adopting Auditing Standard No. 16 in greater detail.

In addition, the Sarbanes-Oxley Act was recently amended by Section 104 of the JOBS Act[115/] to provide that any additional rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs[116/] unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation."[117/] As a result, Auditing Standard No. 16, which was adopted by the Board after April 5, 2012, is subject to a separate determination by the SEC regarding its applicability to audits of EGCs.

The Board is thus requesting that the Commission also take action to apply Auditing Standard No. 16 to audits of EGCs, pursuant to Section 104 of the JOBS Act. In this submission, the Board is providing information to assist the SEC in its consideration of whether it is "necessary or appropriate in the public interest, after considering the protection of investors and whether the action will

---

115/ Pub. L. No. 112-106.

116/ Section 3(a)(80) of the Exchange Act defines the term "emerging growth company."

117/ *See* Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as added by Section 104 of the JOBS Act.

promote efficiency, competition, and capital formation," to apply Auditing Standard No. 16 to audits of EGCs.

The information provided in this submission summarizes the Board's record in adopting Auditing Standard No. 16 and includes a discussion of the following areas to assist the SEC in its consideration pursuant to Section 104 of the JOBS Act: (i) the background of and reasons for the new standard; (ii) the Board's approach to developing the new standard, including consideration of alternatives; (iii) key changes and improvements from existing audit committee communication requirements; and (iv) characteristics of EGCs and economic considerations.

Background and Reasons for the New Standard

The following discussion provides summary information regarding the background and reasons for Auditing Standard No. 16. These matters are also discussed in greater detail in the Board's adopting release.

Auditing Standard No. 16 would replace PCAOB interim standards AU sec. 380 and AU sec. 310.[118/] The existing PCAOB requirements regarding auditor communications with audit committees are primarily in AU sec. 380, while

---

[118/] Shortly after its inception, the Board adopted the existing standards of the AICPA, as in existence on April 16, 2003, on an initial, transitional basis. *See* PCAOB Release No. 2003-006 (Apr. 18, 2003). References to AU sections ("AU secs.") throughout this document are to these PCAOB interim auditing standards, which consist of generally accepted auditing standards, as described in the AICPA Auditing Standards Board's Statement on Auditing Standards No. 95, as in existence on April 16, 2003, to the extent not superseded or amended by the Board.

AU sec. 310 discusses establishing an understanding between the auditor and the client regarding the audit engagement.

AU sec. 380 became effective in January 1989, at a time when management typically hired and retained the auditor and had oversight of the work of the auditor. AU sec. 380 indicates that audit committee communications are "incidental to the audit" and are not required to occur prior to the issuance of the auditor's report. AU sec. 380 includes a variety of specified communication requirements.

Subsequently, changes to the federal securities laws and related SEC rules imposed additional communication requirements that are not currently reflected in AU sec. 380. Most significantly, in 2002, the Sarbanes-Oxley Act changed the role of the audit committee and the interaction between the audit committee and the auditor, requiring the auditor of a listed company to report directly to the audit committee. Section 301 of the Sarbanes-Oxley Act made changes to the federal securities laws to require the audit committee of a listed company to be directly responsible for the appointment, compensation, and oversight of the work of the external auditors, including the resolution of disagreements between management and the auditor regarding financial reporting. In addition, Section 204 of the Sarbanes-Oxley Act made other changes to the federal securities laws to require the auditor to report the following matters to the audit committee on a timely basis:

- All critical accounting policies and practices to be used;
- All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
- Other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

Since the adoption of AU sec. 380, certain PCAOB auditing standards also have changed as a result of the Board's ongoing efforts to revise its interim standards. For example, in 2010 the Board adopted eight standards on assessing and responding to risk in an audit (the "risk assessment" standards), which cover the entire audit process, from initial planning activities to evaluating audit evidence to forming the opinion to be expressed in the auditor's report.[119/] The risk assessment standards address, among other things, requirements for the auditor in the areas of audit planning, audit strategy, and risk assessment, including requirements for the auditor to identify significant risks of material misstatement. As one of the PCAOB's interim auditing standards, AU sec. 380's communication requirements are not aligned with the procedures performed

---

119/ *See* PCAOB Release 2010-004 (Aug. 5, 2010).

pursuant to the PCAOB's risk assessment standards, which became effective for audits for fiscal years beginning after December 15, 2010.

Additionally, observations from the Board's oversight activities raised matters for consideration. For example, some inspection observations indicate that auditors have not made all required audit committee communications, possibly because they are not aware of the varying sources of communication requirements contained throughout the Board's standards and rules. Currently, thirteen auditing standards and rules require the auditor to communicate with the audit committee, and other additional communication requirements are located in the federal securities laws and SEC rules.

In light of these changes and considerations, the Board adopted Auditing Standard No. 16 with the goal of improving the audit by enhancing communications between auditors and audit committees. With the passage of the Sarbanes-Oxley Act and the establishment of the PCAOB, Congress acknowledged that auditors play an important role in protecting the interests of investors by preparing and issuing informative, accurate, and independent audit reports.[120/] The audit committee also plays an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to a company's shareholders and others to oversee the integrity of a company's accounting and financial reporting processes and audits.

[120/] *See* Section 101(a) of the Sarbanes-Oxley Act; Senate Report No. 107-206, at 5-6 (July 3, 2002).

In the Board's view, both the auditor and the audit committee benefit from a meaningful and timely exchange of information regarding significant risks of material misstatement in the financial statements and other matters that may affect the integrity of the company's financial reports. Communications with the audit committee improve the audit by providing auditors with the audit committee's insights about the company as well as providing auditors with a forum separate from management to discuss complex and significant matters about the audit and the company's financial reporting process. Communications between the auditor and the audit committee allow the audit committee to be well-informed about accounting, auditing, and disclosure matters, including the auditor's evaluation of matters that are significant to the financial statements, and to be better able to carry out its oversight role.

Auditing Standard No. 16 also updates the auditing standards to reflect the communication requirements mandated by the federal securities laws and aligns the audit committee communication requirements with auditor performance requirements, including those in the risk assessment standards. Bringing these requirements together in one place should promote the auditor's compliance with relevant statutory and regulatory requirements (as well as facilitating audit planning and informing audit scope). Updating auditing standards to incorporate new statutory and regulatory requirements can help ensure that audit firms update their audit methodologies to include all required and relevant procedures. Such updating is particularly critical with respect to AU sec. 380 because, as noted earlier, AU sec. 380 treats audit committee communications as "incidental," and does not focus on the important role of the audit committee in the current regulatory environment.

The Board's Approach to Development of Auditing Standard No. 16, including Consideration of Alternatives

Auditing Standard No. 16 was adopted by the Board after several years of consideration and public outreach. For example, the issue of auditor communications with the audit committee was discussed with the Board's Standing Advisory Group ("SAG") on several occasions prior to the Board's decision to propose a new standard.[121/]

The Board proposed a new standard on March 29, 2010, which was open for comment until May 28, 2010. The comment period reopened on September 7, 2010 and was extended until October 21, 2010, to accommodate comments received in connection with a public roundtable held by the Board on September 21, 2010.

The standard was then reproposed on December 20, 2011, and open for comment until February 29, 2012. The Board adopted the new standard on August 15, 2012.

The Board received and considered 44 comment letters on the original proposal, which included the reopened comment period, and 39 comment letters

---

121/ The SAG discussed the audit committee communications standard at a number of its meetings, including meetings prior to proposing a new standard on: June 21-22, 2004, June 8, 2005, Oct. 5-6, 2005, and Oct. 14-15, 2009.

on the reproposed standard. Most commenters were supportive of the Board's efforts to enhance communications between the auditor and the audit committee. Those commenters agreed that fuller and more relevant communications between the auditor and audit committee would allow the auditor to perform a more informed, and thus more effective, audit and also would enable the audit committee to more effectively fulfill its oversight responsibilities regarding the financial reporting process.

The Board's adopting release explains in greater detail the Board's consideration of significant comments received and the reasons for making the changes reflected in the new standard. In general, as discussed below, the Board made a number of decisions as it developed Auditing Standard No. 16 that make the new standard more efficient and effective to apply, and avoid unnecessary costs. The following summary describes the Board's overall approach and highlights some of the choices made, and alternatives considered.

- Auditing Standard No. 16 is scalable, based on a company's size and complexity. In developing the new standard, the Board sought to promote high-quality audits, while considering the standard's overall effect on current audit practice and on audit committees and companies. In doing so, the Board sought to achieve the standard's intended benefits, without imposing unnecessary costs, and to create a standard that is scalable based on the company's size and complexity. A company's size and complexity can affect the risks of material misstatement, create auditing challenges, and involve other significant matters that warrant bringing to the attention of the audit committee. Thus, an auditor of a smaller, less complex company with fewer difficult auditing or financial reporting issues may have fewer matters to communicate than for an audit of a larger, more complex company. Accordingly, under Auditing Standard No. 16, in an audit of a small, less complex company, an auditor may make less extensive audit committee communications than in an audit of a larger, more complex company. The original proposal asked for comment on whether any of the requirements of the proposed standard were inappropriate based on the size or industry of the company. Commenters considered the proposed requirements to be applicable and appropriate to companies of different sizes and industries.

- Auditing Standard No. 16 has been carefully designed to: (i) retain the pre-existing communication requirements in auditing standards; (ii) incorporate the communication requirements already imposed by the Sarbanes-Oxley Act and related SEC rules; and (iii) link new communications to related performance requirements arising out of the Board's existing auditing standards. As a result of this approach, the auditor's communications under the new standard are limited to *communicating* the results of the audit or specific audit procedures already required under the existing standards. Auditing Standard No. 16 does not impose new performance obligations on the auditor, other than the standard's required communications.

- Auditing Standard No. 16 organizes and compiles information regarding other PCAOB auditor communication requirements. Auditing Standard No. 16 contains an appendix that lists in one place other PCAOB standards and rules that require the auditor to communicate specific matters to the audit committee. This aspect of the new standard responds to observations from the Board's oversight activities that suggest that auditors may not make all required audit committee communications because they might not be aware of the varying sources of such requirements. This convenient list facilitates auditors' identification of other PCAOB standards and rules that contain communication requirements.
- Auditing Standard No. 16 focuses on the communication of significant matters relating to the audit. In developing the new standard, the Board sought to focus on communication of significant matters relating to the audit. In response to comments, the requirements in Auditing Standard No. 16 were changed from the original proposal to focus the auditor on communicating matters that are significant to the audit committee's oversight of the financial

reporting process. For example, changes were made to limit communications regarding the need for specialized skill or knowledge in the audit to only those relevant to significant audit risks. Similarly, the standard was narrowed to require communications relating to matters on which the auditor consulted to only those 'difficult or contentious' matters that are relevant to the audit committee's oversight of the financial reporting process.

- Auditing Standard No. 16 provides the auditor with flexibility to communicate orally or in writing. AU sec. 380 provides the auditor with the flexibility to communicate orally or in writing. Several commenters to both the original proposal and the reproposal suggested that the communications to the audit committee should be required to be in writing. The Board considered this approach, but determined that requiring all communications to be in writing could reduce the effectiveness of the communication process. The Board's goal is to promote effective two-way communication between the auditor and the audit committee, whether through presentations, written reports, or interactive discussions. Allowing different forms of communication also makes the communication requirement more flexible for companies of all sizes and natures.
- Auditing Standard No. 16 recognizes that management, as well as the auditor, may discuss issues relating to the company's financial

statements with the audit committee, and that it would not be cost-effective or practical for the audit committee to receive the same communication twice. With respect to certain auditor communications, the new standard provides that the auditor need not duplicate communications made by management at the same level of detail, so long as certain conditions specified in Auditing Standard No. 16 are met.[122/] These changes allow for better use of auditor, management, and audit committee time and resources while, at the same time, help to ensure that the audit committee is informed of important accounting issues.

- Auditing Standard No. 16 reflects practical considerations. The scope of the new standard was narrowed in response to practical concerns raised during the comment process. For example, the original proposed standard included a requirement for the auditor to evaluate whether the two-way communications between the auditor and the audit committee were adequate to support the objectives of the audit. Commenters were concerned that the evaluation might not be effective, as it would reflect only the auditor's evaluation of the communications, and would not provide information about the audit committee's understanding of the nature of the

[122/] *See* note to Paragraph 12 of Auditing Standard No. 16 and discussion in PCAOB Release No. 2012-004 (Aug. 15, 2012) at pages A4-24 to A4-25.

communications. The Board agreed and did not adopt the requirement.

Key Changes and Improvements from Existing Standards

The following discussion provides a summary of the existing standards relating to auditor communications. The summary also includes a discussion of improvements that have been made in the new standard that should benefit audit quality. These matters also are discussed in greater detail in the Board's adopting release.

Existing Requirements. As previously noted, the existing requirements for communications with the audit committee are primarily in AU sec. 380. In addition, AU sec. 310 requires the auditor to establish an understanding with the client regarding the audit engagement.

Requirements Retained from Existing Standard. The new standard retains from AU sec. 380 the following audit committee communication requirements:

- Major issues discussed with management prior to the retention of the auditor;
- The company's significant accounting policies and practices;
- The auditor's responsibility related to other information in documents containing audited financial statements;
- Difficulties encountered in performing the audit; and
- Disagreements with management.

Incorporation of Statutory Communication Requirements. Auditing Standard No. 16 also incorporates the following specific auditor communication requirements contained in Exchange Act Section 10A(k) and SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"):

- All critical accounting policies and practices to be used;
- All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
- Other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.[123/]

Improvements Made to Existing Communication Requirements. While Auditing Standard No. 16 retains many of the communication requirements in AU sec. 380, it also revises certain requirements to be consistent with existing audit performance requirements or to respond to other requirements in the Sarbanes-Oxley Act as well as SEC Rule 2-07. The new standard improves current communication requirements in the following areas:

[123/] *See* Section 10A(k) of the Exchange Act, 15 U.S.C. §78j-1(k), and implementing changes in Rule 2-07(a)(1)-(3) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(1)-(3).

- Timing/Shift in Approach to Audit Committee Communications. AU sec. 380 provides that audit committee communications are "incidental to the audit." While AU sec. 380 requires auditors to "discuss" or determine that the audit committee is "informed" regarding a range of matters on a timely basis, AU sec. 380 also provides that communications are not required to occur prior to the issuance of the auditor's report. The new standard indicates that communications between the auditor and the audit committee are integral to the audit and that communications should occur in a timely manner and prior to the issuance of the auditor's report. By requiring communications prior to the issuance of the auditor's report, Auditing Standard No. 16 makes a significant difference in the standard regarding the timing of communications by giving auditors and audit committees the ability to take appropriate action to address the matters communicated, including any effect on the company's financial statements. This timing requirement aligns with the timing of communications required by Exchange Act Section 10A(k) and SEC Rule 2-07.
- Understanding the Terms of the Audit and the Engagement Letter. AU sec. 310 requires the auditor to establish an understanding with the "client" regarding the terms of the audit and services to be performed. Auditing Standard No. 16 retains the requirement for the

auditor to establish an understanding of the terms of the audit engagement and the services to be performed, but requires the understanding to be with the audit committee. The new standard also requires that the understanding be recorded in an engagement letter. These changes align the new standard with the audit committee's oversight of the work of the external auditor.[124/] These new requirements also build on the requirement in AU sec. 310 for the auditor to document the understanding in the working papers, preferably through a written communication with the client. Having a mutually clear understanding of the terms of the engagement, including the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management in connection with the audit, should benefit both the auditor and the audit committee.

- Definition of "Audit Committee." AU sec. 380 does not have a formal definition of audit committee, but describes the audit committee as "those that have responsibility for oversight of the financial reporting process." Auditing Standard No. 16 incorporates the definition of audit committee used in the Sarbanes-Oxley Act and modifies the Sarbanes-Oxley Act's definition for companies that are nonissuers, such as brokers and dealers.

[124/] *See* Section 301 of the Sarbanes-Oxley Act, and Section 10A(m)(2) of the Exchange Act, 15 U.S.C. § 78j-1(m)(2).

- Qualitative Aspects of the Company's Financial Reporting. AU sec. 380 requires the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles, including the consistency of the entity's accounting policies and their application, and the clarity and completeness of the entity's financial statements and related disclosures. Many commenters indicated that it was unclear what was meant by the quality, clarity, and completeness of the company's financial statements and related disclosures. Auditing Standard No. 16 aligns the communication requirement with an underlying performance requirement in Auditing Standard No. 14, *Evaluating Audit Results.* Under this approach, the auditor communicates, among other things: (i) the results of the auditor's evaluation of and conclusions about the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments and (ii) the results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including such matters as consideration of the form, arrangement, and content of the financial statements. This approach aligns with existing performance requirements and was favored by most commenters.

- Critical Accounting Estimates. AU sec. 380 requires the auditor to determine that the audit committee is informed about the process used by management in formulating "particularly sensitive" accounting estimates. Auditing Standard No. 16 largely retains the auditor communication requirement from AU sec. 380, but uses the term "critical accounting estimates," which conforms to the term used by the SEC.[125/] Auditing Standard No. 16 adds related requirements to communicate matters pertaining to management's significant assumptions and changes to the process or assumptions used to develop critical accounting estimates. These additional requirements address communication of the results of the auditor's procedures performed under AU sec. 342, *Auditing Accounting Estimates.* The purpose of this communication is to focus the audit committee's attention on the estimates that might be subject to higher risk of material misstatement.

- *Uncorrected and Corrected Misstatements.* Auditing Standard No. 16 incorporates the communication requirements from AU sec. 380 related to uncorrected and corrected misstatements. In addition,

---

125/ *See* SEC, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (Dec. 19, 2003).

Auditing Standard No. 16 incorporates the requirement from the Sarbanes-Oxley Act and SEC Rule 2-07 for the auditor to report to the audit committee other material written communications between the auditor and management, such as a schedule of unadjusted differences.

- *Significant Unusual Transactions*. AU sec. 380 requires the auditor to determine that the audit committee is informed about the methods used to account for significant unusual transactions. Auditing Standard No. 16 revises the requirement by adding requirements based on the auditor's procedures under AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* for the auditor to communicate: (i) significant transactions that are outside the normal course of business for the company or otherwise appear to be unusual due to their timing, size, or nature and (ii) the auditor's understanding of the business rationale for significant unusual transactions. Communications of significant unusual transactions by the auditor will improve audit quality by promoting discussion of such transactions. It will also allow the audit committee to gain insight into such transactions and take appropriate actions, if necessary, to address the financial statement or disclosure impact of such transactions.

- Management Consultations with Other Accountants. When the auditor is aware that management consulted with other accountants about auditing and accounting matters, AU sec. 380 requires the auditor to discuss with the audit committee the auditor's views about significant matters that were the subject of such consultation. Auditing Standard No. 16 modified this requirement. The new standard requires the auditor to communicate to the audit committee only when the auditor has identified a concern regarding such consultations. Commenters viewed this change as an improvement as they noted that it may be good practice for management to consult with other accountants as experts to assist them regarding complex accounting matters, but that the audit committee need not be informed of all such consultations, rather just those matters for which the auditor identified a concern.
- Obtaining Information Relevant to the Audit. Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* requires the auditor to inquire of the audit committee regarding the matters important to the identification and assessment of risks of material misstatement, including fraud risks. Pursuant to Auditing Standard No. 16, the auditor also inquires about whether the audit committee is aware of additional matters relevant to the audit. As a result, the auditor has an opportunity to focus on any additional

matters relevant to the audit, such as possible violations of laws or regulations. This inquiry requirement might enable the auditor to learn from the audit committee about a possible previously unidentified risk.

New Communication Requirements. Auditing Standard No. 16 also contains new communication requirements that improve the audit by promoting discussion about significant aspects of the audit, while also providing valuable information to the audit committee. These new communications relate to audit procedures that already will be performed under existing PCAOB standards, with the auditor communicating the results of such procedures to the audit committee. The new communication requirements include:

- <u>Overall Audit Strategy and Significant Risks.</u> Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and to discuss with the audit committee significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks. These changes are aligned with the results of the audit procedures performed under the PCAOB's risk assessment standards, in particular, Auditing Standard No. 9, *Audit Planning,* and Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement.*

- Other Participants in the Audit. Auditing Standard No. 16 requires the auditor to communicate, as applicable, information about specialized skill or knowledge needed for the audit. In addition, the auditor is required to communicate: (i) information regarding other participants in the audit, such as the extent of the use of internal auditors, company personnel, other third parties (including other independent public accounting firms), or other persons not employed by the auditor that are involved in the audit and (ii) the basis for the auditor's determination that the auditor can serve as the audit engagement's principal auditor, if significant parts of the audit are performed by other auditors. The communications related to others involved in the audit, including the nature and extent of their involvement, could be important for an audit committee to understand in its oversight of the audit. These communications should reflect the results of other audit procedures that the auditor is currently required to perform in accordance with PCAOB standards.
- Difficult or Contentious Matters for which the Auditor Consulted. Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit

committee's oversight of the financial reporting process. Audit committees might better appreciate the importance of difficult or contentious matters, benefiting their governance responsibility, if they are aware that such consultations took place. Communications are based on the results of the procedures the auditor performed regarding difficult or contentious matters.

- Going Concern. Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the auditor's evaluation of the company's ability to continue as a going concern. The communication requirements in Auditing Standard No. 16 are based on the auditor's performance requirements under AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.* This communication enables the auditor to improve the audit by facilitating discussion between the auditor and the audit committee about the company's ability to continue as a going concern. This communication also can serve to further inform the audit committee, by focusing attention on financial difficulties the company is encountering. Through this communication, the auditor can benefit from the audit committee's views of the concerns identified by the auditor. Such communications also could be significant in terms of the audit committee's role in overseeing the company's financial reporting process to ensure that the company's financial statements contain the necessary disclosures.

- Other Matters. Auditing Standard No. 16 requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process, such as complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit. The auditor benefits from a robust discussion of such complaints or concerns with the audit committee. Also, the audit committee should be better able to exercise its oversight activities if the auditor informs the audit committee of these matters. Communication to the audit committee is based on the results of the auditor's procedures relating to such other matters.
- New Accounting Pronouncements. Auditing Standard No. 16 requires the auditor to communicate to the audit committee situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. This communication informs the audit committee of situations relevant to the audit committee's oversight

of the company's financial reporting process. Auditing Standard No. 16 requires only that the auditor communicate concerns identified as a result of existing audit performance requirements and does not require the auditor to perform additional procedures to identify such concerns.

- <u>Departure from the Auditor's Standard Report</u>. Auditing Standard No. 16 requires the auditor to communicate to the audit committee when the auditor expects to: (i) modify the opinion in the auditor's report or (ii) include explanatory language or an explanatory paragraph in the auditor's report. The requirement is intended to provide the basis for a discussion between the auditor and the audit committee in those circumstances in which the auditor expects to change the auditor's standard report. This requirement is limited to the communication of changes to the audit report determined by the auditor during the course of the audit and does not require the performance of new audit procedures.

Other Considerations Relating to Changes to the Standard. As part of the Board's regular standard-setting process, the Board takes into account costs related to its proposed changes based on, among other things, the Board's general knowledge of audit firm practice based on the Board's oversight activities. The Board did not specifically seek or receive comment that attempted to quantify costs related to the new standard.[126/]

The Board has sought to devise an overall framework for auditor communications that is sensitive to the new standard's overall effect. The Board has sought to avoid unnecessary costs in developing the new standard. To the extent that the new standard changes existing or imposes new communication requirements, however, the Board recognizes that those requirements will impose some incremental costs.

To avoid unnecessary costs:

- Auditing Standard No. 16 incorporates significant existing and new communication requirements into one standard. Bringing these requirements together in one place should promote the auditor's compliance with relevant statutory and regulatory requirements, as well as potentially reducing auditor time searching for requirements. Similarly, an appendix to the new standard lists and identifies the location of other auditor communication requirements contained in other PCAOB rules and standards; and
- The new standard does not impose new auditor performance requirements, other than the required communications themselves.

126/ The discussion in this section reflects the Board's qualitative assessment of the new standard's impact based on the overall design of the new standard, and the changes made by the Board in response to comments, both of which are discussed throughout this submission and in the record for Auditing Standard No. 16.

In other words, the new audit committee communication requirements in Auditing Standard No. 16 are based on the results of audit procedures performed under existing standards.

In considering costs, as a threshold matter, the Board notes that auditors and audit committees already engage in audit committee communications under the federal securities laws and existing auditing standards and thus registered firms and companies already incur some costs in complying with existing requirements.

Registered firms will need to incur the one-time cost to update their audit methodologies to reflect the new requirements and conduct initial training of their personnel on the new requirements.[127] In addition, registered firms will incur the recurring costs of the additional time required to prepare and make the communications in each audit in which they are required and to document that those communications were made. The Board also recognizes that audit committees will need to receive or read, and potentially discuss and act upon, the new required communications, which might result in the ongoing cost of increased time required for audit committee meetings. The Board sought to ensure that the recurring communication requirements are scalable – that is, they vary based on the size and complexity of the company – in part to avoid unnecessary costs.

---

[127] Those firms that in the past did not use an engagement letter for audits subject to the standard will now have to develop one. In the Board's experience, most firms currently use an engagement letter for such audits.

For all the reasons discussed above and in the Board's adopting release, the Board does not anticipate the incremental costs imposed by the new standard would be significant.

Characteristics of EGCs and Economic Considerations

The PCAOB has begun to monitor implementation of the JOBS Act in order to understand the characteristics of EGCs and inform the Board's request to apply Auditing Standard No. 16 to audits of EGCs.[128/]

To obtain data regarding EGCs, the PCAOB's Office of Research and Analysis has reviewed registration statements and Exchange Act reports filed with the SEC with filing dates between April 5, 2012, and June 4, 2012, for disclosures by entities related to their EGC status. Only those entities that have voluntarily disclosed their EGC status have been identified.[129/]

[128/] Pursuant to the JOBS Act, an "emerging growth company" is defined in Section 3(a)(80) of the Exchange Act. In general terms, an issuer qualifies as an EGC if it has total annual gross revenue of less than $1 billion during its most recently competed fiscal year (and its first sale of common equity securities pursuant to an effective Securities Act registration statement did not occur on or before December 8, 2011). *See* JOBS Act Section 101(a), (b), and (d). Once an issuer is an EGC, the entity retains its EGC status until the earliest of: (i) the first year after it has total annual gross revenue of $1 billion or more (as indexed for inflation every five years by the SEC); (ii) the end of the fiscal year after the fifth anniversary of its first sale of common equity securities under an effective Securities Act registration statement; (iii) the date on which the company issues more than $1 billion in non-convertible debt during the prior three year period; or (iv) the date on which it is deemed to be a "large accelerated filer" under the Exchange Act (generally, an entity that has been public for at least one year and has an equity float of at least $700 million).

[129/] The PCAOB has not validated these entities' self-identification as EGCs. The information presented in this submission also does not include data for entities that have confidentially submitted draft registration statements to the SEC for confidential non-public review in accordance with the JOBS Act. Thus, *Characteristics of Self-Identified EGCs.* As of June 4, 2012, based on the PCAOB's research, 196 entities have voluntarily identified themselves as EGCs in SEC filings. These 196 entities operate in diverse industries. The five most common Standard Industrial Classification (SIC) codes applicable to these entities are for: blank checks; pharmaceutical preparations; prepackaged software services; computer processing/data preparations services; and crude petroleum/natural gas.

Of the 196 entities, approximately 78% are companies that were identified in a registration statement filed to conduct an initial public offering. The other 22% were identified through Exchange Act filings. Forty-one entities have securities listed on a national securities exchange.

The reported assets for the 196 entities ranged from zero to approximately $13 billion, based on filings for the period reported. The average and median reported assets of the 196 entities were approximately $260.6 million and approximately $24.9 million, respectively.[130/] The reported revenue for the 196

---

the data and analysis are not based on the complete population of EGCs. The Board recognizes that its initial analysis of self-identified EGCs does not include all entities that may be EGCs and that, after the JOBS Act has been in effect for a longer period of time, additional analysis of the characteristics of EGCs may be possible.

130/ For purposes of comparison, the PCAOB compared the data compiled with respect to the 196 entities with companies listed in the Russell 3000 Index in order to compare the EGC population with the broader issuer population. The Russell 3000 was chosen for comparative purposes because it is intended to measure the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market (as marketed on the Russell website). The average and median reported assets of issuers in the Russell 3000 was approximately $11.5 billion and approximately entities, based on filings for the period reported, ranged from zero to approximately $958.1 million. The average and median reported revenue of the 196 entities was approximately $106.9 million and approximately $6.7 million, respectively. Seventy-eight of the 196 entities identified themselves as "development stage entities" in their financial statements.[131/] Of the 196 entities, 103 were audited by firms that are annually inspected by the PCAOB (i.e., firms that have issued audit reports for more than 100 public company audit clients). The remaining 93 were audited by triennially inspected firms (i.e., firms that have issued audit reports for 100 or fewer public company audit clients).

Based on the Board's initial analysis of EGCs, these entities appear to represent diverse industries and are audited by a diverse group of firms. Although these entities range in size, approximately 61% or 119 have reported revenue of less than $50 million. Given the December 8, 2011, initial starting point for EGC eligibility, one key difference between EGCs and other entities

---

$1.4 billion, respectively. The average and median reported revenue of issuers in the Russell 3000 was approximately $4.6 billion and $742.8 million, respectively.

[131/] According to Financial Accounting Standards Board ("FASB") guidance, development stage entities are entities devoting substantially all of their efforts to establishing a new business and for which *either* of the following conditions exists: (a) planned principal operations have not commenced or (b) planned principal operations have commenced, but there has been no significant revenue from operations.) *See* FASB Accounting Standards Codification, Subtopic 915-10, *Development Stage Entities – Overall*.

appears to be the length of time an EGC has been subject to the reporting requirements under the Exchange Act.[132/]

Economic Considerations and Application of Auditing Standard No. 16 to Audits of EGCs. The Board adopted Auditing Standard No. 16 to "further the public interest in informative, accurate, and independent audit reports." Auditing Standard No. 16 is intended to improve the relevance, timeliness, and quality of communications between auditors and audit committees. The Board's determination to adopt Auditing Standard No. 16 is based on a record developed over several years that includes extensive public outreach and comment.

As discussed above and in the Board's release, improved communications should result in both auditors and audit committees becoming better informed and, therefore, better equipped to fulfill their respective roles in the company's financial reporting. Through this communication, the auditor may obtain more complete information about the company, enabling the auditor to be more effective in identifying and assessing risks of material misstatement in the company's financial statements and designing and performing audit procedures to address those risks. Similarly, a better informed audit committee should contribute to management oversight, which may also improve the company's financial reporting as well as its oversight of management more generally.

[132/] The Board notes that its initial analysis is generally consistent with the legislative history of the JOBS Act, which anticipated that EGCs will be somewhat smaller entities that may have less experience in complying with some aspects of the federal securities laws. *See* House Report No. 112-406, at 5-7.

The Board believes the standard will enhance the quality of the audit and the quality of the financial reporting process. In attempting to obtain these benefits through the new standard, the Board sought to avoid imposing unnecessary costs. The approach used by the Board was to consider the new standard's overall effect on current audit practice and on audit committees and companies. This approach was used to develop a standard that is scalable based on a company's size and complexity, thereby avoiding unnecessary costs for audits of smaller or less complex companies, including smaller or less complex companies that are EGCs.

The benefits of the standard, which are summarized throughout this submission and described more fully in the Board's adopting release, should also be applicable to companies of various types and natures. For example, auditors and audit committees of all types of companies should benefit from a meaningful exchange of information regarding significant matters that may affect the integrity of a company's financial reports. Communications with the audit committee should improve the audit by providing auditors with the audit committee's insights about the company, as well as providing auditors with a forum that is separate from management to discuss complex and significant matters about the audit and the company's financial reporting process. Communications between the auditor and the audit committee should allow the audit committee to be well-informed about accounting, auditing, and disclosure matters that are significant to the company's financial statements, and to be better able to carry out its oversight role. These general benefits of the new standard should accrue to audits of all companies, including EGCs.

Moreover, enhanced audit committee communications may be of particular benefit to EGCs. Based on the Board's preliminary analysis of EGC data, EGCs generally appear to be companies that are relatively new to the SEC reporting process. Such companies may have new audit committee members and may be relatively less familiar with SEC reporting requirements, and have relatively more questions regarding how to present their financial statements for SEC reporting purposes. Similarly, some EGCs may be considering for the first time initial choices in their accounting policies and practices that could have implications for their financial reporting.

Another benefit of the new standard is that it provides for communications regarding significant matters on a timely basis. Timely communications with the audit committee help improve the audit by, among other things: (i) informing the audit committee, which has responsibility for the oversight of financial reporting, about significant matters related to the audit and the financial statements; (ii) enabling the auditor to obtain the audit committee's insights and information about transactions and events; (iii) enabling the auditor to learn from the audit committee about additional matters relevant to the audit, including possible violations of laws or regulations; and (iv) assisting the auditor in gaining a better understanding of the company and its environment. Timely communications also permit both the auditor and the audit committee to take appropriate action to address the matters communicated, including any effect on the company's financial statements. Again, these benefits were designed to benefit audits of all companies, including audits of EGCs.

The new standard also promotes communications that are tailored to the circumstances of the company and informative, rather than "boiler-plate" or standardized. Under Auditing Standard No. 16, required communications would vary by the nature and complexity of the company being audited. Effective communication between the auditor and the audit committee also need not be in writing, but may involve many forms of communication, such as presentations, charts, and robust discussions, as well as written reports. Such flexibility in the form of communications is an important element of the new standard and part of what allows the standard to work for audits of companies of varying sizes and complexity, including EGCs.

The Board has also considered other potential economic effects on efficiency and capital formation. The Board's overall approach is designed to: (i) scale the required communications to the size and complexity of the company being audited; (ii) maintain flexibility (for example, with respect to communicating orally or in writing); (iii) minimize duplicative or redundant communications to the audit committee from the auditor and management; (iv) focus the communications on the accounting matters that are significant to the auditor and the audit committee; and (v) reduce auditors' search costs (i.e., the costs associated with researching the federal securities laws' and auditing standards' various communication requirements) by providing a list of other PCAOB standards and rules that contain audit committee communication requirements in one place. Moreover, as previously discussed, the auditor's requirements under the new standard are focused on communicating the results of audit procedures that the auditor is already required to perform.

The Board also considered alternatives to the communication requirements in the final standard. Before commencing this project, the Board considered whether a new standard was necessary, particularly since a number of the standard's requirements were already required by existing auditing standards or provisions of the federal securities laws. The Board also discussed whether to develop a new standard on audit committee communications with its SAG, and had subsequent discussions with the SAG on the nature and extent of communications in a new standard. The Board proposed the standard, extended the proposal's comment period, held a roundtable, and reproposed the standard to obtain additional public input. As a result of the public comment and outreach, through which many commenters were supportive, the Board decided to proceed with a new standard. The Board did so because it believes that establishing the new communication requirements, as well as clarifying, updating and consolidating the other communication requirements, would improve audits and audit committee oversight with respect to all types of companies, including EGCs, without imposing unnecessary costs.

Many now agree that the interaction between the auditor and the audit committee – as mandated by the Sarbanes-Oxley Act – improves audit quality and the quality of financial reporting.[133] Research has indicated that improved auditor communications with audit committees can enhance the quality of the audit and the quality of the financial reporting process.[134] Also, most commenters on the new standard generally agreed that fuller and more relevant communications between the auditor and audit committee would allow the auditor to perform a more informed, and thus more effective audit, and would

---

133/ For example, research conducted by the Center for Audit Quality and published in its March 2008, *Report on the Survey of Audit Committee Members*, found that increased audit committee oversight was believed to have had a positive impact on the overall quality of audits by 92% of its audit committee member respondents. As recently as June 12, 2012, the United Kingdom's Financial Reporting Council issued its annual report, *Audit Quality Inspections*, which indicate, among other things, that: "Audit committees play an essential role in ensuring the quality of financial reporting. In particular, their work with auditors in planning the audit and reviewing its results contributes greatly to the quality of the audit."

134/ *See, e.g.,* Jeff Cohen, Ganesh Krishnamoorthy, and Arnie Wright, *Views to Strengthen Auditor Independence and Skepticism*, PCAOB meeting (March 22, 2012). Among other things, the statement provides: "Our research has validated the very important role the audit committee plays in enhancing audit and financial reporting quality." *See also* Jeffrey Cohen, Lisa Milici Gaynor, Ganesh Krishnamoorthy, and Arnold M. Wright, *Auditor Communications with the Audit Committee and the Board of Directors: Policy Recommendations and Opportunities for Future Research,* Accounting Horizons, at 183 (June 2007) ("Frequent communications with a well-informed, financially sophisticated audit committee and communications among the audit committee, the auditor and the full board improve financial reporting quality.").

enable the audit committee to more effectively fulfill its oversight responsibilities regarding the financial reporting process.[135]

Higher quality financial reporting (as a result of better informed auditors, better informed audit committees, or both) improves the quality of information available to the markets and reduces the information asymmetry that exists about the company among investors as well as between investors and the company's management.[136/] Academic research indicates that improving the quality of financial reporting can reduce investors' uncertainty about the information being provided in companies' financial reports and thus increase efficiency in capital allocation and foster capital formation.[137/] Higher quality financial reporting (and

---

135/ For a discussion of comments received on the new standards, *see* PCAOB Release No. 2012-004 (Aug. 15, 2012) and PCAOB Release No. 2011-008 (Dec. 20, 2011).

136/ Shareholders and other financial statement users possess less information about the company than the company's management. This information asymmetry can provide an opportunity for management to act in ways that are not aligned with the interests of the company's investors. *See, e.g.*, Greenwald, B. C., and J. E. Stiglitz, *Asymmetric Information and the New Theory of the Firm: Financial Constraints and Risk Behavior*, 80 American Economic Review 2, at 160-165 (1990). Also, information asymmetry between informed and uninformed investors makes the latter less willing to trade and require higher risk premiums when they do invest. *See, e.g.*, Easley, D., and M. O'Hara, *Information and the Cost of Capital*, 59 The Journal of Finance 4, at 1553-1583 (2004).

137/ *See, e.g.*, Lambert R. A., C. Leuz, and R. E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research, at* 385-420 (2007). The authors show that accounting information influences a company's cost of capital directly and indirectly. Improved financial reporting quality can reduce a company's cost of capital by increasing precision of investors' assessments of a company's future cash flows. The lower cost of capital can subsequently affect real investment choices of the company, improving future cash flows and increasing the value of the company. *See also* Easley, D., and M. O'Hara, *Information and the Cost of* improved corporate governance) can mitigate principal-agent problems and reduce agency costs.[138/]

There will be some costs associated with audit committee communications under the new standard, including additional costs incurred by companies. As previously discussed, the costs for a company to operate and maintain an audit committee may increase because of the need for additional meetings and increased audit committee member time demands. However, for the reasons explained above, the Board does not believe these additional costs will significantly expand the time or resources companies spend on audit committees.

With respect to competition, as noted above, the standard is designed to be scalable based on a company's size and complexity. The required communications can be tailored or adjusted to fit the size and nature of the company under audit. By doing so, the Board sought to avoid imposing unnecessary costs that could have a disproportionate effect on, and thereby

---

Capital, 59 The Journal of Finance 4, at 1553-1583 (2004). Their model suggests that increasing reliable public information about a company reduces the risk premium investors require. Also, Lambert et al. (2012) show that cost of capital decreases with higher average precision of information. *See* Lambert R. A., C. Leuz, and R. E. Verrecchia, *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 Review of Finance, at 1-29 (2012).

[138/] In a principal-agent situation, the goals of principals and agents generally differ and it is expensive for the principals to directly verify the agents' actions. In a corporation, management acts as agent for the shareholders (principals), with the audit committee and the auditor serving as intermediary agents. Well informed intermediary agents can more effectively exercise their oversight responsibilities to mitigate undesired behaviors of the management and reduce the goal incongruence between management and shareholders.

potentially have an adverse competitive impact on, smaller and less complex public companies. In response to the Board's solicitation of comment on the appropriateness of the standard's requirements for audits of companies of different sizes and in different industries, commenters generally considered the requirements of the standard to be applicable and appropriate to companies of varying sizes and industries. Commenters did not raise concerns regarding the standard's impact on competition and the Board has not identified any economic effects on competition.

Conclusion

As discussed throughout this submission, and in the Board's adopting release, the Board believes that Auditing Standard No. 16 will contribute to audit effectiveness. In addition, the new standard should assist the audit committee in its oversight over financial reporting. Moreover, more effective and informed communications between the auditor and the audit committee also should help enhance the quality of a company's financial reporting.

In both its proposing and reproposing releases, the Board sought comment on all aspects of the standard and as part of the process specifically asked questions regarding the appropriateness of the standard for companies of all sizes or industries, which include EGCs. Commenters considered the requirements of the standard to be applicable and appropriate to companies of different sizes and industries. Notably, the Board received comments from a wide spectrum of commenters, including from auditors that represented the interests of both small and large accounting firms and that audit companies of various sizes.

After the enactment of the JOBS Act, the Board compiled data available from entities voluntarily identifying themselves as EGCs in SEC filings. Based on data available to the Board, it appears that a wide range of entities, of differing sizes and industries, identify themselves as EGCs. One key difference between EGCs and other issuers appears to be the length of time that they have been subject to Exchange Act reporting requirements.

The Board believes that Auditing Standard No. 16 is in the public interest, and, for the reasons explained above, after considering the protection of investors and the promotion of efficiency, competition, and capital formation, recommends that the standard should apply to audits of EGCs. Accordingly, the Board requests that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply Auditing Standard No. 16 to audits of emerging growth companies. The Board stands ready to assist the Commission in considering any comments the Commission receives on these matters during the public comment process.

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with the requirements of Title I of the Sarbanes-Oxley Act. Comments may be submitted by any of the following methods:

Electronic comments:

1. Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or
2. Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB-2012-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2012-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/pcaob/shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. PCAOB-2012-01 and should be submitted on or before [insert 21 days from publication in the Federal Register].

By the Commission.

Elizabeth M. Murphy
Secretary

1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES AND RELATED AMENDMENTS TO CERTAIN PCAOB AUDITING STANDARDS	PCAOB Release No. 2010-001 March 29, 2010 PCAOB Rulemaking Docket Matter No. 030

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is proposing an auditing standard, *Communications with Audit Committees,* which would supersede the Board's interim standards AU sec. 380, *Communication With Audit Committees,* and AU sec. 310, *Appointment of the Independent Auditor*, and would amend certain other PCAOB auditing standards. The text of the proposed standard and the related amendments (Appendices 1 and 2) will be applicable to all registered firms conducting audits in accordance with PCAOB standards.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by email to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 030 in the subject or reference line and should be received by the Board no later than 5:00 PM (EDT) on May 28, 2010.

Board Contacts: Jennifer Rand, Deputy Chief Auditor (202/207-9206, randj@pcaobus.org), Barbara Vanich, Associate Chief Auditor (202/207-9363, vanichb@pcaobus.org), and Jessica Watts, Assistant Chief Auditor (202/207-9376, wattsj@pcaobus.org).

I. Introduction

For many companies and their auditors, the Sarbanes-Oxley Act of 2002 ("the Act") fundamentally changed the relationship between the audit committee[1/] and the auditor. The Act, along with the U.S. Securities and Exchange Commission's ("SEC") related implementation rules, strengthens and expands the role of the audit committee in overseeing a company's financial reporting process. The following sections of the Act amended the Securities Exchange Act of 1934 (the "Exchange Act"):[2/]

- Sections 201 and 202 of the Act - An issuer's audit committee shall pre-approve all audit and non-audit services to be provided by its auditor.
- Section 204 of the Act - Auditors shall communicate certain information to the audit committee.
- Section 301 of the Act - The SEC shall direct national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not comply with certain requirements, including assigning the audit committee the responsibility to appoint, compensate, retain, and provide oversight of the auditor's work.

As the Act acknowledged, audit committees play an important role in protecting the interests of investors. The audit committee assists the board of directors in fulfilling its responsibility to company shareholders and others to oversee the integrity of a company's financial statements and the financial reporting process. An audit committee that is well-informed about accounting and disclosure matters relating to the audit may be better able to carry out its role of overseeing the financial reporting process. One way the audit committee may be informed of accounting and disclosure matters is through the communication of the auditor's evaluations of matters that are significant to the financial statements. Effective two-way communications between the auditor and

---

[1/] The term audit committee, as used in this release, refers to a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to a company, the term refers to the entire board of directors of the company.

[2/] The Act amended Section 10A(h), (i), (k) and (m) of the Exchange Act.

the audit committee on such matters might also benefit the auditor in performing the audit.[3/]

The Board is proposing a new auditing standard (the "proposed standard") that would replace interim standards AU sec. 380, *Communication With Audit Committees* ("AU sec. 380"), and AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310"), which were written prior to the Act when management of a listed company, rather than the audit committee, was often responsible for engaging and overseeing the auditor. The Board's primary objectives in proposing a new standard are to: (1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee; and (2) emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit.

The proposed standard has been influenced by a number of factors and developments, including the increasing use of risk-based audit methodologies and the emphasis on judgments and estimates in the financial reporting frameworks. Additionally, the Board's Standing Advisory Group ("SAG") has discussed auditor communications with audit committees on several occasions. SAG members have expressed support for the Board proposing a new standard that enhances the auditor communications with the audit committee, especially in the areas of disclosures and critical accounting estimates.[4/]

To address these factors, the Board considered the following items in drafting the proposed standard:

- Integrating the Requirements for the Auditor's Appointment and Auditor Communications with the Audit Committee – Given the responsibility of many audit committees for the appointment and retention of the auditor, the proposed standard combines the requirements from the Board's interim auditing standards AU sec. 310 and AU sec. 380 into one auditing standard. The Board considered whether required communications in the

---

[3/] An audit is either a financial statement audit or an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

[4/] Webcasts of these meetings are available on the Board's website at: www.pcaobus.org/News_and_Events/Webcasts.

Board's other standards and rules, such as AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, and PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services,* should be amended and also included in the proposed standard. The proposed standard does not combine communication requirements in the Board's other standards and rules. Rather than moving all auditor communication requirements into one standard, the proposed standard includes an appendix that identifies other PCAOB standards and rules that require communication with the audit committee about specific matters. The proposed standard is intended to set forth requirements regarding the auditor's overall communication responsibilities with the audit committee that are applicable to all audits conducted in accordance with PCAOB standards.

- Overview of the Audit Strategy, Including the Auditor's and Audit Committee's Consideration of Significant Risks – In performing a risk-based audit, the auditor's assessment of significant risks[5/] is an important consideration regarding the tests of controls and substantive procedures performed. Communication of the significant risks identified by the auditor gives the audit committee an opportunity to understand the auditor's view of the most important risks of material misstatements and to communicate its views relating to those risks based on its knowledge of the company. The auditor's understanding of the audit committee's view of the company's risks could assist in the development of the auditor's risk assessment and audit strategy, ultimately resulting in an improvement to audit quality.

- Accounting Policies and Estimates – In developing the proposed standard, the Board considered the importance of not just the accounting policies, practices, and estimates used to prepare the financial statements, but also management's judgments and assumptions underlying the financial results. Knowledge of the potential variability that exists relating to assumptions made in developing the estimates also plays a key role in understanding the risks of material misstatement. The proposed standard includes a number of requirements relating to the communication of these matters to the audit committee, including the auditor's evaluation of the quality of the company's accounting policies, practices, and estimates.

[5/] Paragraph A5 of the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement,* defines significant risk.

- Timing of Communications – Timely communications from the auditor provide the audit committee with the opportunity to make informed decisions and to take actions that may affect the quality of both the audit and the financial statements. The significance of the matter to be discussed and any corrective or follow-up action needed on the part of the audit committee are considered in determining the timing of communications required by the proposed standard. Additionally, the proposed standard requires communications be made no later than the issuance of the auditor's report.[6/]

The proposed standard carries forward substantially all of the required communications in AU sec. 380. For certain matters, the proposed standard requires communication of additional matters. For example, to provide the auditor with a central location for required communications with audit committees regarding accounting matters, the proposed standard includes requirements that are consistent with the SEC's audit committee communication requirements. Additionally, in drafting the proposed standard, the Board considered the requirements of the relevant standards of the International Auditing and Assurance Standards Board ("IAASB") and the American Institute of Certified Public Accountant's Auditing Standards Board ("ASB").

Appendix 1 to this release contains the text of the proposed standard, *Communications with Audit Committees*. The proposed standard has three appendices: (1) Appendix A - Definitions, (2) Appendix B - Communications with Audit Committees Required by Other PCAOB Standards and Rules, and (3) Appendix C - Matters Communicated in the Audit Engagement Letter. Appendix 2 to this release contains proposed amendments to other existing standards to conform them to the requirements and direction in the proposed standard. Appendix 3 provides a comparison of the proposed standard to the relevant standards of the IAASB and the ASB.

II. Overview of the Proposed Standard

The Board's proposed standard is intended to strengthen the existing requirements for auditor communications with the audit committee. The Board requests comments on all aspects of the proposed standard and is particularly interested in responses to the specific questions below.

[6/] Consistent with Rule 2-07 of Regulation S-X, in the case of a registered investment company, if the annual communication is not within 90-days prior to the filing, the auditor should provide an update, in the 90-day period prior to the filing, of any changes to the previously reported information.

A. Objectives of the Auditor

Consistent with other recently issued PCAOB auditing standards, the Board has included a section on the objectives of the auditor in the proposed standard. The objectives of the auditor are (a) communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee; (b) communicating to the audit committee an overview of the audit strategy and timing of the audit; (c) providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and (d) evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit.

Question:

1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters 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?

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

In considering the audit committee's responsibility to oversee the appointment, compensation, and retention of the auditor, the Board has included in the proposed standard a requirement for the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee. Unlike AU sec. 310, which requires an understanding to be established with the client of the services to be performed, the proposed standard requires that this understanding be established specifically with the audit committee. Unlike AU sec. 310, the proposed standard requires the auditor to record this understanding in a written audit engagement letter, and to include the understanding of the objective of an audit and the responsibilities of the auditor and management. The proposed standard also requires the auditor to provide the engagement letter to the audit committee and, like other communication requirements, the engagement letter is required to be provided annually. Appendix C of the proposed standard describes matters that should be included in an engagement letter. That appendix incorporates the direction in AU sec. 310 relating to the objective of the audit and the responsibilities of the auditor and management and amends that direction to reflect the auditor's current responsibilities under PCAOB standards and rules.

Questions:

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

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

C. Obtaining Information Related to the Audit

The Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement,* includes a requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks.[7/] The proposed standard includes a requirement to inquire of the audit committee about whether they are aware of other matters that may be relevant to the audit, including complaints or concerns raised regarding accounting or auditing matters. Audit committees of listed issuers are required to establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters.[8/] Complaints or concerns may come to the audit committee's attention through the company's process for reporting concerns related to financial reporting[9/] that are relevant to the audit. Inquiring of the audit committee regarding issues relevant to the audit might encourage an open two-way communication between the auditor and the audit committee.

It is important that the discussions of these matters with the audit committee be robust and substantive. For example, an open discussion may encourage more dialogue between the auditor and the audit committee regarding the risks of material misstatement and other matters relevant to the audit.

[7/] Paragraph 51 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement* and paragraph 22 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit.*

[8/] See Exchange Act Section 10A(m)(4) and Rule 10A-3(b)(4).

[9/] See Exchange Act Rule10A-3(b)(3).

Question:

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?

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

The proposed standard has a new requirement for the auditor to communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified by the auditor, and the timing of the audit. Early communication of these matters may enable the audit committee to understand the auditor's views regarding risk and to provide insights regarding additional risks not identified by the auditor in order for the auditor to incorporate them into the audit strategy.

The proposed standard also includes a requirement for the auditor to communicate, in a timely manner, significant changes to the planned audit strategy or the significant risks initially identified that may occur during the audit due to the results of audit procedures or in response to external factors, such as changes in the economic environment.

Additional matters that the auditor should communicate as part of the audit strategy, if relevant, include:

- 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;[10/]

- The auditor's consideration of and planned use of the company's internal audit function to perform audit procedures in the audit of financial statements;

- The auditor's consideration of the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or

---

10/ Paragraph 16 of Proposed Auditing Standard, *Audit Planning and Supervision,* requires the auditor to determine whether specialized skill or knowledge is needed to perform audit procedures.

the audit committee when conducting an audit of internal control over financial reporting;

- The roles, responsibilities, and locations of firms participating in the audit; and

- The basis for the auditor's determination that he or she can serve as principal auditor.

The proposed standard includes these communication requirements to address instances in which the auditor uses the assistance of other firms to perform audit procedures. Auditors may use affiliated or network firms, outsourcing arrangements, or non-affiliated firms to perform audit procedures. Communication of these arrangements to the audit committee provides information regarding the parties involved in the audit who will perform audit procedures that the auditor will evaluate as part of the consideration of whether sufficient appropriate audit evidence has been obtained and also facilitates an effective discussion of how the work of other parties affects the audit.

The proposed standard notes that care is required when the auditor communicates the audit strategy and timing of the audit so as not to compromise the effectiveness of the audit procedures. For example, communicating details about specific audit procedures might reduce the effectiveness of those procedures.

Questions:

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?

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?

E. Accounting Policies, Practices, and Estimates

The proposed standard retains the requirements in AU sec. 380 on communication requirements relating to accounting policies, practices, and estimates. Similar to AU sec. 380, the proposed standard also acknowledges that management may be communicating certain matters related to the financial reporting process to the audit committee. In such cases, AU sec. 380 requires that the auditor determine whether the audit committee was informed about certain matters related to accounting policies, practices, and estimates required by that standard. Similarly, the proposed standard requires the auditor to communicate matters related to accounting polices, practices, and estimates. However, if management has already communicated the matters in paragraph 12 of the proposed standard, the auditor should determine whether the matters were adequately described by management, and if not, the auditor should communicate any omitted or inadequately described matters required by the proposed standard to the audit committee. A related proposed amendment to paragraph .34 of AU sec. 722*, Interim Financial Information,* is included in Appendix 2.

Accounting Policies and Practices

AU sec. 380 requires the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the company's accounting principles. AU sec. 380 requires this discussion generally to include such matters as the consistency of the company's accounting polices and their application and the clarity and completeness of the company's financial statements, which include related disclosures. Similarly, the proposed standard requires the auditor to communicate the auditor's evaluation of the quality, not just the acceptability, of the company's significant accounting policies and practices and the quality of disclosures related to the company's accounting policies and practices. In evaluating the quality of disclosures, the auditor understands, however, that an accurate application of authoritative accounting pronouncements in the financial statements often either requires, or would be more informative if accompanied by, appropriate and clear disclosures that facilitate an investor's understanding of the company's accounting and financial condition. In making his or her evaluation of the overall quality of the disclosures, therefore, the auditor considers whether all appropriate disclosures are made and whether the disclosures facilitate an investor's understanding of the financial statements and related financial information.

Companies should include disclosure regarding the potential effects of adoption of accounting standards that have been issued but not yet adopted in registration statements and reports filed with the SEC.[11/] The proposed standard includes a new requirement for the auditor to communicate, or determine that management has adequately communicated to the audit committee, the anticipated application of new accounting or regulatory pronouncements that are not yet effective, but which may, upon adoption, have a significant effect on the company's financial reporting. The auditor may develop a view regarding changes to processes or systems that could impact the financial reporting process that would not be included in management's

---

[11/] See Codification of Staff Accounting Bulletins, Topic 11.M., Question 1.

disclosures in the financial statements, but which the auditor may wish to communicate to the audit committee. A discussion of such matters in more detail with the audit committee may allow audit committees time to properly consider the effects on future financial statements as well as ramifications on the financial reporting process.

The proposed standard includes requirements that are consistent with those in Rule 2-07 of Regulation S-X[12/] for the auditor to communicate critical accounting policies and practices directly to the audit committee as well as alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items discussed with management. Communication to the audit committee of critical accounting policies and practices is not considered a substitute for communications regarding the initial adoption of and changes in significant accounting policies and practices. Management's selection of significant accounting policies and practices involves a broader range of transactions and events over time, while the description of critical accounting policies and practices is tailored to specific events in the current year. These requirements may help the auditor in making all the required accounting-related communications to the audit committee, including those of the SEC. With respect to the communication of critical accounting policies, the proposed standard requires the auditor to communicate, among other things, how current and anticipated future events may affect the determination by the auditor of whether certain policies and practices are considered critical. For example, 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.

The proposed standard also includes another new requirement for the auditor to communicate to the audit committee significant accounting matters on which the auditor has consulted outside the engagement team. This could include discussions with the firm's national office or industry specialists, or consultations with external parties when the firm does not have a national office. These consultations do not include discussions with the engagement quality reviewer. This information will benefit the financial reporting process by providing the audit committee with information about complex transactions that may be high risk or controversial.

Accounting Estimates

Accounting estimates including fair value measurements are an integral part of the financial statements prepared by management and are based upon management's

---

12/ 17 CFR 210.2-07.

current judgments. Those judgments normally are based on knowledge and experience about past and current events and assumptions about future events.

The proposed standard defines the term "critical accounting estimate" as an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (b) the impact of the estimate on financial condition or operating performance is material. This is the same definition used by the SEC.[13/] The proposed standard uses the term critical accounting estimate to help focus the communication to the audit committee on those estimates including fair value measurements that are subject to a higher risks of material misstatement. The definition of a critical accounting estimate is intended to include those that are "particularly sensitive" as used in AU sec. 380.

Further, the proposed standard includes new requirements for the auditor to communicate, or to evaluate whether management has adequately communicated, the following matters:

a. How management subsequently monitors critical accounting estimates;

b. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;

c. A discussion of any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes; and

d. 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.

The proposed standard requires the auditor to communicate his or her evaluation regarding the reasonableness of the process used by management to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates. In addition, the proposed standard requires the

---

13/ *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Release No. 33-8350 (December 19, 2003).

auditor to communicate to the audit committee situations where the auditor determines that potential bias exists in management's accounting estimates.[14/] This requirement is similar to the requirement in paragraph .09 of AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312.*

Questions:

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)?

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

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

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?

F. Management Consultations with Other Accountants

The proposed standard carries forward the requirement from AU sec. 380 for the auditor to communicate to the audit committee when the auditor is aware that management consulted with other accountants about auditing or accounting matters (e.g., if management consults with other accountants about the appropriate accounting for a transaction). In those situations, the auditor should communicate to the audit committee his or her views about significant matters that were the subject of such consultation.

[14/] Paragraph 27 of the Proposed Auditing Standard, *Evaluating Audit Risks,* includes requirements regarding the auditor's evaluation of bias in accounting estimates.

Question:

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

G. Going Concern

As part of the audit, the auditor has a responsibility to evaluate whether there is substantial doubt about the company's ability to continue as a going concern[15/] for a reasonable period of time.[16/] The auditor's evaluation is based on, among other things, his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor's report.

The proposed standard requires the auditor to communicate to the audit committee certain matters, when applicable, relating to his or her evaluation of a company's ability to continue as a going concern. The matters to be communicated depend on the auditor's conclusion. If the auditor concludes that there could be substantial doubt but the auditor's doubt is mitigated, the proposed standard requires the auditor to communicate the conditions and events that, when considered in the aggregate, indicate that there could be substantial doubt about the company's ability to continue as a going concern as well as the information that mitigates the auditor's doubt. 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 certain additional matters be communicated.

Question:

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

[15/] The requirements included in this standard may change depending on the outcome of the Financial Accounting Standards Board's project regarding going concern.

[16/] AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

H. Corrected and Uncorrected Misstatements

The proposed standard requires the auditor to provide the audit committee with the schedule of uncorrected misstatements relating to accounts and disclosures that was presented to management. Presenting only a schedule that, for example, shows only the net effect of the uncorrected misstatements rather than the individual misstatements may be misleading. The proposed standard also requires the auditor to communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative factors[17/] considered as well as 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.

Questions:

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

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

I. Other Matters

The proposed standard includes a new requirement for 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, including situations where the auditor is aware of complaints or concerns raised regarding accounting or auditing matters, not including matters previously reported to the auditor by the audit committee. This requirement acknowledges that there are other matters that may be beneficial to the financial reporting process when communicated to the audit committee.

J. Form and Content of Communications

Similar to AU sec. 380, the proposed standard provides for written or oral communication of the matters the standard requires, unless otherwise specified in the proposed standard. Effective communication may take many forms, such as presentations, written reports, or robust discussions. Having written communications

---

[17/] Paragraphs .15-.17 of AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* include qualitative factors to consider the qualitative characteristics of misstatements.

may provide the auditor with a basis to lead an active two-way discussion with the audit committee. When considering how to communicate highly complex information (e.g., information about critical accounting estimates), written information often makes it easier for others to understand the information; however, having a robust dialogue on key matters is the most important factor in effective communications with the audit committee.

The auditor is required to document the communications, whether communicated orally or in writing, in sufficient detail to enable an experienced auditor,[18/] having no previous connection with the engagement, to understand the communications made to comply with the provisions of this proposed standard. An amendment to paragraph .30 of AU sec. 722, *Interim Financial Information,* to include a similar requirement regarding documentation of communications with audit committees is included in Appendix 2. These documentation requirements follow the direction in PCAOB Auditing Standard No. 3, *Audit Documentation.* Regardless of the method of communication, the auditor is encouraged to have open and substantive dialogue with the audit committee.

Question:

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?

K. Timing

The Board considers communications with audit committees to be an integral part of the audit process. Therefore, unlike AU sec. 380, which states that audit committee communications are incidental to the audit and are not required to occur before the issuance of the auditor's report, the proposed standard requires timely communication by the auditor to the audit committee of the matters required by the proposed standard, and that all matters required by the proposed standard be communicated prior to the issuance of the auditor's report. AU sec. 380 also does not require the auditor to repeat the communication of recurring matters each year. The proposed standard requires that matters be communicated annually, as significant

---

[18/] As described in paragraph 6 of AS No. 3, *Audit Documentation,* "[a]n experienced auditor has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry."

matters may change based on changes in the economy, the volume of transactions, or the significance to the audit or the financial statements. Although the communications are required to be made annually, the time spent on the discussion of matters presented could vary from year to year based on changes in circumstances or other factors, such as a change in the members of the audit committee.

An amendment to paragraph .36 of AU sec. 722, *Interim Financial Information,* to require that the auditor complete any necessary communications with the audit committee prior to the company's filing of its interim financial information with a regulatory agency, such as the SEC is included in Appendix 2.

The appropriate timing for communications may vary with the circumstances of the engagement. For example, some communications, such as information regarding the audit strategy and the significant risks, should be made as early as possible and other matters, such as changes to the auditor's significant risks initially identified should be communicated in a timely manner. The auditor should communicate certain matters earlier than other matters, and more frequently, depending on the relative significance of the matters noted, the corrective follow-up actions by the audit committee, and other factors. For instance, the auditor should communicate significant difficulties with management or other matters that are adversely affecting the progress of the audit as soon as practicable to allow the audit committee to take appropriate action to enable the audit to be completed.

Question:

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

L. Adequacy of the Two-way Communication Process

Certain SAG members have emphasized that effective two-way communications between the auditor and the audit committee will benefit the audit process. The proposed standard includes a new requirement for the auditor to evaluate whether the two-way communications between the auditor and the audit committee have been adequate to support the objective of the audit. If not, the proposed standard requires the auditor to evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence. This requirement is included to emphasize that effective two-way communications are beneficial to achieving the objective of the audit. The auditor should base the evaluation on observations resulting from his or her interactions with the audit committee throughout the audit process.

Question:

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

M. Other Communication Requirements

Significant Issues Discussed with Management Prior to the Appointment or Retention

The proposed standard retains the requirement in AU sec. 380 for the auditor to discuss with the audit committee any major issues that were discussed with management in connection with the initial appointment or retention of the auditor. This requirement was originally written when auditors often were hired directly by management. As previously stated, Section 301 of the Act and SEC rules require that audit committees of companies with securities listed on a national exchange or with a national securities association be directly responsible for the appointment, compensation, and oversight of the work of the auditors. However, even when ultimate authority rests with the audit committee, the audit committee may ask management for its views of the auditor's performance based on the significant amount of interaction between the auditor and management.

To ensure that the audit committee is aware of all discussions that may influence management's views about the auditor or about significant accounting or auditing issues, the proposed standard retains the requirement from AU sec. 380 for the auditor to communicate significant issues discussed with management prior to his or her appointment or retention. 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.

Other Information in Documents Containing Audited Financial Statements

The proposed standard retains the requirement for the auditor to communicate to the audit committee the auditor's responsibility for other information presented in documents containing audited financial statements, any related procedures performed, and the results of such procedures.[19/]

Departure from the Standard Auditor's Report

The proposed standard includes a new requirement for the auditor to communicate to the audit committee when the auditor expects to modify the opinion in the auditor's report or include an explanatory paragraph,[20/] the reasons for the modification or explanatory paragraph, and the proposed wording of the modification or explanatory paragraph.

Disagreements with Management

The proposed standard includes the requirement from AU sec. 380 for the auditor to discuss with the audit committee any disagreements with management, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the financial statements or the auditor's report. Examples include disagreements with management about the application of accounting principles to the company's specific transactions and events, and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report. This communication requirement does not include differences of opinion based on incomplete facts or preliminary information that are later resolved prior to the issuance of the auditor's report.

Difficulties Encountered in Performing the Audit

The proposed standard includes the requirement from AU sec. 380 for the auditor to inform the audit committee of any significant difficulties encountered in dealing with management related to the performance of the audit. Significant difficulties encountered during the audit include:

[19/] Paragraphs .04-.07 of AU section 550, *Other Information in Documents Containing Audited Financial Statements,* require that the auditor read the information and consider whether it is materially inconsistent with information in the financial statements or whether it contains any material misstatements.

[20/] Paragraphs .11-.76 of AU sec. 508, *Reports on Audited Financial Statements*.

- Significant delays by management or an unwillingness by management to provide information needed for the auditor to perform his or her procedures;

- An unnecessarily brief time within which to complete the audit;

- Extensive, unexpected effort required to obtain sufficient appropriate audit evidence;

- Unreasonable restrictions imposed on the auditor by management; and

- Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested.

Questions:

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

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?

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 of the company under audit?

N. Appendices

The proposed standard includes the following three appendices:

- Appendix A – Definitions

- Appendix B - Communications with Audit Committees Required by Other PCAOB Standards and Rules

- Appendix C - Matters Communicated in the Audit Engagement Letter

Question:

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

O. Effective Date

The Board anticipates that the standard would be effective, subject to approval by the SEC, for audits of fiscal years beginning after December 15, 2010.

III. Opportunity for Public Comment

The Board will seek comment on the proposed standard and related amendments for a 60-day period. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 030 in the subject or reference line and should be received by the Board no later than 5:00 PM (EDT) on May 28, 2010.

The Board will consider all comments received. Following the close of the comment period, the Board will determine whether to adopt final rules, with or without amendments. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of the Act, proposed rules of the Board do not take effect unless approved by the Commission. Standards are rules of the Board under the Act.

On the 29th day of March, in the year 2010, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

Proposed Auditing Standard

Communications with Audit Committees

Supersedes AU sec. 380: Communication With Audit Committees, and AU sec. 310: Appointment of the Independent Auditor

Introduction

1. This standard establishes requirements for the auditor regarding certain matters related to the conduct of an audit[1/] that are communicated to a company's **audit committee**[2/] in connection with an audit. The communications between the auditor and the audit committee include establishing a mutual understanding of the terms of the audit engagement. The standard also requires the auditor to document that understanding in an engagement letter. Effective two-way communications throughout the audit assist the auditor and the audit committee in understanding matters related to the audit. The standard requires the auditor to evaluate the adequacy of the two-way communications between the auditor and the audit committee.

2. Other Public Company Accounting Oversight Board ("PCAOB") rules and standards identify additional matters to be communicated to a company's audit committee, which complement the requirements of this standard (see Appendix B). Various laws or regulations also require other matters to be communicated.[3/] The requirements of this standard do not modify communications required by those other laws or regulations. Nothing in this standard precludes the auditor from communicating other matters to the audit committee.

[1/] For purposes of this standard, an audit is either a financial statement audit or an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

[2/] Terms defined in Appendix A, *Definitions,* are set in **boldface type** the first time they appear.

[3/] See, e.g., Rule 2-07 of Regulation S-X, 17 CFR 210.2-07; Item 407 of Regulation S-K, 17 CFR 229.407; and Rule 10A-3 under the Securities Exchange Act of 1934, 17 CFR 240.10A-3.

Objectives

3. The objectives of the auditor are:

   a. Communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee;

   b. Communicating to the audit committee an overview of the audit strategy and timing of the audit;

   c. Providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and

   d. Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit.

Matters to be Communicated

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

4. The auditor should 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.

Establish a Mutual Understanding of the Terms of the Audit

5. The auditor should establish a mutual understanding of the terms of the audit engagement with the audit committee in connection with the audit.[4/] This mutual understanding includes communicating to the audit committee the following:

[4/] Audit committees of public companies with securities listed on a national exchange or with a national securities association have specific responsibilities regarding the appointment, retention, compensation, and oversight of the auditor. See Rule 10A-3(b)(2) under the Securities Exchange Act of 1934, 17 CFR 240.10A-3(b)(2).

a. The objective of the audit;

b. The responsibilities of the auditor; and

c. The responsibilities of management.

6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee. The auditor should have the engagement letter executed by the appropriate party or parties.

Note: Appendix C describes in more detail, matters that should be included in the engagement letter about the terms of the audit engagement.

7. If the auditor cannot establish a mutual understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept or perform the engagement.

Overview of the Audit Strategy and Timing of the Audit

Obtaining Information Related to the Audit

8. The auditor should 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.[5/]

[5/] Paragraph 53.b.(3) of the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, requires the auditor to inquire of the audit committee, or its chair, whether the audit committee is aware of tips or complaints regarding the company's financial reporting (including those received through the audit committee's internal whistleblower program) and, if so, the audit committee's responses to such tips and complaints.

Audit Strategy and Timing of the Audit

9. The auditor should communicate to the audit committee an overview of the audit strategy,[6/] including a discussion of the significant risks[7/] identified during his or her risk assessment procedures, and the timing of the audit.

> Note: The overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures. Communicating specific details regarding audit procedures might reduce the effectiveness of those procedures.

10. The auditor also should communicate the following matters to the audit committee, if applicable:

a. 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;[8/]

b. The auditor's consideration of, and planned use of, the company's internal audit function to perform audit procedures in an audit of financial statements;[9/]

c. The auditor's consideration of the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal

---

6/ Paragraph 8 of the Proposed Auditing Standard, *Audit Planning and Supervision,* describes the auditor's responsibilities for establishing an audit strategy.

7/ Paragraph A5 of the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement,* defines significant risk.

8/ Paragraph 16 of Proposed Auditing Standard, *Audit Planning and Supervision,* requires the auditor to determine whether specialized skill or knowledge is needed to perform audit procedures.

9/ AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* describe the auditor's responsibility for considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor in an audit.

auditors), and third parties working under the direction of management or the audit committee when conducting an audit of internal control over financial reporting;[10/]

d. The roles, responsibilities, and locations of firms participating in the audit; and

e. The basis for the auditor's determination that he or she can serve as principal auditor.[11/]

11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified.

Issues Arising from the Audit

Accounting Policies, Practices, and Estimates

12. The auditor should communicate the following matters to the audit committee regarding accounting policies, practices, and estimates:

a. Accounting policies and practices:

i. The initial selection of, and changes, in significant accounting policies or their application by management;

ii. 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;

iii. The methods used by management to account for significant and unusual transactions; and

---

10/ Paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* describes the auditor's responsibility related to using the work of others in an audit of internal control over financial reporting.

11/ AU sec. 543, *Part of Audit Performed by Other Independent Auditors,* discusses the professional judgments the auditor makes in deciding whether he or she may serve as principal auditor.

iv. The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

b. **Critical accounting estimates**:

i. A description of the process used by management to develop the critical accounting estimates and how such estimates are subsequently monitored by management;

ii. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;

iii. Any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes; and

iv. 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.

Note: As part of its communications to the audit committee, management may communicate the above matters 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.

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

13. The auditor should communicate to the audit committee the following matters:

a. Significant accounting policies and practices. The results of the auditor's evaluation of the quality, and not just the acceptability under the applicable financial reporting framework, of the company's significant accounting policies and practices, including a discussion of the:

i. Quality, clarity, and completeness of the company's financial statements, which includes related disclosures; and

ii. Consistency of the company's disclosures and of its selection and application of significant accounting policies and practices.

b. **Critical accounting policies and practices**. The discussion of critical accounting policies and practices should include:[12/]

i. An evaluation of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that were not made by management;

ii. The reasons certain policies and practices are considered critical by the auditor including those not considered critical by management; and

iii. How current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical.

Note: Communication to the audit committee of critical accounting policies and practices is not considered a substitute for communications regarding the initial selection of, and changes in, significant accounting policies and practices. Management's selection of significant accounting policies and practices involves a broader range of transactions and events over time, while the description of critical accounting policies and practices should be tailored to specific events in the current year. Those accounting policies and practices considered to be critical might change from year to year.

c. Critical accounting estimates. Both the auditor's evaluation of the reasonableness of the process used by management to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates.

d. Accounting Estimates. If the auditor determines that potential bias exists in management's accounting estimates.[13/]

[12/] See also Rule 2-07(a)(1) of Regulation S-X.

[13/] Paragraph 27 of the Proposed Auditing Standard, *Evaluating Audit Risks,* includes requirements regarding the auditor's evaluation of bias in accounting estimates.

e. Alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures, and the treatment preferred by the auditor.

f. Significant accounting matters for which the auditor has consulted outside the engagement team.

Note: This communication does not include discussions with the engagement quality reviewer in accordance with AS No. 7, *Engagement Quality Review.*

Other Information in Documents Containing Audited Financial Statements

14. When other information is presented in documents containing audited financial statements,[14/] the auditor should communicate to the audit committee his or her responsibility for such information,[15/] any related procedures performed, and the results of such procedures.

Management Consultations with Other Accountants

15. When the auditor is aware that management consulted with other accountants about auditing or accounting matters, the auditor should communicate to the audit committee his or her views about significant matters that were the subject of such consultation.[16/]

[14/] AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.*

[15/] In addition to AU sec. 550, discussion on the auditor's consideration of other information is included in AU sec. 558, *Required Supplementary Information,* AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents,* and AU sec. 711, *Filings Under Federal Securities Statutes.*

[16/] AU sec. 625, *Reports on the Application of Accounting Principles,* includes requirements regarding circumstances in which the auditor should be informed of such consultations.

Going Concern

16. The auditor should communicate to the audit committee, when applicable, certain matters relating to his or her evaluation of a company's ability to continue as a going concern:

a. If conditions and events that, when considered in the aggregate, indicate that there could be substantial doubt about the company's ability to continue as a going concern for a reasonable period of time[17/] but the auditor's doubt was mitigated, the auditor should communicate those conditions and events as well as the information that mitigated the auditor's doubt;[18/] or

b. If the auditor concludes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the following matters should be communicated:[19/]

   i. The auditor's assessment of management's plans to overcome the conditions and events and management's ability to implement the plans;

   ii. The effects, if any, on the financial statements and the adequacy of the related disclosure; and

---

17/ AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* includes requirements regarding an auditor's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited.

18/ Paragraph .03a of AU sec. 341 discusses the auditor's evaluation related to when there are factors that indicate there could be substantial doubt about the company's ability to continue as a going concern.

19/ Paragraphs .03b-c of AU sec. 341 discuss the auditor's evaluation related to when there are factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

iii. The effects, if any, on the auditor's report.[20/]

Note: These communication requirements apply even when the auditor has concluded that implementation of management's plans mitigate the effects of the conditions or events indicating there is substantial doubt about the company's ability to continue as a going concern.

Corrected and Uncorrected Misstatements

17. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that was presented to management.[21/]

18. The auditor should communicate to the audit committee the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative[22/] factors considered. The auditor also should 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.

Note: The auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.

[20/] Paragraphs .12-.16 of AU sec. 341 discuss the effect on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

[21/] See Section 13(i) of the Securities Exchange Act of 1934, which states, in part, that financial statements prepared in accordance with generally accepted accounting principles and filed with the Securities and Exchange Commission "shall reflect all material correcting adjustments that have been identified by a registered public accounting firm …."

[22/] Paragraphs .15-.17 of AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* discuss the qualitative characteristics of misstatements.

Departure from the Standard Auditor's Report

19. When the auditor expects to modify the opinion in the auditor's report or to include an explanatory paragraph in the report, the auditor should communicate with the audit committee the reasons for the modification or explanatory paragraph and the proposed wording of the report.

Disagreements with Management

20. The auditor should communicate to the audit committee disagreements with management about matters, whether or not satisfactorily resolved that individually or in the aggregate could be significant to the company's financial statements or the auditor's report.

> Note: Disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved prior to the issuance of the auditor's report.

Difficulties Encountered in Performing the Audit

21. The auditor should communicate any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include:

a. Significant delays by management or an unwillingness by management to provide information needed for the auditor to perform his or her procedures;

b. An unnecessarily brief time within which to complete the audit;

c. Extensive, unexpected effort required to obtain sufficient appropriate audit evidence;

d. Unreasonable restrictions imposed on the auditor by management; and

e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested.

Note: Difficulties encountered during the audit could lead to modifying the auditor's opinion on the basis of a scope limitation.[23/]

Other Matters

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.[24/]

Form and Content of Communications

23. The auditor should communicate to the audit committee the matters in this standard either in writing or orally,[25/] unless otherwise specified in this standard. The auditor should document the communications, whether communicated orally or in writing, in sufficient detail to enable an experienced auditor,[26/] having no previous connection with the engagement, to understand the communications made to comply with the provisions of this standard.

Note: If management communicated matters identified in paragraph 12, the auditor should include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.

[23/] See paragraphs .22-.32 of AU sec. 508, *Reports on Audited Financial Statements,* for a discussion on scope limitations.

[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.

[25/] See AU sec. 532, *Restricting the Use of an Auditor's Report,* which applies to certain reports on matters coming to the auditor's attention during the course of the audit.

[26/] As described in paragraph 6 of AS No. 3, *Audit Documentation,* "[a]n experienced auditor has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry."

Timing

24. Audit committee communications should occur in a timely manner, unless other timing requirements are specified. The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed.

> Note: Communications with the audit committee chair may be appropriate if done in order to communicate matters timely during the audit. The auditor should, at a later date, communicate such matters to the full audit committee.

25. All communications required by this standard should be made annually to the audit committee prior to the issuance of the auditor's report.[27/]

Adequacy of the Two-Way Communications

26. Prior to the issuance of the auditor's report, the auditor should evaluate whether the two-way communications between the auditor and the audit committee have been adequate to support the objectives of the audit. The auditor should base the evaluation on observations resulting from his or her interactions with the audit committee, which include, but are not limited to the following:

a. The appropriateness and timeliness of actions taken by the audit committee in response to matters raised by the auditor;

b. The openness of the audit committee in its communications with the auditor;

c. The willingness and capacity of the audit committee to meet with the auditor without management present; and

d. The extent to which the audit committee probes issues raised by the auditor.

> Note: The auditor should read the minutes, if any, relating to audit committee meetings for consistency with the auditor's understanding of the communications.

27/ Consistent with Rule 2-07 of Regulation S-X, in the case of a registered investment company, if the annual communication is not within 90- days prior to the filing, the auditor should provide an update in the 90-day period prior to the filing, of any changes to the previously reported information.

27. If the auditor determines that the two-way communications have not been adequate, the auditor should evaluate the effects, if any, on his or her assessment of the risks of material misstatement and on his or her ability to obtain sufficient appropriate audit evidence, and should take appropriate action.

> Note: In an integrated audit, the auditor also should include the evaluation of the results of tests of controls related to the control environment regarding the audit committee.[28/]

28. If the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved, the auditor should consider taking such actions as:

a. Communicating with the full board of directors;

b. Modifying the auditor's opinion on the basis of a scope limitation;[29/] or

c. Withdrawing from the engagement.

28/ Paragraph 25 of AS No. 5.

29/ Paragraphs .22-.32 of AU sec. 508 discuss scope limitations.

APPENDIX A – Definitions

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Audit committee – a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to a company, the entire board of directors of the company.

A3. Critical accounting estimate – an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (b) the impact of the estimate on financial condition or operating performance is material.

A4. Critical accounting policies and practices – a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

APPENDIX B – Communications with Audit Committees Required by Other PCAOB Standards and Rules

This appendix identifies paragraphs within other PCAOB standards[1/] and rules that require communication of specific matters by auditors with audit committees.

- PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*
- PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting*
- PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* paragraphs .22, and .78 - .81
- AU sec. 317, *Illegal Acts by Clients,* paragraph .17
- AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* paragraphs 4 - 7, and 9
- AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* paragraph .50
- AU sec. 333, *Management Representations,* paragraph .05
- AU sec. 722, *Interim Financial Information*, paragraphs .08, .09, .30, .31, and .33 - .36
- Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist,* paragraphs 60, 62, and 64

[1/] Paragraph 53 of the Proposed Auditing Standard, *Identifying and Assessing Risks of material Misstatement,* includes additional communication requirements with audit committees.

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* paragraphs 78 - 80, and 91

Appendix C – Matters Communicated in the Audit Engagement Letter

C1. The auditor should include the following matters in the engagement letter.[1/] The auditor's description of these matters will vary depending on whether the auditor is engaged in a financial statement audit or in an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

a. The objective of the audit is:

   1. Integrated audit: The expression of an opinion on both the effectiveness of internal control over financial reporting and the financial statements.

   2. Audit of financial statements: The expression of an opinion on the financial statements.

b. Auditor's responsibilities:

   1. The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

      a. Integrated audit: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance. Also, an integrated audit is not designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial

---

[1/] Certain matters should not be included in an engagement letter, e.g., under Section 602.02.f.i. of the Codification of Financial Reporting Policies indemnification provisions are not permissible for audits of issuers.

reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

b. Audit of financial statements: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

2. An audit includes:

a. Integrated audit: In fulfillment of the responsibilities noted above, the auditor should communicate in writing:

i. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit.

ii. To the audit committee: all significant deficiencies identified during the audit and inform the audit committee when the auditor has informed management of all internal control deficiencies.

iii. To management: all internal control deficiencies identified during the audit and not previously communicated in writing by the auditor or by others, including internal auditors or others within the company.

iv. To the board of directors: any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective.

b. Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed.[2/] An audit of financial statements is not designed to provide assurance on internal control or to identify internal control deficiencies. However, the auditor is responsible for communicating in writing:

i. To the audit committee and management: all significant deficiencies and material weaknesses identified during the audit.

ii. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion.

c. Management's responsibilities:

1. Management is responsible for the company's financial statements, including disclosures.

2. Management is responsible for establishing and maintaining effective internal control over financial reporting.

3. Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities.

[2/] AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, provides direction on control deficiencies identified in an audit of financial statements.

4. Management is responsible for making all financial records and relevant information available to the auditor.

5. At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.

6. Management is responsible for adjusting the financial statements to correct material misstatements relating to accounts or disclosures and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

C2. In connection with a review of interim financial information, to confirm and document the understanding, the auditor should either: (a) document in the audit engagement letter the nature and objectives of the engagement to review interim financial information and the responsibilities of management and the auditor or (b) issue a separate engagement letter that addresses such matters.[3/]

[3/] Paragraphs .08 - .09 of AU sec. 722, *Interim Financial Information*, discusses the auditor's responsibilities related to establishing an understanding with the audit committee in connection with a review of the company's interim financial information.

APPENDIX 2

Proposed Amendments to PCAOB Standards

Auditing Standards

AU sec. *310, Appointment of the Independent Auditor*

SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards,* vol. 1, AU sec. 310, "Relationship Between the Auditor's Appointment and Planning," as amended, is superseded.

AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312*[1/]

AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* is amended as follows –

The last sentence of paragraph .09 is deleted.

AU sec. 316, *Considerations of Fraud in A Financial Statement Audit*[2/]

AU sec. 316, *Considerations of Fraud in A Financial Statement Audit,* is amended as follows –

In the second bullet point in paragraph .50 the reference to section 380, *Communication With Audit Committees,* paragraph .11 is replaced with paragraphs 12-13 of Proposed Auditing Standard, *Communications with Audit Committees.*

[1/] PCAOB Release No. 2009-007, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, includes proposed amendments which would supersede or delete paragraphs for which amendments are included in this proposed standard. If, at the conclusion of the above mentioned rulemaking, the Board adopts amendments which would affect amendments proposed in this standard, the Board will make a conforming change to this proposed standard.

[2/] Ibid.

AU sec. 328, *Auditing Fair Value Measurements and Disclosures*

AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* is amended as follows –

AU Paragraph .50 is replaced with -

Paragraphs 12-13 of Proposed Auditing Standard, *Communications With Audit Committees,* require auditors to communicate to the audit committee matters related to certain accounting estimates which include fair value measurements.

AU sec. 333, *Management Representations*

AU sec. 333, *Management Representations,* is amended as follows –

The following sentence is added as the last sentence to paragraph .05 –

> The auditor should provide a copy of the representation letter to the audit committee, if management has not already provided the representation letter to the audit committee.

AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* is amended as follows –

a. A heading after paragraph 17 is added, "Communications with Audit Committees."

b. The following paragraph 17a is added –

> Paragraph 16 of Proposed Auditing Standard, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the company's ability to continue as a going concern for a reasonable period of time.

AU sec. 380, *Communication with Audit Committees*

SAS No. 61, *Communication with Audit Committees* (AU sec. 380*, Communication with Audit Committees*), as amended, is superseded.

AU sec. 9380, *Communication with Audit Committees: Auditing Interpretations of Section 380*

AU sec. 9380, *Communication with Audit Committees: Auditing Interpretations of Section 380*, is superseded.

AU sec. 532, *Restricting the Use of an Auditor's Report*

AU sec. 532, *Restricting the Use of an Auditor's Report,* is amended as follows –

The reference to Section 380, *Communications With Audit Committees,* in the second bullet point of paragraph .07 is replaced with Proposed Auditing Standard, *Communications with Audit Committees.*

AU sec. 722, *Interim Financial Information*

AU sec. 722, *Interim Financial Information*, is amended as follows –

a. The heading preceding paragraph .08, "Establishing an Understanding With the Client" is replaced with the heading, "Establishing an Understanding With the Audit Committee."

b. Paragraph .08 is replaced with –

The accountant should establish a mutual understanding of the terms of an engagement to review interim financial information with the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee).[6/] This mutual understanding includes the objective of the review of interim financial information, the responsibilities of the auditor and the responsibilities of management. Such an understanding reduces the risk that either the accountant or the audit committee may misinterpret the needs or expectations of the other party. The accountant should record this understanding of the terms of the engagement in an engagement letter and should provide the engagement letter to the audit committee. If the accountant believes he or she cannot establish a mutual understanding of the terms of an engagement to review interim financial information with the audit committee the accountant should decline to accept or perform the engagement.

c. Footnote 6 to paragraph .08 is replaced with –

See Paragraph 16 of Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

d. In the first sentence of paragraph .09, the word "client" is replaced with the words "audit committee."

e. Paragraph .30 is replaced with –

If management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should communicate these matters to the audit committee as soon as practicable. The communications to the audit committee should be made and documented in accordance with paragraph 23 of Proposed Auditing Standard, *Communications with Audit Committees.*

e. Paragraph .34 is replaced with –

When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Proposed Auditing Standard, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee. For example, the accountant should communicate a description of the process used by management to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole. Management may communicate, as part of its communications to the audit committee, certain matters identified in paragraph 12 of Proposed Auditing Standard, *Communications with Audit Committees,* regarding accounting policies, practices and estimates, in which case the accountant should determine whether all the matters were adequately described and, if not, the accountant should communicate any omitted or inadequately described matters to the audit committee.

f. Paragraph .36 is replaced with –

If the accountant has identified matters to be communicated to the audit committee, the accountant should communicate such matters to the audit committee, or at least its chair, and a representative of management before the entity files its interim financial information with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 23 of Proposed Auditing Standard, *Communications with Audit Committees.*

Quality Control Standards

QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*

QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice,* is amended as follows –

a. In paragraph .16, in the first sentence the word "client" is replaced with the words "audit committee."

b. The last sentence in paragraph .16 is deleted.

APPENDIX 3

Comparison of the Objectives and Requirements of the Proposed Auditing Standard to the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants

Introduction

This appendix discusses certain significant differences between the objectives and requirements of the accompanying proposed standard in this release and the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and analogous standards of the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants. The comparable IAASB standards are International Standard on Auditing ("ISA") 210, *Agreeing the Terms of the Audit Engagements*, and ISA 260, *Communication with those Charged with Governance*. The comparable ASB standards are proposed Statement on Auditing Standard ("SAS"), *Terms of Engagement* and SAS 114, *The Auditor's Communication with Those Charged with Governance*,.[1/] The analysis does not cover the application and explanatory material in the IAASB standards or ASB standards.[2/]

[1/] Other proposed or adopted standards of the IAASB and the ASB, including ISA 570, *Going Concern,* ISA 450, *Evaluation of Misstatements Identified During the Audit,* ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),* ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,* the Proposed SAS, *Evaluation of Misstatements Identified During the Audit,* the Proposed SAS, *Audits of Group Financial Statements (Including the Work of Component Auditors)* and the Proposed SAS, *Other Information in Documents Containing Audited Financial Statements,* were considered in this comparison to the extent they include comparable requirements.

[2/] Paragraph A59 of International Standard on Auditing ("ISA") 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,* indicates that the Application and Other Explanatory Material section of the ISAs "does not in itself impose a requirement," but "is relevant to the proper application of the requirements of an ISA." Paragraph A63 of the Proposed SAS, *Overall Objectives of the Independent Auditor and the Conduct of*

This appendix is provided for informational purposes only. It is not a substitute for the proposed standard itself, which is presented in Appendix 1 of this release.

This analysis may not represent the views of the IAASB or ASB regarding the interpretation of their standards.

Objectives of the Auditor

PCAOB

The Board's proposed standard would replace AU sec. 310, *Appointment of the Independent Auditor*, ("AU sec. 310"), and AU sec. 380, *Communication with Audit Committees* ("AU sec. 380"). Those standards were written before the Sarbanes-Oxley Act of 2002 (the "Act") when management of a listed company, rather than the audit committee, was often responsible for engaging and overseeing the auditor. Given the responsibility of many audit committees for the appointment and retention of the auditor, the proposed standard combines the requirements from the Board's interim standards, AU secs. 310 and 380, into one auditing standard. Accordingly, the objectives in the proposed standard reflect both the appointment and retention of the auditor as well as the overall communication responsibilities. The objective for the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee was included as the audit committee, not management, should be the primary contact for the auditor of issuers with respect to matters regarding oversight of the audit. The proposed standard has an additional objective for the auditor to evaluate whether the two-way communications between the auditor and the audit committee have been adequate to support the objectives of the audit. The proposed standard includes this objective due to the importance of the relationship between the auditor and the audit committee.

---

an Audit in Accordance with Generally Accepted Auditing Standards, states that although application and other explanatory material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU section."

IAASB and ASB

ISA 210 and the Proposed SAS, *Terms of Engagement* ("Proposed SAS"), both include an objective to establish whether the preconditions for an audit are present. The proposed standard does not include this objective, because some of the related requirements in ISA 210 and in the Proposed SAS are not applicable to the audits of issuers. To the extent these related requirements are applicable they are included as requirements in the proposed standard for establishing a mutual understanding of the terms of the audit engagement with the audit committee.

Both ISA 260 and SAS 114 include an objective for the auditor to promote effective two-way communication between the auditor and those charged with governance, although the standards do not impose related requirements to promote effective two-way communications. Rather, ISA 260 and SAS 114 include a requirement for the auditor to evaluate the adequacy of the two-way communications. The proposed standard includes an objective to evaluate the adequacy of the two-way communications, and includes a requirement similar to the ISA and SAS to evaluate the adequacy of the communication process.

Significant Issues Discussed with Management Prior to the Appointment or Retention

PCAOB

The proposed standard retains the requirement for the auditor to discuss with the audit committee any significant issues that were 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. Section 301 of the Act and Securities and Exchange Commission ("SEC") rules require that audit committees of companies with securities listed on a national exchange or with a national securities association be directly responsible for the appointment, compensation, and oversight of the work of the auditors. However, even when ultimate authority rests with the audit committee, management may have discussions with the auditor regarding the application of accounting principles or auditing standards prior to the initial appointment or retention of the auditor, and as such, the proposed standard retains this requirement from AU sec. 380.

IAASB and ASB

ISA 260 and SAS 114 do not include a similar requirement.

Establish a Mutual Understanding of the Terms of the Audit

PCAOB

The proposed standard requires the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee in connection with the audit. This mutual understanding includes communicating to the audit committee the objective of the audit, the responsibilities of the auditor, and the responsibilities of management similar to AU sec. 310. The proposed standard requires this mutual understanding of the terms of the audit engagement be established with the Audit Committee rather than with management, since Section 301 of the Act and SEC rules require that audit committees of companies with securities listed on a national exchange or with a national securities association be directly responsible for the appointment and retention of the auditors.

The proposed standard requires the terms of the audit engagement to include the objective of the audit, the responsibilities of the auditor, and the responsibilities of management in a written in an engagement letter similar to ISA 210 and the Proposed SAS. The proposed standard also requires the auditor to provide the engagement letter to the audit committee.

IAASB and ASB

ISA 210 and the Proposed SAS require the auditor to agree on the terms of the audit engagement with management or those charged with governance, as appropriate.

ISA 210 and the Proposed SAS require the engagement letter to be in writing, although there is no requirement that the engagement letter be given to the audit committee. Additionally, ISA 210 and the Proposed SAS state that for recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The proposed standard requires a written engagement letter to be provided to the audit committee annually.

Both ISA 210 and the Proposed SAS also establish requirements for the auditor to determine whether the preconditions for an audit exist. The proposed standard does not include similar requirements as these requirements were either not applicable to the audits of issuers or were addressed through the requirements in the proposed standard for establishing a mutual understanding of the terms of the audit engagement with the audit committee.

ISA 210 includes requirements regarding financial reporting standards supplemented by law or regulation as well as requirements regarding the financial reporting framework. The Proposed SAS does not include similar requirements. The proposed standard also does not include similar requirements as they are not relevant to the audits of issuers.

ISA 210 and the Proposed SAS also include requirements regarding limitation of scope prior to audit engagement acceptance, other factors affecting audit engagement acceptance, and acceptance of a change in the terms of the audit engagement. The proposed standard does not include such requirements as they are not applicable to the audits of issuers.

The Proposed SAS also includes requirements regarding initial audits and re-audits. The proposed standard does not include similar requirements, although similar requirements are included in the Board's interim standard, AU sec. 315, *Communications Between Predecessor and Successor Auditors*.

Additionally, ISA 260 and SAS 114 include a requirement for the auditor to communicate with those charged with governance the form, timing, and expected general content of communications. The proposed standard does not include this requirement, although the proposed standard does not preclude the auditor from communicating other matters to the audit committee.

Obtaining Information Related to the Audit

PCAOB

The proposed standard requires the auditor to inquire of the audit committee about whether they are aware of other matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. The Board's Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement,* includes a requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks.[3/] The requirement in the proposed standard complements the requirement in the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement.*

IAASB and ASB

ISA 260 and SAS 114 do not contain a similar requirement.

Audit Strategy and Timing of the Audit

PCAOB

The proposed standard requires the auditor to communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified during the risk assessment procedures as well as the timing of the audit. The auditor also should communicate the following matters to the audit committee, if applicable: a) 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; b) the auditor's consideration of the planned use of the company's internal audit function, third parties or others within the company; c) the roles, responsibilities, and locations of firms participating in the audit, and d) the basis for the auditor's determination that he or she can serve as principal auditor. In addition, the auditor should communicate to the audit committee significant changes to the planned audit strategy and the significant risks initially identified.

These communications are intended to provide the audit committee with insight into the auditor's evaluation of risk and approach to the audit. The proposed standard includes these communication requirements to address instances where the auditor uses the assistance of other firms to perform audit procedures. Communication of these arrangements to the audit committee provides information regarding the parties involved in the audit who will perform audit procedures that the auditor will evaluate as part of the consideration of whether sufficient appropriate audit evidence has been obtained. Communication of the roles, responsibilities, and locations of firms participating in the

---

[3/] Paragraph 51 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement.*

audit also facilitates an effective discussion of how the work of other parties affects the audit.

IAASB and ASB

Similar to the proposed standard, ISA 260 and SAS 114 require the auditor to communicate an overview of the planned scope and timing of the audit. However, ISA 260 and SAS 114 do not require the auditor to communicate significant changes to the planned scope and timing of the audit, which is required in the proposed standard. Further, ISA 260 and SAS 114 do not include requirements for the auditor to communicate information about the use of other auditors. ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),* and the Proposed SAS, *Audits of Group Financial Statements (Including the Work of Component Auditors)*, includes requirements for the auditor to communicate certain matters to those charged with governance including: an overview of the type of work to be performed on the financial information of the components; an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components; and instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of the auditor's work.

Accounting Policies, Practices and Estimates

PCAOB

The proposed standard expands on the requirements in AU sec. 380 regarding communication requirements relating to accounting policies, practices, and estimates. Similar to AU sec. 380, the proposed standard acknowledges that management may communicate matters relating to the financial reporting process. However, the proposed standard requires the auditor to determine whether the matters were adequately described by management, and if not, the auditor should communicate any omitted or inadequately described matters to the audit committee.

The proposed standard requires the auditor to communicate the results of his or her evaluation of the quality, clarity and completeness of the company's financial statements, including related disclosures. This requirement is similar to the requirement in AU sec. 380, which requires the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability of the company's accounting principles.

The proposed standard also includes requirements consistent with those in Rule 2-07 of Regulation S-X[4/] for the auditor to communicate critical accounting policies and practices directly to the audit committee as well as alternative treatments within the applicable financial reporting framework for policies and practices related to material items discussed with management. These requirements may assist the auditor in complying with all of the required accounting related communications to the audit committee, including those imposed by the SEC.

The proposed standard includes a new requirement for the auditor to communicate, or evaluate management's communication to the audit committee, of the anticipated application of new accounting or regulatory pronouncements that are not yet effective, but which may, upon adoption, have a significant effect on the company's financial reporting. The auditor may develop a view regarding changes to processes or systems that could impact the financial reporting process that would not be included in management's disclosures in the financial statements, but which the auditor may wish to communicate to the audit committee. A discussion of such matters in more detail with the audit committee may allow audit committees time to properly consider the effects on future financial statements as well as ramifications on the financial reporting process.

The proposed standard includes a requirement for the auditor to communicate to the audit committee significant accounting matters for which the auditor has consulted outside the engagement team, as this may provide the audit committee with additional information on accounting matters that may pose more risk to the financial statements.

The proposed standard defines the term "critical accounting estimate" as an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (b) the impact of the estimate on financial condition or operating performance is material. The proposed standard uses the term critical accounting estimate to help focus the communication to the audit committee on those estimates that are subject to a higher risk of material misstatement.

Further, the proposed standard includes new requirements for the auditor to communicate, or to evaluate whether management has adequately communicated, the following matters:

a. How management subsequently monitors critical accounting estimates;

[4/] 17 CFR 210.2-07.

b. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;

c. Any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes; and

d. When critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and generally how various selections within the range would affect the company's financial statements.

In addition, the proposed standard requires the auditor to communicate his or her evaluation of the reasonableness of the process used by management to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates.

If the auditor determines that potential bias exists in management's accounting estimates, the proposed standard requires the auditor to communicate this determination.

IAASB and ASB

ISA 260 and SAS 114 require the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures and when applicable, to communicate why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstance of the entity. ISA 260 and SAS 114 do not address the auditor's communication responsibilities when management has communicated accounting matters to the audit committee.

Other Information in Documents Containing Audited Financial Statements

PCAOB

The proposed standard carries forward the requirement from AU sec. 380 for the auditor to communicate his or her responsibility when other information is presented in documents containing audited financial statements, any related procedures performed, and the results of such procedures. The proposed standard includes this requirement since the auditor's report is included in filings with the SEC that contain financial information outside of the financial statements (i.e., Form 10-K section on "Management's Discussion and Analysis").

IAASB and ASB

ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,* requires the auditor to notify those charged with governance if there is a material misstatement of fact in the other information which management refuses to correct. The proposed SAS, *Other Information in Documents Containing Audited Financial Statements,* contains a similar requirement to the Board's proposed standard.

Management Consultations with Other Accountants

PCAOB

The proposed standard incorporates the requirement from AU sec. 380 for the auditor to discuss with the audit committee when the auditor is aware that management has consulted with other accountants about auditing or accounting matters. In such case, the auditor should discuss his or her views about significant matters that were the subject of such consultation.[5/] This communication was included in the proposed standard as the audit committee should be aware of issues which may affect the current or future financial statements and which may have implications to the audit.

IAASB and ASB

The ISA does not include a similar requirement. SAS 114 includes a similar requirement to the proposed standard.

[5/] AU sec. 625, *Reports on the Application of Accounting Principles,* discusses the circumstances in which the auditor should be informed of such consultations.

Going Concern

PCAOB

As part of the audit, the auditor has a responsibility to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.[6/] The proposed standard includes a requirement for the auditor to communicate to the audit committee, when applicable, certain matters regarding the auditor's evaluation of the company's ability to continue as a going concern.

IAASB and ASB

The IAASB includes a similar requirement in ISA 570, *Going Concern*. The ASB does not have a similar requirement.

Corrected and Uncorrected Misstatements

PCAOB

The proposed standard requires the auditor to provide the audit committee with the same schedule of uncorrected misstatements related to accounts and disclosures presented to management, rather than a summary of the uncorrected misstatements, so as not to misrepresent the nature of the underlying differences when considered individually. The proposed standard also requires the auditor to communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative factors considered. The auditor also should 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.

IAASB and ASB

SAS 114 requires the auditor to communicate uncorrected misstatements and the effect that they may have on the auditor's report. Unlike the proposed standard, the SAS requires that the auditor request that uncorrected misstatements be corrected

---

[6/] Paragraph .02 of AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

and to communicate the effect of the uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. The proposed standard does not include the requirement to request management to correct the misstatements. However, for audits of issuers, management represents to the auditor in the management representation letter that the effects of any uncorrected financial statement misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.[7/]

ISA 450, *Evaluation of Misstatements Identified During the Audit,* includes requirements for the auditor to communicate uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. Similar to the SAS, ISA 450 also requires the auditor to request that uncorrected misstatements be corrected. The auditor also is required to communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

ISA 450 and SAS 114 do not include a requirement to communicate corrected misstatements.

Timing

PCAOB

The proposed standard requires the communications required by the standard to be made annually and prior to the issuance of the auditor's report.[8/] The importance of the auditor's audit committee communications to help achieve the objectives of the audit supports that these communications occur prior to the issuance of the auditor's report. This is consistent with the required timing of communications to the audit committee required by the SEC. Further, while an annual communication may require the repetition

---

[7/] See paragraph .06 g. of AU sec. 333, *Management Representations.*

[8/] The proposed standard includes the following exception for registered investment companies: consistent with Rule 2-07 of Regulation S-X, in the case of a registered investment company, if the annual communication is not within 90 days prior to the filing, the auditor should provide an update, in the 90 day period prior to the filing, of any changes to the previously reported information.

of certain matters, the importance of those matters merits a yearly discussion as views and circumstances may change.

IAASB and ASB

ISA 260 and SAS 114 require that the auditor should communicate with those charged with governance on a timely basis.

Other Matters

PCAOB

The proposed standard includes a requirement for the auditor to communicate 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. This new requirement is included to acknowledge that there are other matters that are not addressed by specific communication requirements in the proposed standard that may be beneficial to the financial reporting process.

IAASB and ASB

ISA 260 and SAS 114 include a similar requirement for the auditor to communicate other matters to the audit committee that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

Public Company Accounting Oversight Board

Exhibit 2(a)(B)

Alphabetical List of Comments on the Rules Proposed in PCAOB Release No. 2010-001

1	American Federation of Labor and Congress of Industrial Organizations; Daniel Pedrotty, Director, AFL-CIO Office of Investment
2	Association of Audit Committee Members, Inc.; Frederick D. Lipman
3	Chris Barnard
4	BDO Seidman, LLP
5	Dennis R. Beresford, Ernst & Young Executive Professor of Accounting; The University of Georgia, Terry College of Business, J.M. Tull School of Accounting
6	California Public Employees' Retirement System (CalPERS); Mary Hartman Morris, Investment Officer, Global Equity
7	California Society of Certified Public Accountants; Jo Ann Guattery, Chair, Accounting Principles and Auditing Standards Committee
8	Center for Audit Quality; Cindy Fornelli, Executive Director
9	Roger G. Coffin; University of Delaware, Alfred Lerner College of Business and Economics, John L. Weinberg Center for Corporate Governance
10	Council of Institutional Investors; Jeff Mahoney, General Counsel
11	Crowe Horwath LLP
12	Deloitte & Touche LLP

13	Deloitte & Touche LLP
14	Eli Lilly and Company; Arnold C. Hanish, Vice President, Finance and Chief Accounting Officer
15	Ernst & Young LLP
16	Federation of European Accountants; Hans van Damme, President
17	Financial Executives International; Arnold C. Hanish, Chairman, Committee on Corporate Reporting
18	Florida Institute of Certified Public Accountants; Steven Morrison, CPA; Laura Prevaratil, CPA, CFE
19	Florida Institute of Certified Public Accountants; Steven Wm. Bierbrunner, CPA Chair; Robert P. Bedwell, CPA, Member; Laura Prevratil, CPA, Member, FICPA Accounting Principles and Auditing Standards Committee
20	Grant Thornton LLP
21	Gary Holstrum, Ph.D., CPA, CFE, CFF
22	Illinois CPA Society; Kevin V. Wydra, CPA; James Gerace, CPA
23	Institut Der Wirtschaftsprüfer; Klaus-Peter Feld, Executive Director; Gillian G. Waldbauer, Technical Manager
24	KPMG LLP
25	Lord & Benoit, LLC; Robert Benoit, President
26	Mayer Hoffman McCann P.C.
27	Mazars; Wendy Stevens, WeiserMazars Quality Assurance; Denis Usher, Mazars US Desk; Jean-Luc Barlet, Mazars Chief Compliance Officer
28	McGladrey & Pullen, LLP
29	National Association of Corporate Directors; Barbara Hackman Franklin, Chairman, NACD; Kenneth Daly, NACD President and CEO
30	New York State Society of Certified Public Accountants (NYSSCPA); David J. Moynihan, President

31	Piercy Bowler Taylor & Kern, Certified Public Accountants; Howard B. Levy, Sr. Principal and Director of Technical Services
32	PricewaterhouseCoopers LLP
33	Arthur Siegel
34	Society of Corporate Secretaries & Governance Professionals
35	Sprint; Larry C. Glasscock, Chairman of the Audit Committee of the Board of Directors
36	Texas Society of Certified Public Accountants; Melissa A. Frazier, CPA, Chair, Professional Standards Committee
37	The Advanced Auditing Class, Hunter College of The City University of New York
38	The Institute of Chartered Accountants in England and Wales; Katharine E Bagshaw FCA, Manager, Auditing Standards, ICAEW Audit and Assurance Faculty
39	The Institute of Internal Auditors; Richard F. Chambers, CIA, CGAP, CCSA, President and Chief Executive Officer
40	The Value Alliance and Corporate Governance Alliance; Eleanor Bloxham, CEO
41	United States Chamber of Commerce, Center for Capital Markets Competitiveness; Tom Quaadman, Executive Director, Financial Reporting and Investor Opportunity
42	United States Government Accountability Office; James R. Dalkin, Director, Financial Management and Assurance
43	Robert N. Waxman, CPA
44	Xerox Corporation; Gary R. Kabureck, Vice President, Chief Accounting Officer

815 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 637-5000
www.aflcio.org

May 26, 2010

Sent via Electronic and U.S. Mail

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

Re: Rulemaking Docket Matter No. 030, Proposed Auditing Standard Related to Communications with Audit Committees

Dear Mr. Seymour:

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") proposed auditing standard related to communications with audit committees.

The AFL-CIO is the largest labor federation in the United States, representing 11.5 million members. Union-sponsored pension plans hold approximately $480 billion in assets and union members also participate directly in the capital markets as individual investors.

Collectively, America's workers have lost hundreds of billions of dollars of their retirement savings through accounting-related scandals in the past decade. These include scandals involving Enron, WorldCom, Global Crossing, American International Group, and many others. The ability of investors to rely on accurate and reliable audited financial statements is fundamental to ensuring the integrity of the capital markets.

The Sarbanes-Oxley Act of 2002 (the "Act") requires that audit committees approve all audit and non-audit services provided by the auditor. Auditors, in turn, are required to keep the audit committee well-informed. It follows, then, that "an audit committee that is well- informed...may be able to better able to carry out its role of overseeing the financial reporting process."[1]

The AFL-CIO commends the PCAOB for updating the interim auditing standards to reflect that the auditor reports directly to the audit committee and to expand and clarify the rules governing communications between them. As Acting Chairman Daniel Goelzer said, the provisions of the Act which deal with the audit committee's oversight of the audit "are predicated on the idea that independent, informed, and pro-active audit committees can and should be one of the keys to protecting the interests of public company investors."[2]

We strongly support the requirement in the proposed standards for the auditor to establish a mutual understanding of the terms of the audit in an annual engagement letter to the audit committee. However, we agree with the comment of Dennis Beresford, a professor of accounting at the University of Georgia and a former chairman of the Financial Accounting Standards Board, that to guard against excessive boilerplate, auditors should highlight changes in the engagement letter from one year to the next.[3]

To ensure that auditors undertake their duties with the diligence and care that they warrant, it is essential that auditors are legally responsible for the integrity of their work. For this reason, the AFL-CIO believes that audit committees and companies should not indemnify auditors. We concur with the Council of Institutional Investors that if companies indemnify auditors for their work, the engagement letter should explain the potential impact of such a provision on the quality of the audit.[4]

We also support the proposal's new requirement that auditors communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified, and the timing of the audit. Ultimately, the overarching objective of the proposal should be to ensure that the audit committee is recognized as the ultimate client, and has all the information it needs to make educated decisions regarding the auditor. In particular, this is especially important if the audit is conducted by a foreign audit firm that is not subject to inspections by the PCAOB. The PCAOB recently published a list of more than 400 foreign firms whose securities trade in U.S, but are domiciled in countries where the PCAOB is not allowed to conduct inspections. [5]

---

[1] PCAOB Proposed Auditing Standard Related to Communications With Audit Committees, March 29, 2010.
[2] Statement of Acting Chairman Daniel L. Goelzer, March 29, 2010 open meeting.
[3] Comment letter of Dennis Beresford, April 23, 2010.
[4] Comment letter of the Council of Institutional Investors, May 26.2010.
[5] PCAOB press release, May 18, 2010.

While we recognize that it is ultimately up to audit committees to ask the tough questions of auditors, we believe the proposal will encourage more open, forthright and robust communications between auditors and audit committees. The PCAOB's Auditing Standard No. 5 notes that "ineffective oversight of the company's external financial reporting and internal control over financial reporting by the company's auditing committee" is in itself a material weakness.[6]

Finally, we support the proposal's new requirements for auditors to communicate to audit committees "significant assumptions used in critical accounting estimates that have a high degree of subjectivity."[7] The proposal appropriately requires auditors to discuss material changes to these estimates during the year in question, as well as a range of possible outcomes. As PCAOB board member Steven B. Harris said, these requirements are intended to ensure that the audit committee "is knowledgeable of critical financial reporting decisions made by management."[8]

Thank you again for the opportunity to comment on the proposal. If you need any additional information, please contact me at 202-637-3900.

Sincerely,

Daniel Pedrotty
Director, AFL-CIO Office of Investment

DFP/sw
opeiu # 2, afl-cio

---

[6] Auditing Standard No. 5, Indicators of Material Weaknesses.
[7] PCAOB Proposed Auditing Standard Related to Communications With Audit Committees, March 29, 2010.
[8] Statement of Steven B. Harris, Board Member, March 29, 2010 open meeting.

Association of Audit Committee Members, Inc.

Dedicated to Strengthening the Audit Committee

Frederick D. Lipman
(215) 569-5518
Fax (215) 832-5518
lipman@aacmi.org
www.aacmi.org

October 12, 2011

James R. Doty, Chairman
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Re: Whistleblower Policies

Dear Chairman Doty:

The Association of Audit Committee Members, Inc. ("AACMI") is a non-profit organization devoted to developing best practices for audit committees. I believe that you are familiar with the Chair of our board of directors, Roderick Hills. The views expressed in this letter are my own and do not necessarily reflect the views of the entire board of directors. I mentioned some of these points to Dan Goelzer, who was kind enough to speak at our annual meeting on October 4,2011.

I believe that the PCAOB should insist that the registered independent accounting firms evaluate the effectiveness of the public company's whistleblower policies as part of their audit. According to a 2010 survey by the Association of Certified Fraud Examiners, approximately 40% of all frauds is discovered through tips from whistleblowers. The percentage of frauds discovered by independent auditors and internal auditors collectively accounts for only 19% of fraud discoveries, according to the same survey.

Therefore, the whistleblower system within each public company is an important entity level internal control, which is equally deserving of review as the audit committee operations

Unfortunately, many public companies have ineffective whistleblower systems. This was demonstrated in the last financial crisis when high-level executives at various firms, such as Lehman Bros., AIG, etc., failed to use the employee hotline, even though they knew of the major risks that were being taken by the CEO and CFO of these companies. One example would be Matthew Lee, a senior vice president of Lehman Bros., who failed to use the employee hotline to the audit committee even though he was aware of accounting improprieties. (See Bankruptcy Examiner Report – Pages 21, 1460 and 1464.) Another example would be Gene Park, an AIG executive, who was referred to in both the Financial Crisis Inquiry Report and Michael Lewis' book "The Great Hangover" ,who was aware of the huge risk being undertaken by AIG in insuring credit default swaps, but nevertheless failed to use the anonymous employee hotline to the audit committee. Other examples are given in my book entitled "Whistleblowers: Incentives, Disincentives and Protection Strategies" (John Wiley & Sons, Inc., 2012), which will be released in December 2011.

Association of Audit Committee Members, Inc.

James R. Doty, Chairman
PCAOB
October 12, 2011
Page 2

The primary problem with the current hotlines is that there are no meaningful rewards given to whistleblowers even though executives are risking their career by communicating directly with the audit committee and the failure to provide adequate anonymity protection for executive whistleblowers. (such as permitting them to communicate through a lawyer whose fee is paid by the company if the information is legitimate.) Other problems with existing hotlines are detailed in my new book.

Audit committees can only act on the information that is available to them which, today, comes primarily from the CEO, CFO and the independent and internal auditors. Ineffective hotlines have resulted in audit committees being duped by the CEO and CFO, as has been claimed in financial disasters starting with Enron and ending with Lehman Bros.

Registered independent auditors should be asking the following questions of public companies with regard to their whistleblower systems:

- Does the whistleblower system provide meaningful rewards for legitimate whistleblowers? As discussed in my forthcoming book, the potential for retaliation against executive whistleblowers is so high that they will not risk destroying their careers by becoming whistleblowers without sufficient incentive.

- Is there absolute protection for the whistleblower's identity? Most potential executive whistleblowers will not take the risk of being discovered by the company through having their voices traced by voice recognition software or through computer searches or by the company hiring private detectives. My book suggests that permitting them to hire personal counsel through whom they communicate and permitting them to form entities to further hide their identity is necessary. Although many hotlines permit further questions to anonymous whistleblowers, it is my view that no executive whistleblower would be willing to give his or her contact information to a hotline provider paid for by the company and that the only practical method of asking further questions to an anonymous whistleblower is to permit him or her to obtain a personal attorney.

- Does the compliance policy of the company require the disclosure not only of potential law violations but also of major risk exposures? Many companies today have compliance policies which do not address major risk exposures.

- Does the whistleblower system have independent administration? My book suggests that potential whistleblowers will not take the risk of using the hotline if the hotline complaints are not independently administered.

- Does the whistleblower system require independent investigation of complaints? Except for minor complaints, potential whistleblowers would not have confidence in a system which permits employees of the company (e.g. internal auditor, inside general counsel, compliance officer, etc.) to investigate complaints.

- Does the whistleblower system require reports to the whistleblower of the progress of the investigation?

- Is there a rule that anonymous complaints should be investigated with the same effort as complaints where the whistleblower is disclosed? A 2010 study by Hunton and Rose indicates that audit committees tend to give less credence to anonymous whistleblowers. The study was of 73 experienced audit committee members having an average of 23 years of business experience.

- Do the motivations and personality of the whistleblower play a role in determining the truth of their allegations? The failure of Harry Markopolis to convince the SEC about the Madoff Ponzi scheme 10 years before it was discovered was due in part to the focus by SEC officials on the motivations of Mr. Markopolis and his difficult personality, according to the report by the SEC Inspector General. The motivations and personality of the whistleblower should not be relevant to the truth of the whistleblower's allegations.

- Are annual reports given to all employees as to actions taken with respect to whistleblower complaints?

- Has there been effective communication of the whistleblower policy to all employees?

- Finally, does the audit committee, as well as the CEO, play an active role in creating a tone at the top?

Association of Audit Committee Members, Inc.

I believe that the PCAOB can play an important role in preventing the next financial crisis by insisting that independent auditors view the whistleblower systems of public companies as important internal control mechanisms which require probing questions to be asked of management.

If you have any questions, please do not hesitate to contact me.

Sincerely yours,

Frederick D. Lipman

FDL:bjh

Chris Barnard
Actuary

Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
United States

22 October 2010

-Release No. 2010-001
-PCAOB Rulemaking Docket Matter No. 030
-Proposed Auditing Standards Related to Communications With Audit Committees and Related Amendments to Certain PCAOB Auditing Standards

Dear Sir.

Thank you for giving us the opportunity to comment on your Proposed Auditing Standards Related to Communications With Audit Committees and Related Amendments to Certain PCAOB Auditing Standards.

I would prefer to see a principles based standard, rather than one based overly on rules, which would lead to a checklist approach being adopted by participants. I also prefer to see substance over form. In this case we should concentrate on the more substantive issues, those which could affect the management of business, and the effective discharge of duties by the auditors and audit committee. In principle, communications between the auditors and the audit committee should always encompass the following:

- any outstanding matters of material significance, including misstatements
- suspected bias in critical accounting estimates, and significant sensitivities thereon
- disagreements with management
- any judged shortfalls in processes or personnel in critical functions including governance, compliance, internal audit, risk management and legal, whether currently material or not

All such communications should be in writing.

Yours faithfully

C.R.B.

Chris Barnard

Tel: 212-885-8000
Fax: 212-697-1299
www.bdo.com

100 Park Avenue
10th Floor
New York, New York
10017

May 28, 2010

Via E-mail: comments@pcaobus.org

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

Re: PCAOB Release No. 2010-001, Rulemaking Docket Matter No. 030,
Proposed Auditing Standard Related to Communications With Audit Committees And Related Amendments to Certain PCAOB Auditing Standards

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO Seidman, LLP welcomes this opportunity to comment on the PCAOB's Proposed Auditing Standard, *Communications with Audit Committees* (the "proposed standard"), which would supersede the Board's interim standards AU sec. 380, *Communication With Audit Committees*, and AU sec. 310, *Appointment of the Independent Auditor*, and would amend certain other PCAOB auditing standards. Overall, we support the issuance of the proposed standard, which we believe strengthens the functioning of the audit committee by encouraging a more robust discussion between the auditor and the audit committee.

Our comments are organized such that our overall comments are provided first, followed by our responses to the specific questions posed in the release.

Overall Comments

We support the Board's efforts to improve auditor communications with the audit committee, including recognition of the importance of two-way communication between the auditor and the audit committee, specifically as it relates to the audit committee's oversight of the financial reporting process and the external auditor. Given the important role audit committees play in overseeing the financial reporting process, it is essential that audit committee members are active participants. We believe that the proposed standard promotes such participation. Effective communication, which includes discussions regarding significant risks, critical accounting estimates, and the overall clarity of the financial statements, among other matters, helps ensure the integrity of the financial reporting process.

<u>Consideration of the Requirements of the Relevant Standards of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB)</u>

We support the PCAOB's efforts to converge with the IAASB's International Standards on Auditing (ISAs) when it is appropriate to do so in the context of the public company audit. Furthermore, we are pleased to see the comparison of the objectives and requirements of the proposed auditing standard with the ISAs, in addition to the ASB's Statements on Auditing Standards, as set out in Appendix 3.

We note that this analysis does not cover the application and explanatory material in the IAASB and ASB standards. We encourage the PCAOB to consider such guidance and cover it in the release accompanying the final standard, because while the application guidance does not impose requirements on the auditor, it does provide important guidance about how to implement those requirements. ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,* emphasizes the importance of application guidance to the proper application of the requirements. In particular, ISA 200, paragraph 9, states "The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly."

Development of Guidance to Enhance the Effectiveness of Audit Committees

While we recognize the importance of effective two-way communication and support the efforts of the PCAOB to strengthen such communication, we are also aware that the PCAOB does not have jurisdiction over audit committees. As such, efforts to strengthen communication may require additional actions by other regulators and professional organizations. In that regard, we encourage the PCAOB to initiate efforts to work with others such as the National Association of Corporate Directors in the development of guidance to enhance the effectiveness of audit committees.

A. Objectives of the Auditor

1. **Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?**

Overall, we believe that the objectives set out in the proposed standard are appropriate and satisfactorily emphasize communications from the auditor to the audit committee. However, we believe that effective communication requires not only participation by the auditor, but also participation by the audit committee, and as such, suggest adding an additional objective of the auditor relating to obtaining information relevant to the audit from the audit committee. We believe that including this additional objective will foster a constructive interaction between the auditor and the audit committee to enhance audit quality and the financial reporting process.

We note that a similar objective is included within ISA 260, *Communication with Those Charged with Governance*, and the ASB's Statement on Auditing Standard No. 114, *The Auditor's Communication With Those Charged with Governance* (SAS 114).

Further, we note that one objective of the auditor within this proposed standard is to *evaluate* the adequacy of the two-way communications between the auditor and the audit committee, whereas the corresponding objective in ISA 260 and SAS 114 is to *promote* effective two-way communication. Given that the emphasis of this standard is to foster more effective two-way communication, we believe that this objective should more closely align with the ISA and state that the objective of the auditor is to "promote effective two-way communication."

Moreover, we believe that the necessity to evaluate the adequacy of the two-communication is more akin to a requirement than an objective and suggest including such guidance (similar to ISA 260) within the requirements section of the proposed standard as follows:

> "The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor should evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and take appropriate action."

Additionally, similar to ISA 260 and SAS 114, we recommend supporting such a requirement with implementation guidance that would explain how to perform such an evaluation.

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?**

We think the objective should focus on the outcome that should be achieved – which is effective communication.

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?**

We believe it is appropriate to require that an engagement letter be prepared annually to avoid any misunderstandings about the scope of work and to reconfirm the responsibilities of each party in the financial reporting process. Additionally, obtaining an engagement letter each year ensures that changes in client circumstances that may affect the audit are appropriately reflected.

However, we believe that the guidance in the proposed standard is not clearly stated. For example, paragraph 6 requires the auditor to record the understanding of the terms of the audit engagement in an engagement letter and provide that letter to the audit committee; however, there is no mention that the engagement letter should be provided annually. Only later, in paragraph 25, does the proposed standard state that all communications should be made annually. To clarify that an engagement letter should be provided annually, we suggest revising paragraph 6 to state that the auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the letter to the audit committee *annually.*

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

Paragraph 5 explains that in establishing a mutual understanding of the terms of the audit engagement, the auditor should communicate (a) the objective of the audit, (b) the responsibilities of the auditor, and (c) the responsibilities of management. While we agree that these communications are essential to the establishment of a mutual understanding of the terms of the engagement, we believe that it is important to also include in the engagement letter the responsibility of the audit committee to communicate any matters of which it is aware that may be related to the audit.

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?**

We agree that it is appropriate to inquire of the audit committee about matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. However, we believe that the auditor's inquiry should be broader and should encompass other matters that may be related to the audit. As such, we recommend adding the following additional matters as examples of inquiries the auditor may make:

- Strategic decisions that may affect the nature, timing or extent of audit procedures
- Suspicion or detection of fraud or incentive for bias in the financial statements
- Concerns related to the integrity or competence of senior management
- Known and potential illegal acts

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?

Overall, we agree that the requirements to provide information on the audit strategy and timing of the audit are appropriate. We recognize that the note to paragraph 9 explains that the overview of the auditor's strategy for the audit is not intended to provide specific details about the audit that might compromise the effectiveness of the audit procedures; however, we believe that additional guidance about the extent of the information would be helpful.

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?

Paragraph 10(d) requires the auditor to communicate, when applicable, the roles, responsibilities, and locations of firms participating in the audit. However, we believe the definition of the term "firm" is not sufficiently clear since, as noted in the release accompanying the proposed standard, some firms operate within a network of affiliates and the reference to "firm" may or may not be clear. To clarify the definition, we suggest including the definition of "firm" for purposes of this standard in Appendix A.

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)?

We believe that the proposed standard has not adequately described the auditor's role as it relates to communications with respect to accounting policies and practices as described in paragraph 12. We believe the auditor's responsibility should be focused on providing an objective perspective of management's judgments. As explained in the note to paragraph 12, management may have communicated the matters set out in paragraph 12, in which case, the auditor would determine whether such items were adequately described, and if not, communicate any omitted or inadequately described matters to the audit committee.

We believe that it is management's responsibility to communicate the matters outlined in paragraph 12 to the audit committee, and that the auditor's role is to ensure that those matters were appropriately communicated. As such, the auditor's consideration of management's communications should be the starting point in determining the nature and extent of the auditor's communication related to a company's accounting policies, practices, and estimates. Accordingly, we suggest revising the requirement in paragraph 12 such that the auditor evaluates the sufficiency of management's communications.

We note that the definition of a critical accounting policy is provided in Appendix A and that additional guidance is provided in the note to paragraph 13(b) which explains how critical accounting policies differ from significant accounting policies. This guidance states that management's selection of significant accounting policies and practices involves consideration of a broader range of transactions and events over time, while the description of critical accounting policies and practices should be tailored to specific events in the current year. However, we note that a definition of a significant accounting policy is missing from the definitions included within Appendix A, and believe that without a definition a clear distinction cannot be made. Accordingly, we suggest including such a definition.

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 believe the reference to "regulatory pronouncements" is not sufficiently clear and that the guidance set out in SEC Staff Accounting Bulletin No. 74 (SAB 74) regarding the effect of an enacted but not yet adopted accounting standard is more specific. We therefore suggest revising this requirement to align more closely to SAB 74.

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

We believe it is helpful to consolidate audit committee communications required by the SEC and the PCAOB into the proposed standard for ease of reference.

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

Yes, we believe the definition is appropriate.

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?

We note that paragraph 12(b) (iii) requires the auditor to communicate to the audit committee "a description of the reasons for the changes [to assumptions or processes made by management to critical accounting estimates]." We believe this paragraph should clarify that the auditor should communicate its evaluation of management's basis for significant changes to properly reflect management's responsibility for the company's financial statements. This clarification would more clearly emphasize that such information is management's responsibility, while still addressing the auditor's responsibilities with regard to the information.

F. Management Consultations with Other Accountants

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

We do not believe the proposed standard should be expanded to include management consultations with non-accountants. Given that auditors are not likely to be aware of *all* management discussions with its various professional service providers and that many of such communications may not be relevant to the audit, we do not believe this requirement would be useful in helping the audit committee in its oversight role.

Additional Consultation Requirements

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 agree that it is important to provide audit committees with information regarding areas of a company's financial reporting that are complex or assessed as high risk, which is already a requirement; however, we do not believe it is necessary to communicate all consultations that may occur during an audit. For example, the structure of the consultation process is likely to be different from firm to firm and may result in communications that are not important with respect to the audit committee's oversight role. Additionally, the level of consultation may vary on similar issues across audit engagements due to the expertise within the audit team and specific firm policies. Given the varied manner in which engagement teams and firms may consult on issues, we are concerned that audit committees may place undue weight on certain matters where consultations do or do not take place.

G. Going Concern

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

We do not believe that the communication requirements, as set out in paragraph 16, are clear. For example, the proposed standard requires the auditor to communicate certain matters to the audit committee when conditions and events indicate there *could* be substantial doubt; however, it is unclear when the "could" threshold would be met. We recognize that AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* uses the term "could" in its discussion regarding the auditor's evaluation of whether there is substantial doubt, but we believe that the context of that discussion differs from the proposed standard, in that it is based on the results of procedures performed as part of planning and gathering audit evidence and not simply in terms of "if conditions and events indicate."

H. Corrected and Uncorrected Misstatements

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

We believe that the requirements regarding communications for uncorrected misstatements are appropriate.

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

We do not believe that communicating all corrected misstatements, including those detected by management, is appropriate; rather, we believe that only those corrected misstatements that were not detected by the entity's financial statement close process should be communicated. During the course of the audit, it is not unusual for management to identify adjustments that need to be recorded as part of the normal financial statement close process. An auditor may not have knowledge of all misstatements detected by management, and of those, which were the result of the effective operation of the controls within the financial statement close process or as a result of deficiencies in those controls, depending on the timing of the audit (e.g. interim work). Establishing a requirement to communicate all corrected misstatements, including those detected by management, could cause the auditor to spend significant time in identifying misstatements detected by the company through its routine processes. Further, we do not believe that such communication would significantly enhance the audit committee's oversight of the financial reporting process and may detract from the more important communication of those misstatements not detected by the entity's internal control over financial reporting.

Further, we note that 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. This requirement duplicates the requirements in Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5), and AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, and for this reason we suggest clarifying how the requirement in this proposed standard differs, if at all, from the reporting of control deficiencies as set out in those standards.

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?

We believe that the extant requirement set out in AU sec. 380, which permits communications to be oral or written is appropriate since it permits the form of the communications to reflect the nature of the specific issues. Therefore, we do not agree with a requirement for all or certain communications to be in writing. In addition, we believe that communications that are purely in writing may not always achieve the objective of effective two-way communication.

K. Timing

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

We agree with the requirements regarding the timing of the auditor's communications. However, with respect to interim reviews, we believe that the communication requirements should include discussion of the nature and extent of the interim procedures and as such recognize that the communications at an interim period are based on a level of work less robust than that performed during the year-end audit.

L. Adequacy of the Two-way Communication Process

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

See our response to question 1.

Additionally, we believe that the guidance in paragraph 28 should be revised to require communication with the full board of directors when communications between the audit committee and the auditor have been evaluated as inadequate for purposes of the audit; the proposed standard only requires the auditor to *consider* taking this action. We believe the auditor should then be required to consider the proposed actions in 28(b) and 28(c), should the board of directors not respond appropriately.

M. Other Communication Requirements

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

We note that the release to the proposed standard, on page 18, discusses other communication requirements, specifically, significant issues discussed with management prior to appointment or retention that may have influenced management's views about the auditor or about significant accounting or auditing issues. The release text explains that the discussion with the audit committee should encompass issues the auditor discussed with management throughout the auditor's relationship with the company and should not be limited to discussions that occur shortly before re-appointment. In contrast, paragraph 4 of the proposed standard does not provide similar direction regarding the issues that are expected to be discussed in these circumstances. It is unclear to us how the communication of discussions throughout the audit engagement differs from communications otherwise required by the proposed standard. As such, we suggest that the release be clarified for this issue. In that regard, we believe that such additional guidance should at least clarify that the auditor should communicate those matters deemed significant to the auditor's appointment or reappointment and that have occurred since the auditor's last appointment.

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?

We believe that the matters included as significant difficulties in paragraph 21 of the proposed standard are appropriate; however, we suggest clarifying the last item in this paragraph (item 21(e)) to conform to the guidance included in the ASB's Final Clarified Statement on Auditing Standards, *The Auditor's Communication With Those Charged With Governance* (Redrafted), to more clearly communicate that management is responsible for making an assessment of the entity's ability to continue as a going concern and that the auditor evaluates such an assessment. That guidance states:

> -management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

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 of the company under audit?

We do not believe that any of the requirements in the proposed standard would be inappropriate based on the size of the company or industry.

N. Appendices

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Except as noted in our comments to questions 7 and 8, related to definitions, and question 17, related to interim reviews, we believe the information in Appendices A-C are sufficiently clear.

With respect to audit engagement letters, we do not believe that other items should be required.

******

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Wayne Kolins, National Director of Assurance at 212-885-8595 (wkolins@bdo.com) or Susan Lister, National Director of Audit Policy at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO Seidman, LLP

BDO Seidman, LLP

1785
The University of Georgia

Terry College of Business
J.M. Tull School of Accounting

RECEIVED
APR 27 2010

April 23, 2010

Office of the Secretary

PCAOB

1666 K Street, N.W.

Washington, DC 20006-2803

Re: Rulemaking Docket Matter No. 030

Gentlemen:

I am pleased to submit these comments on the PCAOB's Release No. 2010-0001, "Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards." To put my comments in perspective, I currently serve as chairman of the audit committee of three New York Stock Exchange listed companies and previously served in the same capacity for two other NYSE companies. Further, in recent years I have been involved in numerous audit committee educational seminars as a speaker or participant. Therefore, I believe my comments are reasonably representative of many currently serving audit committee members. However, these are my personal views and should not be attributed to the three corporate boards on which I serve or any other organization.

General Comments

Excellent communications between independent auditors and a corporation's audit committee are a critically important contributor to high quality corporate financial reporting, even more so as a result of the Sarbanes-Oxley Act of 2002. Thus, I fully support updating the interim auditing standards that deal with this topic. I also endorse the objectives noted in the release of (1) enhancing the relevance and effectiveness of the communications between the auditor and the audit committee and (2) emphasizing the importance of effective, two-way communications

255 Brooks Hall • Athens, Georgia 30602-6252
Telephone (706) 542-1616 • Fax (706) 542-3630

between the auditor and the audit committee to better achieve the objectives of the audit.

I do not know the extent to which the PCAOB consulted with audit committee members in reaching the decisions in the proposed standard. However, my own reservations about certain key matters lead me to believe that much more consultation is essential before issuing a final standard. The impression I have of the current draft is that it seems to represent what auditors think audit committee members should want to receive from them rather than representing what those audit committee members really want.

There are already a fairly large number of required communications from auditors to audit committees and this proposal would add many new ones. A significant danger is that auditors would perhaps focus too much on meeting these extensive requirements to the detriment of truly effective communications with audit committees. For example, audit committee members probably are more interested in knowing auditors' assessment of the quality of financial management and the "tone at the top" of a corporation than most of the matters covered by the required communications. I'm not necessarily suggesting that these should be the subject of additional requirements but I do think that the PCAOB really needs to learn more about what audit committee members want to hear from auditors before finalizing a new standard. It may well be that "guidance" does not need to be in the form of more required communications or other auditing standards but rather in best practices ideas that could be published jointly by the PCAOB and the National Association of Corporate Directors, for example.

Directors probably aren't strongly motivated to write comment letters on matters like this so other ways of obtaining their views should be sought. I will encourage other directors to write but I also urge the PCAOB to reach out through focus groups or other approaches to obtain direct input from those most affected by this proposal.

In the remainder of this letter I will address the specific questions raised in the proposal, some of which I have significant reservations about in addition to the general matters mentioned above.

<u>Responses to Questions</u>

Questions 1 and 2 – I agree with the objectives of the auditor in the proposed standard. I think it is important to point out that the four objectives stated deal with communicating aspects of the audit process. However, some of the matters in the proposal arguably go beyond the basic audit process and relate instead to management's role in communicating certain information about accounting estimates or other financial details to the audit committee. As noted below, I take issue with certain of those, particularly the ones that expand on interim auditing standard section 380.08. The stated objectives of the auditor do not seem to encompass such supplemental management reporting to the audit committee, nor should they.

Questions 3 and 4 – I agree with the requirement for an annual engagement letter. Audit committees must decide whether to reappoint the auditor or select a new auditor each year and it is a good practice to have a written agreement of the terms of the current understanding, including the auditor's compensation. One issue is that these letters are often quite lengthy and contain a certain amount of "boilerplate." Thus, I always ask the auditor to highlight what is new or different from the prior year's letter. While I and other members of the audit committee will read the entire letter to be sure we have a good understanding of what has been drafted by the auditor, we want to be sure to focus on any subtle changes the auditor may wish to make for the current year. Thus, the PCAOB might consider adding to a final standard encouragement to highlight changes in the engagement letter from year to year.

Question 5 – The proposed requirement to inquire about risks of material misstatement, including inquiries related to fraud risks, is certainly appropriate. In particular, auditors should inquire about receipt of complaints through "hot lines" or similar procedures. However, in the normal situation it should be extremely rare that a matter would arise for the first time during discussions between the auditor and the audit committee – if important, it should have been discussed by management with the auditor well before this point. In my experience, these discussions about fraud between auditors and the audit committee tend to be relatively perfunctory rather than "robust and substantive" (as suggested in the proposal), simply because normal procedures should have surfaced any important issues at a much earlier date.

Questions 6 and 7 – I absolutely support a new requirement for the auditor to communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified by the auditor, and the timing of the audit. This has been done for several years for each of the companies for which I serve as audit committee chairman. The matters that should be covered according to the proposal are all appropriate. However, here are some specific matters that are not covered in the proposal but should be:

1. The final standard should make clear that this communication must be issued as early as possible in the year under audit. I don't think precise timing can be specified but in general the audit committee should receive and approve this information by at least the end of the second quarter of the year in question.

2. The final standard should specify that the auditor must communicate any "risk rating" he or she has assigned to the company. Also, when that risk rating indicates a higher than normal risk, the auditor should describe the nature of the "extra" procedures that will be performed due to the higher risk.

3. In this document (or perhaps in the audit engagement letter) there should be a listing of upcoming required rotation of key engagement personnel. While audit committees nearly always focus on engagement partner rotation, there may not be as much focus on rotation of other key individuals and the risk that represents at least to future audits.

Questions 8-11 – Paragraphs 12 (Accounting Policies, Practices, and Estimates) and 13 (Auditor's Evaluation of the Quality of the Company's Financial Reporting) are key components of the proposed standard. The Overview of the release provides a reasonably good description of the most important changes from the current interim auditing standard. However, I found the actual detailed changes somewhat difficult to follow because of the different paragraph layout and numerous wording changes. Some of the new wording is undoubtedly due solely to style differences between the PCAOB and the ASB but other new wording may be intended to represent substantive new guidance – it's somewhat hard to tell. In any event, I've analyzed the proposal as best I can and provide my comments below.

First, I strongly object to the new requirements listed on page 12 of the Release:

1. How critical estimates are monitored.

2. Significant assumptions in critical estimates that have a high degree of subjectivity.

3. Discussion of significant changes to estimates, along with reasons therefor, effects on financial statements, and support for changes.

4. How estimates within ranges would affect financial statements.

Essentially, I believe the PCAOB should retain section 380.08 of the existing literature and not require paragraph 12b of the proposal. While I'm sure the proposed changes are well intentioned, they simply go too far beyond any notion of an auditor's obligations to the audit committee or reporting company. Some audit committees may well feel these are useful pieces of information to have, in which case they can ask corporate management to provide them. However, mandating this in the form of a required auditor communication would mean that all companies would be obligated to establish systems to capture this information and corporate management would have to regularly provide these very subjective judgments to the audit committee. Worse yet, in the cases where the company would deem it impractical to do so, the auditor would somehow have to come up with his or her own judgments and communicate them to the audit committee. I'm not sure that this is operational in many cases, such as the wide variety of possible outcomes within a range for loan losses of a large financial institution. And the cost of auditors somehow trying to do this would clearly exceed the benefits in my opinion.

With respect to the reporting on critical accounting policies and accounting estimates, I support continuing the current approach whereby the auditor generally defers to the reporting company's reporting as indicated in the Note to paragraph 12 of the proposed standard. As an important drafting matter, I would put this Note at the beginning of paragraph 12 rather than the end in order to emphasize that in most cases financial management will report these matters to the audit committee and the auditor's responsibility is to verify that this has happened and report only on an exception basis.

I do not agree with the proposed new requirement to require auditors 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 (12aii)." This information is required to be reported by management in annual or quarterly SEC filings and I believe auditors generally would be expected to point out significant errors or omissions without a specific new auditing requirement to this effect. This is an example of perhaps "too many required communications" that could possibly stifle effective communications between auditors and audit committees on things that really matter.

I agree with the new requirement for the auditor to communicate to the audit committee significant accounting matters on which the auditor has consulted outside the engagement team (proposed paragraph 13f). That is something I've asked for on my audit committees for several years. I often ask to see copies of the consultation memos as well, depending on the nature of the issue

Proposed paragraph 13d that requires reporting of potential bias in management's accounting estimates seems unworkable to me. Does the PCAOB have evidence of this ever actually occurring in practice? This seems extremely subjective and I believe it would result in useful information for audit committees in few, if any, situations. On balance, I recommend this paragraph be deleted.

Question 12 – I see no compelling need to expand this requirement to report consultations on accounting or auditing matters beyond discussions with other auditors.

Question 13 – I have no comment on the going concern communication requirement. It seems clear enough.

Questions 14 and 15 – I support the requirement to report the uncorrected misstatements to the audit committee. I think it is useful for the audit committee to also receive a report on adjustments made as a result of the year end audit process although sometimes it's difficult to determine whether those adjustments were initiated by the company or by the auditor.

There are two matters on this issue that the Board may wish to clarify. First, management, of course, has the responsibility for presenting financial statements fairly stated in conformity with generally accepted accounting principles. Thus, management has to accept responsibility for assessing the materiality of any entries that could have been but are not made at period end. However, with respect to the communication requirement in this proposal, it is crystal clear that this is the auditor's responsibility. Nevertheless, in practice I have seen auditors insist that letters of representation be worded so that the company takes responsibility for immateriality of uncorrected misstatements. Thus, in the auditor's communications he refers to the company's position rather than taking a direct position. This may be a matter of compliance that could be addressed through the inspections process rather than standard setting but I do support the position that the auditor ought to explicitly acknowledge agreement with the materiality judgment.

The other matter has to do with disclosures. In paragraph 17, reference is made to "…uncorrected misstatements related to accounts and disclosures …." However, footnote 21 referenced to that paragraph cites SEC guidance and refers only to "…material correcting adjustments…." I am concerned that auditors may not have a common understanding of how to evaluate the materiality of disclosures for purposes of whether and how to communicate them to audit committees on "schedules of passed adjustments." In my experience, I have been notified by an auditor of "passed disclosures" in only a few cases even though I'm reasonably sure that there were other possible disclosures that could have been made but were clearly immaterial.

There is certainly no need for the auditor to communicate a long list of disclosures that were not made because the matter was not present in the company's circumstances. Further, audit committees generally would not be interested in receiving a list of several possible disclosures for matters that were present in the circumstances but were clearly inconsequential. However, there may be other matters for which the materiality judgment for omitting a disclosure is a closer call and I'm not sure if auditors have a common understanding of when these need to be reported to audit committees. I believe the PCAOB needs to clarify the language in the proposal to distinguish between the necessary guidance for immaterial accounting misstatements and immaterial omitted disclosures.

Question 16 – I strongly urge the PCAOB to require all communications pursuant to a final standard to be in writing. My reasons are twofold.

First, time at audit committee meetings is limited and valuable. Generally, audit committee chairs expect members to read materials, including letters and other materials received from auditors, in advance of the meeting. This saves valuable meeting time and allows us to focus on the most important matters and engage in discussion among members rather than having auditors or others present at the meetings simply read their presentations. Allowing auditors to present important required communications orally would almost certainly be an inefficient use of meeting time.

Second, these required communications are important and thus they must be complete and unambiguous. It may make it easier for the auditor to report orally and then just write a memo for the file to satisfy a PCAOB documentation requirement, but that doesn't ensure an understanding by the audit committee members. And members may wish to refresh their memories on a particular matter later. While they may do so by referring to minutes, those minutes are likely to be brief in referring to required communications and having the actual documents in the corporate files is far superior, in my view.

In my experience, substantially all required auditor communications have been in writing. About the only exception is that auditors sometimes feel uncomfortable responding in writing to the requirement to discuss "judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting (380.11)." It is admittedly difficult to assess an entity's overall selection of accounting policies and estimates as "conservative or aggressive" or by some other qualitative measure. However, rather than letting auditors off the hook by allowing an oral and possibly misunderstood response to this requirement, I would prefer to see the PCAOB spend more time refining the requirement so that a satisfactory written response is possible.

Question 17 – The timing specified in the proposal seems adequate other than my comment above on the engagement letter (see Questions 3 and 4). And all of these matters should be communicated annually.

Question 18 – I don't think it is necessary to have a required audit procedure to evaluate the adequacy of the two way communications between the auditor and the audit committee. While having good communications is very important, such an audit requirement is likely to become a "make work" project of limited or no substance in most cases – simply resulting in a boilerplate memorandum in the working papers. If the two way communications are poor, it probably is because of an ineffective audit committee in most cases, in which case the auditor may well conclude that there is a material weakness in internal control. I see no real incremental benefit from this proposed step.

Question 19 – The requirement in paragraph 4 for discussion of significant issues discussed with management prior to the auditor's appointment or retention seems to be a waste of time and should be deleted. Does the PCAOB have any evidence of this ever being answered in the affirmative in practice?

Questions 20-22 – I have no comments on any of these questions.

Please let me know if you have any questions about my comments or if I can provide any further assistance to the PCAOB on this project.

Sincerely,

Dennis R. Beresford

Dennis R. Beresford

Ernst & Young Executive Professor of Accounting

CalPERS

Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
Telecommunications Device for the Deaf - (916) 795-3240
Phone: (916) 795-3400

June 3, 2010 Via E-Mail: comments@pcaobus.org

J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, DC 20006-2803

Re: **PCAOB Release No. 2010-001 Rulemaking Docket Matter No. 030**
"Proposed Auditing Standard Related to Communications with Audit Committees and related Amendments to Certain PCAOB Auditing Standards"

Dear Mr. Seymour and Board Members:

I am writing on behalf of the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the United States with approximately $201 billion in global assets and equity holdings in over 9,000 companies. CalPERS provides retirement benefits to over 1.5 million public workers, retirees, and their families and beneficiaries.

As a significant institutional investor with a long-term investment horizon, CalPERS has a vested interest in maintaining the integrity and efficiency of the capital markets. CalPERS philosophy is to promote best practices that facilitate integrity in financial reporting. The financial interests of CalPERS beneficiaries are most effectively served in an environment where investors can confidently utilize financial statements to evaluate the risk and reward of an investment. Auditors play a key role in decreasing the risk of material misstatements in financial reports whereas Audit Committees play an important role in protecting the interest of investors and in overseeing the integrity of the company's financial reporting.

CalPERS appreciates the opportunity to provide comment to the Public Company Accounting Oversight Board (Board) on the proposed new auditing standard that will replace AU sec 380, Communication with Audit Committees and AU sec 310, Appointment of the Independent Auditor. CalPERS supports the Board's proposed standard to integrate the auditor's appointment and communications with the Audit Committee into one standard. We also agree with Acting Chairman Goelzer's statement on March 29, 2010, that emphasizes communication is a two-way street and from the perspective of the auditor, the Audit Committee is likely to be aware of matters that may affect the audit, including complaints or concerns that have come to the Audit Committee's attention regarding accounting or internal controls. More broadly, we uphold Mr. Goelzer's statement that "As more time elapses since the crisis that led to the enactment of the Sarbanes-Oxley Act it is important that auditors and Audit Committees not lose their focus on the importance of candid and timely communication. "

Objectives of the Auditor

CalPERS supported auditor independence as a core principle underlying the Sarbanes-Oxley Act of 2002 and agree with Board member Steven Harris' statement on March 29, 2010, that "Independence of the auditor is essential to the integrity of an audit of financial statements and the financial reporting process." We agree that the objectives of the auditor are:

- Communicating to the Audit Committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the Audit Committee;
- Communicating to the Audit Committee an overview of the audit strategy; and timing of the audit;
- Providing the Audit Committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and
- Evaluating the adequacy of the two-way communications between the auditor and the Audit Committee to support the objectives of the audit.

Mutual Understanding of the Terms of the Audit

We believe and support that a written annual engagement letter should be a requirement in establishing a mutual understanding by the auditor and Audit Committee of the terms of the audit. We believe the engagement letter should annually provide a statement by the auditor on the independence of the auditor and whether any services provided throughout the year compromised its independence since issuance of the previous engagement letter to the client, the Audit Committee. In 2007, CalPERS focused on the independence and objectivity of the external auditor as a major component of its Financial Market Reform. Today, in 2010 we continue to believe significant financial market reform hinges on disclosure, transparency, the independence of the auditor, and the commitment of Audit Committees to carry out its fiduciary role in overseeing the financial reporting process in the interests of its shareowners and investors.

We also maintain the importance that auditors should define its role in determining and identifying fraud. We do not necessarily believe that inherent limitations exist in determining fraud, but rather cost-benefit limitations exist that should be addressed and decided by the Audit Committee. We reiterate that engagement letters should not be used to limit the liability of the auditors.

Obtaining Information Related to the Audit – Identifying and Assessing Risks of Material Misstatement

Robust and substantive discussions between the auditor and Audit Committee should include inquiry on whether there are matters that may be relevant to the audit, the risks of material misstatement, including complaints or concerns during a client's enterprise risk management assessment and issues brought forward that may impact internal controls.

Overview of the Audit Strategy and Timing of the Audit

CalPERS believes the proposed auditing standard should ensure that auditors are provided adequate direction in its communications role to the Audit Committee. As outlined in the proposed standard, communication should include a robust and substantive overview of the audit strategy, including a discussion of the significant risks identified by the auditor, risks identified through various sources as outlined above, the timing of the audit, and additional matters that include:

- 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;
- The auditor's consideration of and planned use of the company's internal audit function to perform audit procedures in the audit of financial statements;
- The auditor's consideration of the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the Audit Committee when conducting an audit of internal control over financial reporting;
- The roles, responsibilities, and locations of firms participating in the audit; and
- The basis for the auditor's determination that he or she can serve as principal auditor.

CalPERS agrees that care is required when communicating the audit strategy and timing of the audit so not to compromise the effectiveness of the audit procedures. We suggest the Board consider whether this type of communication should be between the Audit Committee and the auditor independent of management. We believe this may facilitate a more open robust dialogue on how audit strategy and procedures will address risks outlined.

Accounting Policies, Practices and Estimates

CalPERS agrees with the importance of the auditor determining whether matters related to accounting policies, practices and estimates are adequately described by management and if not, that the auditor should communicate any omitted or inadequately described matters required by the proposed standard to the Audit Committee. We also agree that an accurate application of authoritative accounting pronouncements in the financial statements often either requires or would be more informative if accompanied by, appropriate and clear disclosures that facilitate an investor's understanding of the company's accounting and financial condition. We support that the proposed standard includes a new requirement of the auditor to communicate, or determine that management has adequately communicated to the Audit Committee, the anticipated application of new accounting or regulator pronouncements that are not yet effective, but which may upon adoption, have a significant effect on the company's financial reporting.

Further, we support the proposed standard include new requirements for the auditor to communicate, or to evaluate whether management has adequately communicated, the following matters

- How management subsequently monitors critical accounting estimates;
- Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;
- A discussion of any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes; and
- 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.

CalPERS believes it is critical that the proposed standard requires the auditor to communicate his or her evaluation regarding the reasonableness of the process used by management to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates. In addition, the proposed standard should require the auditor to communicate to the Audit Committee situations where the auditor determines that potential bias exists in management's accounting estimates. We also agree that it would be helpful to include in the proposed standard the audit communications required by the SEC relating to accounting matters.

Management Consultations with Other Accountants – Expanded to include consultations with non-accountants such as consulting firms or law firms

CalPERS believes that additional consultations with non-accountants , such as consulting firms or law firms should be included in the Board's expanded requirements for disclosure to the Audit Committee by the auditor.

Going Concern

With the challenges posed by financial market instability over the last 18 months, CalPERS believes the proposed standard requiring the auditor to communicate to the Audit Committee the company's ability to continue as a going concern as critical to investors. We also agree that although doubt of going concern may be mitigated, we support that the standard requires the auditor to communicate the conditions and events that, when considered in the aggregate, indicate there could be substandial doubt about the company's ability to continue as a going concern as well as the information that mitigates the auditor's doubt.

Corrected and Uncorrected Misstatements

CalPERS would suggest that a matrix – table format be used to provide the Audit Committee with a schedule of uncorrected misstatements relating to accounts and disclosures that were presented to management. Providing a clear picture of the quantitative and qualitiative factors should assist Audit Committees in viewing the overall impact of corrected and uncorrected misstatement and the risks these pose to the overall financial reporting process.

Other Matters

With recent accounting scandals and events, CalPERS suggests the Board emphasize the need for the auditor to communicate to the Audit Committee other matters arising from the audit that are signicant to the oversight of the financial reporting process, including situations where the auditor is aware of complaints or concerns raised regarding accounting or auditing matters.

Form and Content of Communications

Investor's reliance upon and trust in the integrity of public financial statements should not be taken for granted. The form and content of the auditors communication to the Audit Committee allows for effective communication, which in written format may facilitate communication of highly complex information. CalPERS agrees that robust dialogue on key matters is the most important factor in effective communications with the Audit Committee.

Timing

Financial reports have many different users but their main objective should be to provide information that is useful to present and potential equity investors as the providers of risk capital and bearers of residual risk. Financial information that is material is only useful if disclosed in a timely manner. Information is material if its omission or misstatement could influence users' decisions based on that information.

Adequacy of the Two-way Communication Process

While CalPERS agrees that effective two-way communications between the auditor and the Audit Committee benefits the audit process. We also feel similar to the observation by Board Member Charles D. Niemeier that the proposed standard takes on the challenging task of encouraging open, forthright and robust discussions; however, the problem with ensuring this robust communication is not in the existing standard but in the existing culture in the auditor-audit committee relationship. Again, we suggest the standard allow for independent communication between the auditor and Audit Committee to facilitate robust discussion without management present.

Other Communication Requirements

CalPERS supports retaining requirements for the auditor to communicate significant issues discussed with management prior to appointment or retention as the auditor. We also agree that discussions occurring throughout the auditor's relationship with the company may be pertinent and relevant information that should also be shared with the Audit Committee. It may be helpful for the auditor to color code other information such as disagreements with management or difficulties encountered in performing the audit.

Additionally, CalPERS believes companies should consider asking auditors to provide enhanced reporting to the Audit Committee, which in summary format is shared with investors. The Audit Committee and investors should explore whether the scope of an audit should be expanded. Full disclosure of audit and non-audit fees should be provided both in the notes to the accounts and in the Audit Committee's own report with explanations where appropriate.

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management and it is important that they place a strong emphasis on fraud prevention, reducing opportunities for fraud and increasing the likelihood of detection. Auditors could have a role in this subject to cost considerations.

Making the Standard Auditor's Report more informative should be an ongoing objective and auditors may consider implementing additional disclosure through auditors' discussion and analysis.

Thank you for considering our comments. If you would like to discuss any of these points, please do not hesitate to contact me at (916) 795-4129.

Sincerely,

Mary Hartman Morris

MARY HARTMAN MORRIS
Investment Officer
Global Equity

cc: Joseph A. Dear, Chief Investment Officer – CalPERS
Eric Baggesen, Senior Investment Officer – CalPERS
Anne Simpson, Senior Portfolio Manager – CalPERS

CalCPA

1235 Radio Road
Redwood City CA 94065
(800) 922-5272
www.calcpa.org

May 24. 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 030 – Proposed Auditing Standard Related to Communications with Audit Committees

To the Board:

The Accounting Principles and Auditing Standards Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") is pleased to provide our comments to the PCAOB on PCAOB Rulemaking Docket Matter No. 030 – Proposed Auditing Standard Related to Communications with Audit Committees (the "Proposed Standard").

The Committee is the senior technical committee of CalCPA. CalCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

A. Objectives of the Auditor

Question 1: Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objective?

Response: The objectives established in the proposal are appropriate. However, the objectives should be met without communicating audit strategies, unless such communication is at a very high level. The admonition in paragraph 9 to avoid specific details, which admonition is focused on auditing procedures, is not adequate. Audit strategies can be communicated at a very high level without compromising the independence or integrity of the audit; for example, identified risk areas, sites to be visited, expected coverage of various financial statement categories, etc. Strategies on non-risk areas, strategy on rotation of audit procedures and specific strategies on auditing computer based systems should not be communicated. Illustrative examples of matters considered either appropriate or inappropriate to communicate would be helpful.

Paragraphs 1 and 3.d. of the proposed standard requires the auditor to evaluate the adequacy of two-way communication with the audit committee, and paragraphs 26 through 28 states what the auditor is to do if they are not adequate. This places the auditor in the impossible position of deciding whether the audit committee, which may not have been fully informed by management, has made adequate communication with the auditor, and then reporting to the board of directors, which includes the audit committee members, that something may be amiss. This puts the auditor in the position of making a serious accusation without the ability to get all the facts, and placing blame where it might not belong. This whole notion of evaluation of communications is far too complex to be relegated to four unclear paragraphs, and should be deleted.

Other matters need not be included in the objectives of the proposed standard.

Question 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: The objectives are adequately articulated. However, the outcome that the PCAOB appears to be trying to achieve is NOT directly related to the basic purpose of the audit, which is to determine whether the financial statements are fairly stated. If the PCAOB's desired outcome is something other than this, they should not articulate it, but restate what the focus of the audit is. The auditor is not the "keeper" of the audit committee, and any implication of that responsibility is wrong. The nature and extent of the auditor's evaluation of the audit committee's effectiveness in discharging its responsibilities related to overseeing the financial reporting process should be limited to identifying entity level control weaknesses in the context of the integrated audit, and nothing further.

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

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

Response: Yes, obtaining a written engagement letter prior to the commencement of interim review procedures for the 1st quarter of the audit period is an appropriate requirement.

Question 4: Are there 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: No, there are not.

C. Obtaining Information Related to the Audit

Question 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, making inquiries of the audit committee is an appropriate means of obtaining information used in planning and executing the audit. We do not believe the proposed standard needs to be expanded in this area, as the auditor's application of professional judgment should be sufficient to expand the inquiries directed to the audit committee.

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

Question 6: Are the requirements to provide information on the auditor's 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 useful?

Response: Refer to our response to question 1 above concerning the need for caution in communicating certain aspects of the audit strategy. In light of the direction the proposed standard is aiming for, additional guidance will be needed, which will need to take the form of the PCAOB clarifying what is the real objective of the required communication, so the auditor has a better appreciation of what to communicate. Additional examples of how the audit committee communication process meets these objectives ought to be presented for clarity.

Question 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: Yes, this portion of the proposed standard is sufficiently clear.

E. Accounting Policies, Practices, and Estimates

Question 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: The primary responsibility for the communications in paragraphs 12 and 13 of the proposed standard is management's not the auditor's. The Note in paragraph 12 acknowledges this, but there is no similar acknowledgment in paragraph 13.

If the communication by management has not occurred, the auditor's first step would be to inquire of management about why it has not happened. The auditor should urge management to make the communication, and may consider informing the audit committee that a required communication has not happened. Only then should the auditor consider whether to make the required communication itself. The proposed standard should be amended to clarify the communications responsibilities.

The difference between a "critical" and a "significant" estimate is not clearly drawn. "Critical" is defined in Appendix A, but there is no definition of "significant." However, context demands that "significant" means something with a potentially material effect on the financial statements. Then, what is the difference between "material" and "critical"?

The definition of a critical accounting estimate focuses on materiality due to subjectivity and judgment, and materiality to the financial statements. There are many estimates made in preparing financial statements that have significant elements of subjectivity and judgment, but they do not have a material effect on the financial statements; so, the distinguishing feature in making the estimate "critical" is the materiality to the financial statements.

Thus, there does not seem to be any difference between "critical" and "material." We suggest that the word "critical" not be used, and that expressions of importance, or "significance" be in the context of what is "material" to the financial statements.

The definition of a "critical accounting policy and practice" in Appendix A is even more problematic; it focuses on "most important," "required judgments" and "inherent uncertainty." Where does "most important" fit in the regime of "critical," "material," and "significant"? Further, application of many of a company's accounting policies and practices involve judgments and uncertainty. We suggest that a critical accounting policy and practice be defined in terms solely with relation to its materiality to the financial statements.

Question 9: Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

Response: Yes, placing all applicable standards in one place will be helpful.

Question 10: Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

Response: Refer to our response to Question 8 above concerning use of the word "critical". The proposed standard's definition is not clear or useful. Substitute the word "material".

Question 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: As stated above, we do not agree with the use of the word "critical." The communication requirements should be described in terms of what is "material".

Paragraph 12.b.iv. would require communication of how various selections in a range of possible outcomes would affect the company's financial statements. This may not be realistic. Calculations are often complex and time consuming, and possible ways to make the estimate are rejected because they are too difficult to implement, involve an excessive level of uncertainty or are at the outer edges of what might be considered acceptable. The communication requirement, as stated, should be modified to state that the communication does not require quantification of the various outcomes that were not selected.

Paragraph 13.a.i. would require a discussion of the quality, clarity and completeness of the company's financial statements. It should be clarified that this should be done in the context of existing generally accepted accounting principles. Those principles themselves can lack quality, clarity and completeness, but that does not need to be communicated.

Paragraph 13.b.i. is something the audit committee can do on its own. Paragraph 13.b.ii. has the auditor second guessing management, and paragraph 13.b.iii. requires a crystal ball to look into the future.

Paragraph 13.f should not require communications with those outside the engagement team. Accounting and auditing have gotten so complex that few practitioners can pretend to have all the answers, and registered auditing firms have responded to this by, among other things, encouraging or mandating communication with firm experts in other offices or in national or regional offices. To now have to track and report those communications could stifle the communication process, and the purpose and benefit of such communication is unclear.

F. Management Consultations with Other Accountants

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

Response: The requirements for disclosure of management consultation with other accountants stemmed from a concern over "opinion shopping." We see no purpose in expanding beyond the current requirement. Frequently, management will consult with non-accountants on transactions that have accounting implications (e.g., compensation or business acquisitions) and discuss the accounting implications with the consultants as part of their due diligence; these will later be reviewed with the auditors, if relevant. We see no reason for these discussions with consultants to be reported to the audit committee.

In addition, any communication with law firms may be subject to privilege concerns that may preclude communication to the auditor and/or the audit committee.

G. Going Concern

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

Response: We believe the communication requirement is clear.

H. Corrected and Uncorrected Misstatements

Question 14: Are the requirements appropriate regarding the communications for uncorrected misstatements?

Response: We agree with the communication on the uncorrected misstatements. However, we do not agree with the discussion of the basis for concluding the uncorrected misstatements were not material; that discussion gives the audit committee, which is the company, too much insight into the auditor's judgment process, and could compromise the auditor's independence.

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

Response: Corrected misstatements detected by management should not be reported. The financial statements are not completed until they are issued. Management establishes Internal controls over their preparation that include preventive and detective controls that detect what the preventive controls fail to report. The fact that the detective controls worked properly does not need to be reported to the audit committee. Such communications are best left with the company's internal audit function.

Corrected misstatements detected by the auditor should be reported, because it is indicative of a failure of some aspect of the company's internal controls over financial reporting.

I. Other Matters – No Questions

J. Form and Content of Communications

Question 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:

Written communications should not be required. The auditor has a record of the communication in its work papers if it is ever needed. Auditors and audit committees should have the flexibility to choose the form of communication that they are comfortable with.

K. Timing

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

Response: Paragraph 24 of the proposed standard is adequate. Paragraph 25 should be deleted; it states that the communication can take place just prior to the issuance of the auditor's report, which may be too late to be considered timely.

L. Adequacy of the Two-way Communication Process

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

Response: No, the proposed standard cannot insure that the communication process is effective. The auditor's requirement to communicate any number of matters required under the current standard or the proposed standard are only one way. In order to provide some clarification, we suggest replacing the word "determines" in paragraph 27 with "feels" or "concludes". The use of the word "determines" implies that there is a process by which the auditor can determine that there has been adequate two-way communication, and that can never be "determined", but the auditor can have a sense, or feelings about whether there has been adequate two-way communication.

M. Other Communication Requirements

Question 19: Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?

Response: The other communication requirements appear to be a continuation of existing requirements, and so no need to comment on them. We do not have any additional suggestions for matters requiring communication to the audit committee.

Question 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 suggested in the proposed standard are adequate and no additional matters are proposed.

Question 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 of the company under audit?

Response:

No, we believe a consistent application of the proposed standard to entities of all sizes and industries will help to improve the communication process.

N. Appendices

Question 22: Is the information included in Appendix A-C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Response: Please refer to the previous discussion regarding use of the word "critical" under our responses to questions 8 and 10.

We thank you for the opportunity to comment on the Proposed Standard. We would be glad to discuss our opinions with you should you have further questions or require additional information.

Very truly yours,

Jo Ann Guattery, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants

CENTER FOR AUDIT QUALITY

Serving Investors, Public Company Auditors & the Markets

May 28, 2010

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

Re: Request for Public Comment: *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:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ appreciates 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 proposal or proposed standard). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

The audit committee serves an important role in protecting investors by assisting the board of directors in fulfilling its responsibility to shareholders and others to oversee the integrity of a company's financial statements and the financial reporting process. The Sarbanes-Oxley Act of 2002 (SOX) strengthened the role of the audit committee by specifically vesting it with the authority and responsibility to oversee a company's external auditor. We acknowledge the importance of effective two-way communications between auditors and audit committees to the effective conduct of the audit committee's oversight responsibilities. As such, we are supportive of efforts to continue to strengthen the communications between auditors and audit committees given the important role audit committees play in protecting the interests of investors.

We support the Board's objective of enhancing interim standards by reflecting improvements in the communication between firms and audit committees since the enactment of SOX, centralizing all required communications with audit committees within one standard, and considering the requirements of relevant standards of the International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board (ASB) in development of the standard. We believe that, when taken as a whole, many of the proposed requirements should result in auditors providing audit committees with meaningful information to better inform its oversight of the company's financial reporting process and the external auditor. In addition, we believe that the inclusion of requirements for auditors to make inquiries of the audit committee is appropriate as such inquiries can provide valuable input into the planning and conduct of the audit.

We have certain overall observations that we believe will enhance the PCAOB's proposal and have organized these observations and comments as follows:

- Objective of the standard
- Improving effectiveness of communications between the auditor and audit committee
- Interaction of certain proposed requirements with existing PCAOB standards
- Management's responsibility for communications with the audit committee
- Interim communications
- Use of release text

In addition, we have other specific comments which we have included as an Attachment to this letter.

Objective of the Standard

The PCAOB has proposed the following objectives of the auditor (paragraph 3 of the proposed standard):

- Communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee;
- Communicating to the audit committee an overview of the audit strategy and timing of the audit;
- Providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and
- Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit.

We generally believe that these objectives are appropriate for promoting effective two-way communications between the audit committee and the auditor.

In addition, as stated by Chairman Goelzer in his opening remarks during the PCAOB's March 29, 2010 open meeting, the audit committee's perspective on a company's financial reporting, as well as the manner in which it conducts its oversight responsibilities, is important in supporting the objectives of the external audit.[1] We agree with Mr. Goelzer's statement; however, we do not believe the objectives 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 relevant to the audit. Given the importance of such communications to the audit, we believe a related objective should be added to the standard. We note that International Standard on Auditing 260, *Communication with Those Charged with Governance* (ISA 260),

[1] See "Statement on Proposed Auditing Standard Related to Communications with Audit Committees," Dan Goelzer, Acting Chairman, PCAOB available at http://pcaobus.org/News/Speech/Pages/03292010_GoelzerStatement.aspx.

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 communication as an objective and recommend that the PCAOB consider incorporating this as part of the overall objectives of the standard.

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 the effectiveness of the communication. We 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.

Improving Effectiveness of Communications between the Auditor and Audit Committee

As mentioned previously, we are supportive of the PCAOB's overall objective of facilitating more effective communications between the auditor and the audit committee, which is intended to have a positive impact on audit effectiveness and the audit committee's oversight of a company's financial reporting and the external audit. A key aspect of facilitating effective communications includes providing information that audit committees believe is relevant and meaningful to its oversight responsibilities. In addition, while we believe that many of the requirements within the proposed standard will result in useful information being provided to audit committees, we note that they will result in increasing both the quantity and depth of the information provided.

Therefore, we recommend that the PCAOB consider further outreach to gather additional input on information that audit committee members believe will contribute meaningfully to the conduct of their oversight responsibilities. In addition, to fully realize the benefits of the enhanced communications, audit committees will need to be in a position to evaluate and take action on the information provided. Although we recognize that the PCAOB does not have jurisdiction over audit committees, understanding the information audit committees need to conduct their oversight responsibilities and developing mechanisms by which auditors can effectively provide such information in a manner that is useful, is integral to the accomplishment of the PCAOB's overall objective. As such, we believe the PCAOB should consider initiating efforts to collaborate with others (e.g., partnering with the National Association of Corporate Directors or other organizations) to further inform audit committees of its proposal, to provide the PCAOB with additional perspectives on information that is meaningful to an audit committee's responsibilities, and collaborate in the development of guidance to enhance audit committees' abilities to utilize the information provided by auditors in their governance activities.

Interaction of Certain Proposed Requirements with Existing PCAOB Standards

We note that extant PCAOB standards include consideration of the audit committee as part of the auditor's process to identify and assess the risks of material misstatement and, for an integrated audit, the auditor's consideration of the effectiveness of a company's internal control over financial reporting. While it would appear that the evaluation of the effectiveness of two-way communications required by the proposed standard, which is consistent with the requirements in ISA 260 and the SAS 114, would be an input into the auditor's procedures under extant PCAOB standards, we believe the PCAOB should consider more clearly linking how the evaluation requirement relates to the consideration of the audit committee in accordance with other PCAOB standards.

For example, Auditing Standard No. 5 (AS 5), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, contains explicit requirements for the auditor to evaluate the effectiveness of the audit committee as part of the consideration of entity-level controls, including the control environment and period-end financial reporting process (paragraphs 25 and 26). In addition, we believe situations where an auditor determines that the two-way communications were ineffective would generally represent at least a control deficiency within the company's internal control over financial reporting in accordance with AS 5. Linking the requirements between the standards through cross references would be helpful.

Management's Responsibility for Communications with the Audit Committee

While the PCAOB permits the auditor to consider management's communications to the audit committee for certain communications related to accounting policies, practices and estimates, we do not believe that the PCAOB has adequately emphasized that the auditor's role, particularly in areas related to the company's financial reporting, should be focused on providing an objective evaluation of management's judgments involved in the preparation of the company's financial statements. In this regard, we believe that the auditor's starting point in determining the nature and extent of its communications with the audit committee should be its consideration of management's communications. We are concerned that without such an emphasis throughout the standard, combined with the detailed communication requirements, auditors may provide significant information that is duplicative to that provided by management or already existing in the company's financial statement disclosures or management's discussion and analysis. This may result in the unintended effect of diluting the information provided, which may reduce the usefulness of the information to the audit committee and potentially encourage more boiler plate communications. All of these possible outcomes would be contrary to the PCAOB's objective of facilitating more effective two-way communications between the auditor and audit committee. The following represent examples within the proposed standard that highlight this concern:

- While the Note at the end of paragraph 12 allows the auditor to consider management's communications to the audit committee when determining the nature and extent of its communications with the audit committee related to a company's accounting policies, practices and estimates, we believe that such a consideration may be appropriate for other matters included within the proposed standard. For example, management may communicate to the audit committee matters related to a company's ability to continue as a going concern (paragraph 16 of the proposed standard) as well as other matters arising from the audit that are significant to the oversight of the financial reporting, such as complaints or concerns raised regarding accounting or auditing matters (paragraph 22).

- Question #15 in the release inquires whether the proposed standard should require all corrected misstatements, including those detected by management, be communicated to the audit committee. 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. We are concerned that an auditor may not 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. Furthermore, it may not be clear what constitutes a "misstatement" for the purpose of such communication if management's controls identified and corrected the item under consideration on a timely basis. Establishing such a requirement would likely result in auditors expending significant efforts to identify "misstatements" that were previously identified by the company's internal controls and established financial close process, and we do not believe that the knowledge of such misstatements would significantly enhance the audit committee's oversight.

- Paragraph 12(b)(iii) requires the auditor to communicate to the audit committee "a description of the reasons for the changes [to assumptions or processes made to critical accounting estimates]." We believe this requirement should be clarified to indicate that the auditor should be communicating *management's* reasons for significant changes to properly reflect that management is responsible for the financial statements. This clarification would emphasize that such information was management's responsibility, while paragraph 13(c) addresses the auditor's role with regard to the information.

- 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." We are concerned that such a requirement of the auditor may result in a significant increase in information provided to the audit committee at a level of detail that may dilute the impact of such information, as well as may result in significant increases in auditor effort without a corresponding significant 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 believe the requirement as drafted may also result in auditors and management expending significant amounts of time reconciling views around the ranges associated with the corresponding estimates – even after the auditor has already concluded that the recorded amount is reasonable - a process that may not be necessary in each circumstance in order to enhance the discussion of such matters with the audit committee. In addition, in some circumstances, such an exercise to reconcile ranges would be beyond what is required by auditors in accordance with extant PCAOB standards (e.g., paragraph 40 of AU sec. 328, *Auditing Fair Value Measurements and Disclosures*, and paragraph 10 of AU sec. 342, *Auditing Accounting Estimates*) when evaluating management's estimates. 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.

Interim Communications

Appendix 2, item e (page A2-4) includes a proposed amendment to paragraph 34 of AU sec. 722, *Interim Financial Information* which would require the auditor to communicate *any* items pursuant to the proposed standard that arise during the conduct of a review of interim financial information. We believe that such a requirement is overly broad and 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, we believe that the limited scope procedures of an interim review may prevent the auditor from being able 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 an annual audit. As a result, we believe the Board should reconsider the nature and extent of auditor communications related to review of interim financial information.

Use of Release Text

As we have indicated in previous comment letters, we are supportive of the Board's efforts to increase the transparency of the standards-setting process, including efforts to provide its perspective on the differences between its proposed standards and those of the IAASB and ASB, as well as its consideration of comments received on proposals. However, we are concerned that in some situations, 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. Interpreting standards through release text can result in confusion over the requirements within the related standard and result in inconsistent application by auditors. In addition, given that the release is not ultimately part of the final standard, any interpretive guidance contained within it may not be given the same consideration by auditors and other interested parties. As a result, we encourage the Board, to the extent it believes clarifications need to be made within the release accompanying a standard, to provide such guidance within the standard as opposed to its accompanying release. We have included the following examples where it appears the Board is interpreting aspects of the standard within the release:

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

- *Establish a Mutual Understanding of the Terms of the Audit* - Page 6 of the release indicates that the engagement letter is required to be "*provided annually"* yet in paragraph 6 of the proposed standard there is no indication that the engagement letter is required to be provided annually. We note that paragraph 25 of the proposed standard requires that all communications pursuant to the standard should be made annually. In addition, question 3 in the release asks whether it is appropriate to require that an engagement letter be "prepared" annually. Because these various references raise potential questions, we suggest the PCAOB clarify its expectation in order to minimize any potential misunderstanding.

****

We appreciate the opportunity to comment on the proposed standard and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,

Cynthia M. Fornelli

Cindy Fornelli
Executive Director
Center for Audit Quality

Enclosure

cc: PCAOB
Daniel L. Goelzer, Acting Chairman
Willis D. Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC
Chairman Mary L. Schapiro
Commissioner Luis A. Aguilar
Commissioner Kathleen L. Casey
Commissioner Troy A. Paredes
Commissioner Elisse B. Walter
James L. Kroeker, Chief Accountant

ATTACHMENT

Specific Comments

#	COMMENT
	Significant Issues Discussed with Management Prior to the Auditor's Appointment or Retention
1	Paragraph 4 requires that 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. " We also note that page 18 of the release provides that the communications pursuant to this requirement are not intended to include only discussions that occur around the time of the auditor's reappointment, but could include discussions throughout the audit engagement period. An auditor typically holds discussions with management throughout the engagement period related to the application of accounting principles and auditing standards. Given the communication requirements currently included in the proposal related to accounting policies, practices and estimates, it is unclear whether this requirement is intended to provide any incremental communications and if so, the nature of those communications. Without additional clarity, we are concerned that auditors may be required to provide additional information regarding accounting or auditing matters that may not be meaningful to the audit committee's oversight, potentially over complicating and detracting from the effectiveness of the communications. We believe the PCAOB should clarify the intent of this requirement and at a minimum, clarify that the auditor should communicate any discussions related to these matters that the auditor deems significant to the decision to appoint or reappoint the auditor and that have occurred since the auditor's last appointment or reappointment.
	Establish a Mutual Understanding of the Terms of the Audit
2	Paragraph 5 states that a mutual understanding of the terms of the audit should be established, including communicating the objective of the audit, the responsibilities of the auditor and the responsibilities of management within the audit engagement letter. However, we note that the proposal does not include establishing the audit committee's responsibilities within the audit engagement letter, such as communicating to the auditor any matters related to the audit of which it is aware. Given the important role that the audit committee plays in the oversight of a company's financial reporting, it would appear that outlining the responsibilities of the audit committee in addition to the responsibilities of the auditor and management would help clarify all parties' roles in relation to the audit of the company's financial statements, as well as promote more effective communications.
	Overview of the Audit Strategy and Timing of the Audit
3	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 believe this requirement should be modified as follows to emphasize the intended broad nature of the auditor's inquiry: "The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit including, *but not limited to, knowledge of potential illegal acts and complaints or concerns raised regarding accounting or auditing matters.*"
4	Paragraph 10(e) requires the auditor to communicate the basis for the auditor's determination that he or she can serve as principal auditor. For a majority of audits, this

	conclusion does not require significant judgment and as such, could encourage boiler plate communications to the audit committee that do not enhance its oversight responsibilities. We recommend the PCAOB consider requiring such communications only in situations where more than insignificant portions of the audit are performed by other auditors.
Accounting Policies, Practices, and Estimates	
5	Paragraph 12(a)(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 believe it is unclear what "regulatory pronouncements" is referring to. We believe mirroring the auditor's communication requirements with those required of management under SEC Staff Accounting Bulletin No. (SAB) 74 is appropriate.
6	Paragraph 12(a)(iii) requires the auditor to communicate the methods used by management to account for *significant **and** unusual transactions*. Paragraph 7 of AU sec. 380, *Communication with Audit Committees,* states, "the auditor should also determine that the audit committee is informed about the methods used to account for *significant unusual transactions*." Additionally, recently issued PCAOB Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions*, also utilizes the terminology "significant unusual transactions." We believe the PCAOB should utilize terminology within the proposal that is consistent with existing PCAOB standards and guidance.
Auditor's Evaluation of the Quality of the Company's Financial Reporting	
7	Paragraphs 13(a) and 13(b) propose communication requirements related to both a company's significant accounting policies and practices and critical accounting policies and practices. Paragraph 7 of AU sec. 380 requires the auditor to communicate certain information related to significant accounting policies. Rule 2-07(a)(1) of Regulation S-X requires auditors to communicate all critical accounting policies and practices. We believe that the PCAOB should consider providing further clarification regarding whether the proposal is intended to require any communications incremental to the existing requirements noted above.
8	Paragraph 13(b)(iii) requires 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" related to a company's critical accounting policies and practices. We suggest that the PCAOB further clarify and provide guidance regarding the auditor's consideration of "anticipated future events" that may affect the assessment of whether certain policies and practices are considered critical, as this 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 determine whether they are relevant and/or are likely to affect the company's current policies or practices, we are concerned that auditors, management and audit committees may spend unnecessary efforts debating matters that may not ultimately provide information that is meaningful and/or relevant to the audit committee's oversight. Such discussions could also potentially dilute discussions related to other, more significant matters.

9	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 agree that providing audit committees with information regarding areas of a company's financial reporting that are complex, higher risk and controversial is necessary for the audit committee's oversight of a company's financial reporting. However, we are unclear as to the incremental benefit the requirement to communicate where consultations have occurred will have – particularly given the other communication requirements related to critical matters contained within the proposed standard. In addition, we believe this requirement could result in the following unintended consequences. 1. First, the structure of the consultation process may vary within and among firms. Additionally, the level of consultation may vary on similar issues across audit engagements due to the expertise within the audit team and specific firm policies. As a result, the consultations reported to audit committees will vary by audit and audit firm. Given the varied manner in which engagement teams and firms may consult on issues, we are concerned that audit committees may place an inappropriate level of emphasis on certain matters where consultations occur. For example, a matter that is not consulted on may be more important than one that was consulted on in light of the ultimate judgments and conclusions that are involved. 2. Second, such a requirement may have the effect of discouraging auditors from consulting, particularly if the matter may be less complex, to avoid audit committees perceiving that an audit team lacks expertise.
Management Consultations with Other Accountants	
10	Release question #12 regarding paragraph 15 of the proposed standard asks of commenters whether this requirement 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. We do not believe the proposed standard should be expanded to include management consultations with non-accountants. Given the fact that such communications may not be relevant to the audit, we do not believe such a requirement will provide a benefit to the audit committee's oversight.
Going Concern	
11	Paragraph 16 requires the auditor to communicate certain matters related to the consideration of a company's ability to continue as a going concern. We have two concerns related to this requirement: 1. Paragraph 16(a) 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). Paragraph 3(a) of AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* of the PCAOB's interim standards requires the auditor to consider whether the results of his/her audit procedures identify conditions or events that indicate that there could be substantial doubt about the entity's ability to continue as a going concern. In addition, in such situations, it may be necessary for the auditor to obtain additional evidence that mitigates the auditor's doubt. Since auditors are not required in all situations to perform

	additional procedures to obtain evidence to mitigate the concern, we are concerned that using the threshold “could” may result in the auditor communicating his/her consideration in situations where the auditor does not have a significant doubt about the ability to continue as a going concern. We do not believe communications around such situations provide the audit committee with meaningful information. We note that ISA 570, *Going Concern*, provides additional guidance regarding when to communicate the auditor’s concern and the nature of such communications.[2] 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. 2. 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.). As such, we recommend the PCAOB consider clarifying this perspective in both paragraphs to this section.
Corrected and Uncorrected Misstatements	
12	Paragraph 18 requires auditors to communicate the implications that corrected misstatements might have on the financial reporting process. It appears that this requirement relates to the auditor’s consideration of the impact a misstatement may have on an auditor’s consideration of a company’s internal control over financial reporting. Given the communication requirements related to significant deficiencies and material weaknesses for integrated audits in AS 5, and AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements* for non-integrated audits, we recommend the PCAOB clarify how the proposed requirement relates to those included in AS 5 and AU sec. 325.
13	The Note accompanying paragraph 18 states, “The auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.” We believe the PCAOB should consider clarifying this Note to express that the auditor should communicate only those uncorrected misstatements that, in the auditor’s judgment, have a higher likelihood of causing financial statements in future periods to be materially misstated. We also recommend the PCAOB consider including references to SAB 99 and SAB 108 and modify the Note as follows: “Note: The auditor should communicate *those* ~~that~~ uncorrected misstatements or matters underlying uncorrected misstatements *that* could cause ~~the~~ financial statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.”

[2] See paragraph 23, ISA 570

Departure from the Standard Auditor's Report	
14	Paragraph 19 of the proposed standard states, "When the auditor expects to modify the opinion in the auditor's report or to include an explanatory paragraph in the report, the auditor should communicate with the audit committee the reasons for the modification or explanatory paragraph and the proposed wording of the report." We believe the Board should consider excluding from the communication requirements those standard report modifications related to emphasis of matters and consistency explanatory paragraphs (e.g., situations where the auditor's report discloses the adoption of a new accounting principle). We do not believe such matters should be subject to specific communication requirements given that such matters are subject to other communication requirements contained within the proposed standard and will be clearly disclosed in the financial statements and auditor's report (which are subject to audit committee review).
Difficulties Encountered in Performing the Audit	
15	Paragraph 21(b) states the auditor should communicate significant difficulties encountered during the audit including an unnecessarily brief time within which to complete the audit. We suggest that the PCAOB consider using "inappropriately" rather than "unnecessarily" in the above requirement. We believe such a change would more clearly articulate the situations in which an auditor should provide such a communication to the audit committee.
Form and Content of Communications	
16	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.
Adequacy of the Two-Way Communications	
17	Paragraph 28 of the proposed standard states that the auditor should consider taking the following actions if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved: a. Communicating with the full board of directors; b. Modifying the auditor's opinion on the basis of a scope limitation; or c. Withdrawing from the engagement. In situations in which the auditor determines that the two-way communications are not effective, we believe it would be rare that the auditor would not inform the company's full board of directors. Therefore, we recommend the PCAOB elevate the requirement to communicate with the full board of directors to "should" as opposed to "should consider" to more appropriately describe the auditor's obligation, as well as an obligation for the auditor to consider 28(b) and 28(c) if he or she is not satisfied with the board of directors' response.

Appendix 2 - Proposed Amendments to PCAOB Standards	
18	Appendix 2, page A2-4 item e, details amendments to paragraph 34 of AU sec. 722, *Interim Financial Information*, to conform this guidance to requirements in the proposed standard. We believe the PCAOB should reconsider the interim period auditor communication requirements to the audit committee for the following reasons: 1. 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. 2. 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.

UNIVERSITY OF DELAWARE

ALFRED LERNER COLLEGE OF BUSINESS AND ECONOMICS

JOHN L. WEINBERG CENTER
FOR CORPORATE GOVERNANCE

Alfred Lerner Hall
University of Delaware
Newark, Delaware 19716-2709
Ph: 302/831-6157
Fax: 302/831-3329

Statement of Roger G. Coffin
PACOB Roundtable
Communications with Audit Committees
September 21, 2010

I appreciate the opportunity to participate in the PCAOB's Roundtable Discussion on the Proposed Auditing Standard Related to Communications with Audit Committees. My name is Roger Coffin; I am the Associate Director of the John L. Weinberg Center for Corporate Governance and Associate Professor of the Practice at the University of Delaware. The John L. Weinberg Center for Corporate Governance is one of the most distinguished corporate governance centers in academia. The year 2010 marks the Center's tenth year anniversary, and we remain dedicated to our mission and goals—to provide a forum for the study of corporate governance, to educate through teaching, programs and research, and to promote thoughtful reform by bringing together the business, judicial, legal and academic communities in an neutral, non-partisan context, in which ideas can be created, developed and shared.

The Sarbanes-Oxley Act of 2002 fundamentally altered the nature of the relationship of the external auditor with the audit committee of a public company. The PCAOB's Proposed Standard seeks to further refine the nature of that relationship by enhancing the relevance and effectiveness of communications between the auditor and the audit committee. I am supportive of this overall goal and therefore am generally in support of the Proposed Standard. I believe that an independent and informed board is one of the pillars of sound governance, a hallmark of the system of governance developed in this country over the past century and a half. Independent boards subject to open and fair elections are the most effective agents for the protection of investors and as guardians of shareholder interest. These concepts also form the underpinning of contemporary governance theory.

By seeking to enhance the richness of the communication between the external auditor and the audit committee, the PCAOB admirably and correctly focuses on the ability of an independent director to oversee the audit process. The relationship between the board, through the audit committee, and the external auditor, is perhaps the most important advisory relationship a company can have. Inherent in the board-auditor/advisor relationship is the concept of negotiation, through which the attainment of the best possible result for shareholders is attained through a collaborative but also an "adversarial" process--in that an engaged board should be able to probe, question, and when appropriate, challenge the process or the results.

In order to achieve this result, boards of directors, in discharging their fiduciary duties, should have the freedom and ability to exercise judgment free from overly restrictive or process oriented requirements. The PCAOB in moving forward on the Proposed Standard, and indeed any federal agent crafting rules applicable to public companies, should proceed with caution as to not tip the scale too far to the side of rules and mandated process, lest the fulfillment of those requirements subsume the very activity itself the rule seeks to enhance. There is, I believe, a subtle but important distinction between an auditing standard applicable to the regulated profession of auditors and a rule which would reach into the boardroom and govern director behavior. The former is the proper province of the PCAOB's Proposed Standard, the substance of which I endorse. The latter is an area in which the PCAOB should tread lightly, so as to not stifle the proper exercise of independent director judgment. The trick is in achieving the proper balance between the two. Federal auditing standards, once adopted, are not simple matters to change--yet effective boards must be flexible and able to adapt quickly to changing circumstances.

Through the public comment process, and in the course of this Roundtable, the PCAOB has and will receive detailed comments regarding the specific auditing and accounting implications the Proposed Standard may have. In light of the thorough record being developed in this regard, I believe it would be more useful to the PCAOB to focus my comments on the corporate governance implications of the proposal, and to offer thoughts on how the Proposed Standard may interact with modern corporate governance theory and the fiduciary expectations required of board members of public companies.

Our system of corporate governance has enabled the development and growth of the nation's economy, has encouraged economic innovation, engendered advances in technology and science, and has created capital markets which are broad, deep and resilient. It is built on a framework of interlocking dependencies and relationships, including the shareholder—board—management dynamic and the interplay between state and federal law. Like any functioning system, corporate governance reforms and reinvents itself continually, as its component checks and balances need tweaking or in some cases, recalibration. The recent experiences in the Financial Crisis of 2008 demonstrated how distortions in risk taking and management proved costly to many individuals, companies, and the economy itself. Corporate governance's ability to assimilate new practices is, in my view, critical to its vibrancy and success. We are currently in such a phase, where standing practices are being re-evaluated and reformed.

In order to appreciate current thinking, a brief review of history is instructive. In the earliest days of the corporate form in this country, boards of directors were often comprised of large shareholders, who were elected or appointed by their fellow shareholders to oversee management and to act as stewards of the corporate trust. As a result, early boards of directors received little or no direct compensation for their board service—oversight of their investment was considered both a duty and a reward. Thus early boards were, in a very real sense, oversight mechanisms to protect their own and others investments and provide a check on the agency problems associated with management's day to day conduct of the business of the corporation.

As the country entered a period of growth from the teens and twenties into the post-war period, a different shareholder class emerged—one which was diffuse, "atomistic", and geographically disperse. The phenomena called the "separation of ownership and control" by Adolf Berle and Gardiner Means in their seminal 1932 book "THE MODERN CORPORATION AND PRIVATE PROPERTY" was evident. Small shareholders had little influence over the affairs of the corporation, had little or no ability to exert meaningful oversight over management, nor were they able to easily replace directors or CEOs.

Management, seeking to exert an obvious self-interest in the nature and composition of the body which would serve to oversee them, dominated the board selection process. Unlike the initial stages of the American corporation, shareholders no longer had the ability to sit on the board of the companies they owned, and a class of "management captured" boards developed—board of directors consisting of numerous insiders, together with others considered sympathetic to the CEO and management. This condition existed for some time in this country, and corporations were able to grow and prosper despite this systemic flaw. While boards were losing their effectiveness as an oversight mechanism due to compositional dysfunction, the capital markets, and the takeover markets in specific, served as a surrogate. Weak or poorly performing companies were subject to takeover or management change.

However, in the mid to late 1980s, a variety of legal and structural processes changed the rules of the game. The effectiveness of poison pills and staggered boards served to insulate management from the takeover market as an accountability mechanism. Many boards lost independence, and in fact, several large public companies ran into difficulties as a result. From this period an increased awareness of the linkage between good corporate governance and firm performance was highlighted.

Contemporaneously, shareholders were re-aggregating in the form of large institutional investors, who were equipped with the ability to seek improvements in sound board practices. These institutions were required to vote their proxies in order to discharge their fiduciary duties. In many respects, the modern corporate governance movement began at this time. The last twenty-five years has been characterized by the drive to return boards directors to the original oversight role and away from the advisory role boards had devolved to over time.

I review this history because it gets us to where we can identify the attributes of sound modern corporate governance theory: independent boards properly incented with equity compensation (but no other financial ties to the corporation) and subject to open, fair and regular elections, are the best protection available to investors in a public corporation.

The reformation of the audit profession and the audit committee itself under Sarbanes-Oxley was a significant step along this journey—and relates directly to the first pillar of governance theory—board independence. The reforms contained in the listing standards of the exchanges and the recently adopted Dodd-Frank act have cumulatively served to dictate specific requirements regarding the composition of the compensation and the nominating and governance committees. This is not to suggest that the independence of these committee members is not important or meaningful to investor protection—it is—but rather to suggest that the PCAOB should consider the effect of the Proposed Auditing Standard against this background.

More specifically, it is important to remember that nothing in the reforms adopted in Sarbanes-Oxley or Dodd-Frank have diminished the legal mandate of the board to act as independent fiduciaries for shareholders. These responsibilities are delineated by state corporation laws, including Delaware General Corporate Law Section 141(a). Section 141(a) states, in part, the "business and affairs of ... a corporation shall be managed by or under the direction of a board of directors...." (Delaware law is used as an example because of the majority of US corporations are incorporated in Delaware).

DGCL section 141(a) as amplified by the common law of the state vests the board with broad responsibilities to exercise board judgment, even in cases where shareholder majority votes may indicate a differing view. In fact, in the 2008 case of CA Inc. v AFSCME, the Delaware Supreme Court invalidated a shareholder initiated by-law amendment where the by-law would have the effect of eliminating the board's ability to exercise its judgment required by section 141(a) and case law. Such a by-law, it was ruled, eliminated board discretion, and consequently was invalid under Delaware law.

The takeaway from this case and the prevailing law guiding section 141(a) is that once elected, a board of directors should, and are indeed duty bound to, exercise independent thinking and judgment. Not even the owners of the corporation, its shareholders, can or should diminish this important obligation. In my assessment, federal regulations, including those promulgated by the US Securities and Exchange Commission should exist within the framework of these fiduciary responsibilities. Similarly, the Proposed Standard should seek to define the expectations of the external auditor, while not displacing the role of the board.

It is unquestioned that in the years since the adoption of Sarbanes-Oxley, the time commitment required of board members, and in particular audit committee members, has increased as process and requirements have grown. I raise the concern, and ask the PCAOB to consider, the extent to which the oral or most likely written communications required by the Proposed Auditing Standard, and the inevitable processes that will develop around those communications, may serve to diminish the board's ability to act as the independent bargaining agents that governance reform seeks. Where every communication with the auditor is mandated, and therefore in danger of becoming scripted, an audit committee moves further down the continuum toward being a group functioning largely to comply with federal mandates than one acting in the independent manner suggested by fiduciary theory and law.

As with a compensation committee, part of the value of the audit committee lies in its ability to "bargain" with the external auditor or to engage in, as the Proposed Auditing Standards puts it, two-way communication with the auditor. Will there be time for a typical audit committee member to digest the information required by the proposal (in addition to all the committee's other roles and responsibilities) within the context of a normal board meeting agenda? To engage in meaningful two way communication with the auditor there must be some incentive for the board to go beyond the red letter requirements of the rules. Will precious committee time be consumed by the process of the auditor going through each item in the Proposed Standard in exacting detail?

These are the balancing considerations I urge the PCAOB to consider as it completes the comment process and the analysis of this Roundtable. It is of course possible to have meaningful two way communication between boards and auditors, where the auditor is subject to specific mandates, but the board, not being subject to PCAOB jurisdiction, is not. I recommend the PCAOB consider carefully the impact these standards will have on the board itself, and view that impact through the prism of state fiduciary duties, and modern corporate governance theory. In this way, the PCAOB can consider where on that continuum they would like the proposal to rest.

Thank you for the opportunity to share these remarks with you. I would be happy to answer any questions you may have, or to work with the staff going forward as the Standard becomes finalized.

Council of Institutional Investors
The Voice of Corporate Governance

Via Email

May 26, 2010

J. Gordon Seymour
General Counsel and Secretary
Public Company Accounting Oversight Board
1666 K Street
Washington, DC 20006-2803

Re: Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards (PCAOB Rulemaking Docket No. 030)[1]

Dear Mr. Seymour:

The Council of Institutional Investors ("Council") appreciates the opportunity to provide comments on the Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards ("Proposal"). The purpose of this letter is to express our general support for the Proposal.

The Council is an association of public, corporate, and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term patient capital, we believe that accurate and reliable audited financial statements are critical to investors in making informed investment decisions, and vital to the overall well-being of our capital markets.[2] We also believe that the audit committee plays an important role in ensuring the accuracy and reliability of audited financial statements.[3] That role is acknowledged in the following long-standing Council policy:

> **Audit Committee Responsibilities Regarding Outside Auditors**: The audit committee should have the responsibility to hire, oversee and, if necessary, fire the company's outside auditor.[4]

[1] Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards 1-21 (Mar. 29, 2010), http://pcaobus.org/Rules/Rulemaking/Docket030/Release_No_2010-001.pdf [Hereinafter Proposal].
[2] Council of Institutional Investors, Statement on Independence of Accounting and Auditing Standard Setters (adopted Oct. 7, 2008), http://www.cii.org/UserFiles/file/Statement%20on%20Independence%20of%20Accounting%20and%20Auditing%20Standard%20Setters.pdf.
[3] Council of Institutional Investors, Corporate Governance Policies, **§ 2.12a Audit Committee Responsibilities Regarding Outside Auditors** (updated Apr. 13, 2010), http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%204-13-10.pdf.
[4] *Id.*

We agree with the view of the Public Company Accounting Oversight Board ("PCAOB") that the audit committee may better carry out its responsibilities regarding outside auditors if it "is well-informed about accounting and disclosure matters relating to the audit . . . ."[5] We also agree that "[o]ne way the audit committee may be informed of accounting and disclosure matters is through the communication of the auditor's evaluations of matters that are significant to the financial statements."[6] Thus, we generally support the enhancements in communications between the audit committee and outside auditor as set forth in the Proposal.

There are three aspects of the Proposal that we believe would be of significant benefit to audit committees in fulfilling their oversight responsibilities. First, we strongly support the Proposal's new requirements requiring the auditor to record the mutual understanding of the terms of the audit "in a written audit engagement letter, and to include the understanding of the objective of an audit and the responsibilities of the auditor and management."[7] We agree with PCAOB Acting Chairman Daniel L. Goelzer that these requirements "better align the Board's standards with the requirements of the [Sarbanes-Oxley] Act."[8] We, however, would add one additional matter to the engagement letter that we believe would significantly enhance investor protection.

We would require that for any engagement letter that includes a provision that potentially limits the legal liability of the outside auditor, the letter include an explanation as to why the provision does not reduce audit quality. Such a provision would be consistent with Council policy.[9] It would also be consistent with the views of the staff of the United States ("US") Securities and Exchange Commission and the US federal banking agencies who generally agree that limits on auditor liability place investors at risk.[10]

---

[5] Proposal, *supra*, at 2.
[6] *Id.; See, e.g.,* Michael R. Young, Accounting Irregularities and Financial Fraud 102 (CCH 3rd ed. 2006) ("Meaningful, substantive interaction with the outside auditor is fundamental to effective audit committee oversight of financial reporting").
[7] Proposal, *supra,* at 6.
[8] Daniel L. Goelzer, Acting Chairman, PCAOB, Statement on Proposed Auditing Standard Related to Communications with Audit Committees 1 (Mar. 29, 2010), http://pcaobus.org/News/Speech/Pages/03292010_GoelzerStatement.aspx.
[9] Council of Institutional Investors, **§ 2.12e Liability of Outside Auditors** ("Companies should not agree to limit the liability of outside auditors").
[10] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Nancy M. Morris, Federal Advisory Committee Officer, Securities and Exchange Commission 13-14 (Mar. 31, 2008), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/March%2031,%202008%20SEC%20comment%20letter%20Progress%20Report%20_Final_(1).pdf (Citing the SEC's Codification of Financial Reporting Policies on indemnification by Client and an Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters).

Second, we strongly support the Proposal's new requirements for the auditor to communicate to the audit committee an overview of the audit strategy and timing.[11] More specifically, we support the requirement of a communication about the roles, responsibilities, and locations of firms participating in the audit.[12] This communication is especially relevant given the ongoing interest and opacity surrounding the principal auditor's use of affiliated and non-affiliated firms to perform significant audit procedures.[13] We agree with Acting Chairman Goelzer that these requirements should "make audit committee oversight more effective by arming the committee with up-front information regarding the auditor's view of the risks and how they will be addressed."[14]

Third, we strongly support the Proposal's additions to the existing communication requirements relating to accounting policies, practices, and estimates.[15] In particular, we support the new requirements that auditor communications to the audit committee include a discussion of:

- "[S]ignificant accounting matters on which the auditor has consulted outside the engagement team."

- "[A]ny significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes."

- "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."[16]

We agree with Acting Chairman Goelzer that these "topics are particularly relevant in light of the additional attention that the economic crisis has brought to management's judgments and estimates . . . ."[17] We also agree with PCAOB Board Member Steven B. Harris that the knowledge gained from communications focusing on the critical financial reporting decisions made by management are "vital for an audit committee to effectively oversee the financial reporting and auditing process."[18]

---

[11] Proposal, *supra*, at 8-9.
[12] *Id*. at 9.
[13] *See, e.g.,* PCAOB, Issuer Audit Clients of Non-U.S. Registered Firms in Jurisdictions Where the PCAOB is Denied Access to Conduct Inspections 1 (May 19, 2010), http://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx (Noting that audit firms that have never been subject to a PCAOB inspection are performing significant audit work that is "relied upon by the issuer's principal auditor, in the U.S., or elsewhere").
[14] Daniel L. Goelzer, at 1.
[15] Proposal, *supra,* at 10-13.
[16] *Id*. at 11-12.
[17] Daniel L. Goelzer, at 1.
[18] Steven B. Harris, Board Member, Statement on Proposed Auditing Standard Related to Communications with Audit Committees 2 (Mar. 29, 2010), http://pcaobus.org/News/Speech/Pages/03292010_HarrisStatement.aspx.

Finally, we note that our general support for the Proposal does not diminish our continued support for improvements to communications between outside auditors and *shareowners*. While the audit committee must actively communicate with auditors to fulfill their oversight responsibilities, investors also need better communications with the auditor to fulfill their ownership responsibilities—namely to make an informed vote in connection with the ratification of auditors that occurs annually at most public companies.[19]

Unfortunately, the primary means by which the auditor currently communicates with shareowners is through the auditor's report.[20] Many shareowners and other users of audited financial statements are dissatisfied with content of the auditor's report that, incredibly, has seen little change since the 1930's.[21] We, therefore, encourage the PCAOB, consistent with the recommendations of the Department of the Treasury's Advisory Committee on the Auditing Profession,[22] to aggressively pursue improvements to the auditor's standard reporting model as well as consider other potential changes that would enhance the communications between auditors and shareowners.

Thank you again for the opportunity to provide comments in response to the Proposal. If you have any questions regarding this letter, please feel free to contact me at (202) 261-7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

---

[19] *See, e.g.,* Department of the Treasury, Advisory Committee on the Auditing Profession, Final Report VIII: 20 (Oct. 6, 2008), http://www.ustreas.gov/offices/domestic-finance/acap/ (Although not statutorily required, the majority of public companies in the United States—nearly 95% of S&P 500 and 70%-80% of smaller companies—put auditor ratification to an annual shareholder vote"); *Cf.* Council of Institutional Investors, **§ 2.12f Shareowner Votes on the Board's Choice of Outside Auditor** (Providing that audit committee charters should provide for annual shareowner votes on the board's choice of independent, external auditor).

[20] Department of the Treasury, at VII:13.

[21] *Id.* at VII: 13; 16; *see also* CFA Institute, Independent Auditor's Report Survey Results 3 (Mar. 2010), http://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf (Finding that "94 percent of respondents would like to see additional information in the auditor's report").

[22] Department of the Treasury, at VII:13 (**"Recommendation 5: Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model"**).

Crowe Horwath

Crowe Horwath LLP
Independent Member Crowe Horwath International

330 East Jefferson Boulevard
Post Office Box 7
South Bend, Indiana 46624-0007
Tel 574.232.3992
Fax 574.236.8692
www.crowehorwath.com

May 28, 2010

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

RE: **PCAOB Rulemaking Docket Matter No. 030, *Proposed Audit Standard Related To Communications With Audit Committee And Related Amendments To Certain PCAOB Auditing Standards*, PCAOB Release No. 2010-01**

Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Proposed Auditing Standard, (the "Proposed Standard"). This letter contains our general comments on certain matters contained in the Proposed Standard.

We support the Proposed Standard, and believe the requirements it proposes will enhance the relevance and effectiveness of the communications between the auditor and audit committee as well as emphasize the importance of effective two-way communication between the auditor and the audit committee to better achieve the objectives of the audit.

However, we believe there are several matters that should be addressed before the Proposed Standard is adopted. We have provided specific observations and comments on the Proposed Standard in the body of this letter which we believe will assist the Board in achieving its goals for this Proposed Standard. The matters are organized by paragraph number to expedite consideration.

Paragraph 8
This paragraph states: *"The auditor should 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."* The Proposed Standard does not address how this inquiry should be documented. The Board should consider requiring an audit committee representation letter addressed to the auditor which would provide written confirmation of their awareness of certain matters relating to the audit. The Board could provide within the Proposed Standard an example representation letter that would be modified based on individual circumstances as well as a requirement that the letter be signed by the Audit Committee Chairman and the Audit Committee designated accounting expert. We believe this would help strengthen and clarify the communication between the auditors and the audit committee.

Paragraph 10a

Auditors are to communicate the following 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."* It is unclear whether the Board intended this to be all persons, just persons outside of the audit firm, or both. Audit firms may have individuals with specialized skills who are part of the engagement team, and it is not clear if the above provision requires disclosure of those individuals to the audit committee. We suggest that the Board add clarification to the requirements set forth in this Paragraph by specifying if the auditor needs to communicate to the audit committee specialists employed by the firm, external specialists or both.

Paragraph 12 (Note)

According to the "Note" at the end of paragraph 12, the auditor is responsible for determining whether or not all the matters in paragraph 12 were adequately described by management to the audit committee. Considering that the auditors may not know all communications between management and the audit committee, we believe it is inappropriate to require the auditors to determine if the communication was adequate.

Paragraph 13b.iii

In disclosure of critical accounting policies and practices with the audit committee, the auditor is responsible to include *"how current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical."* We do not believe it is appropriate to include "anticipated future events" in this communication. The auditor cannot predict the future and we believe it is inappropriate to require such conjecture by the Proposed Standard. We recommend the phrase "and anticipated future" be dropped from the sentence.

Paragraph 13d

Reference in paragraph 13c is based on "Critical accounting estimates". However, the term "critical" is excluded from paragraph 13d and we believe it is appropriate to add "critical" to this paragraph so it reads *"Critical Accounting Estimates. If the auditor determines that potential bias exists in management's critical accounting estimates."*

* * * * * * * * * * * *

Crowe Horwath LLP supports the Board's efforts to improve its auditing standards with the objective of furthering the public interest. We hope our comments and observations will assist the Board in its consideration of the Proposed Standard. We would be pleased to discuss our comments with members of the Board or its staff. If you would like to discuss with us any of our observations, please contact Wes Williams or Mike Yates.

Cordially,

Crowe Horwath LLP

Crowe Horwath LLP

Deloitte.

Deloitte & Touche LLP
Ten Westport Road
Wilton, CT 06897-0820
USA

Tel: +1 203 761 3000
Fax: +1 203 761 3013
www.deloitte.com

May 28, 2010

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

Re: Request for Public Comment on Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards (PCAOB Release No. 2010-001, March 29, 2010, Rulemaking Docket Matter No. 030)

Deloitte & Touche LLP appreciates the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Auditing Standard Related to Communications with Audit Committees* (PCAOB Release No. 2010-001 ("Release"), March 29, 2010, PCAOB Rulemaking Docket Matter No.030) (the "Proposed Standard").

Overall, we are supportive of the Proposed Standard. We believe that auditors, in most cases, are already providing meaningful communications on the financial statement and audit areas that meet the spirit of the requirements in the Proposed Standard and go beyond what is currently required by the extant standards. We agree with the Board's decision to combine the requirements of AU 310, *Appointment of the Independent Auditor*, and AU 380, *Communication with Audit Committees* ("AU 380"), to be consistent with the responsibilities of the audit committee outlined in the Sarbanes-Oxley Act of 2002 ("the Act"). We also support the PCAOB's consideration of International Standards on Auditing ("ISA") 260, *Communication with Those Charged with Governance* ("ISA 260"), and ISA 210, *Agreeing the Terms of Audit Engagements*, in the development of the Proposed Standard. We believe that the Board's primary objectives to "(1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee and (2) emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit" have been achieved in the Proposed Standard.[1] It is also important to consider the information audit committees need to conduct their oversight responsibilities. We recommend and encourage the Board to initiate efforts with other groups to develop helpful materials to assist audit committees in understanding how the information provided by the auditor pursuant to the Proposed Standard and other information provided by management can be used in their oversight responsibilities. We believe this will be particularly beneficial to audit committees of smaller companies.

[1] See Release, Page 3.

We have some concerns in the following areas:

- Management Communications with the Audit Committee
- Correlation of Requirements in the Proposed Standard and Other PCAOB Standards
- Requirements in the ISAs, Rule 2-07 of Regulation S-X, and the Extant Standards Not Included in the Proposed Standard
- Consultations
- Clarification of Certain Requirements in the Proposed Standard
- Requirements Embedded in the Release Associated with the Proposed Standard

We would welcome an opportunity to further discuss these matters with the Board and the staff. If you have any questions or would like to discuss these matters further, please do not hesitate to contact John Fogarty at (203) 761-3227. We thank you for your consideration of these matters.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Daniel L. Goelzer, Acting PCAOB Chairman
Bill Gradison, PCAOB Member
Steven B. Harris, PCAOB Member
Charles D. Niemeier, PCAOB Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Kathleen L. Casey, SEC Commissioner
Troy A. Paredes, SEC Commissioner
Elisse B. Walter, SEC Commissioner
James L. Kroeker, SEC Chief Accountant

Management Communications with the Audit Committee

We share the views of Acting Chairman Goelzer that the communications between the auditor and the audit committee should be "meaningful and robust" to help achieve the objective of the Act to "strengthen the role of the audit committee by placing it squarely at the center of the relationship between a public company and its auditor."[2] We also agree that open dialogue between the auditor and the audit committee enables both parties to perform their jobs more effectively. However, we believe that it is equally important, if not more so, for management to communicate openly and frequently with the audit committee about matters relating to financial reporting because management is ultimately responsible for the preparation and presentation of an entity's financial statements and management has a greater knowledge than the auditor of many matters related to the entity's financial reporting. In practice, management often communicates initially to the audit committee about items such as the accounting policies and practices, the critical accounting estimates and related information, and management's consultations with other accountants. The requirement for the auditor to make communications about such matters provides the opportunity for the auditor to communicate his or her views on these matters, including whether the auditor believes that management's communication is inaccurate or incomplete.

We don't believe, however, that the Proposed Standard necessarily contemplates communications to the audit committee as being primarily management's responsibility. The Note at the end of paragraph 12 for example seems to indicate that management does not have to communicate the items listed to the audit committee and can rely on the auditor to communicate these items on behalf of management. We believe the auditor's communication of such matters should not be in lieu of management fulfilling its responsibility to communicate with the audit committee about relevant information related to the entity's financial statements. We therefore believe that paragraph 12 and certain other requirements in the Proposed Standard should be redrafted in the context of management making the initial communication to the audit committee, and the required auditor's communication about the same matters being incremental and more focused on the auditor's views or judgments about the same matters. This model is utilized in certain requirements in extant AU 380. For example, paragraphs 7 and 8 of extant AU 380 require the auditor to "determine that the audit committee is informed" of specific aspects of significant accounting policies and accounting estimates, respectively. These requirements infer that when management initially communicates these items to the audit committee, the auditor's responsibility to communicate to the audit committee is premised upon the auditor's determination of whether additional information needs to be provided to supplement what has already been communicated by management.

[2] See Statement by Acting Chairman Daniel L. Goelzer at the March 29, 2010, open Board meeting on http:\\www.pcaobus.org.

Furthermore, to eliminate the impression that the auditor's communication to the audit committee of the items in paragraph 12 replaces the need for management's communication of these items, we recommend using the following language in the note associated with paragraph 12, which is similar to the wording used in paragraph 5 of ISA 260:

> Although the auditor is responsible for communicating specific matters in accordance with this standard, management also has a responsibility to communicate matters of interest to the audit committee. Communication by the auditor does not relieve management of this responsibility. Similarly, management's communication of these matters to the audit committee does not relieve the auditor of the responsibility to also communicate them.

The guidance in paragraphs 5 and 11 of extant AU 380 that illustrates management's involvement in relation to the communication of certain matters, including its involvement in the discussion with the audit committee of the quality, and not just the acceptability, of the company's significant accounting policies and practices, is key in describing the correlation between management's communications and the auditor's communications with the audit committee. We therefore recommend that the Board consider including this guidance in the Proposed Standard.

Correlation of Requirements in the Proposed Standard and Other PCAOB Standards

Linkage of evaluation of two-way communications with evaluation of audit committee

We believe the correlation of the requirements in paragraphs 26-28 of the Proposed Standard with requirements in other standards is not clear. We understand the adequacy of the two-way communications between the auditor and the audit committee to be a part of understanding and evaluating the effectiveness of an entity's control environment as described in paragraph 25 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements* ("AS 5"), for an integrated audit, and a part of obtaining an understanding of a company's control environment as described in paragraphs 23 and 24 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*. We noted the reference to paragraph 25 of AS 5 in footnote 28 of the Proposed Standard; however, no reference is made to paragraphs 23 and 24 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*. Therefore, in addition to the reference to AS 5.25, we recommend that a reference to paragraphs 23 and 24 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, be added to link the evaluation of the adequacy of two-way communications with the evaluation of the control environment as a whole in a financial statement only audit.

Furthermore, the effect of inadequate two-way communications on requirements in other standards is not clearly identified in paragraph 28 of the Proposed Standard. Inadequate two-way communications could have an effect on an auditor's assessment of the risks of material misstatement, which could in turn affect the nature, timing, and extent of audit procedures performed to address the risks of material misstatement. The effectiveness of internal control could also be altered by inadequate two-way communications. The requirement in paragraph 28 lists three actions that the auditor should consider taking if the inadequate two-way communications cannot be resolved; none of the actions address the potential impact on internal control or the auditor's assessment of the risks of material misstatement. Therefore, in addition to the possible actions already listed in paragraph 28 of the Proposed Standard, we recommend additional considerations be added to consider the potential effect on internal control (e.g., a possible material weakness) and on the auditor's opinion on internal control over financial reporting as well as the auditor's risk assessment.

Communications related to interim financial information

The relationship between the auditor's communications with the audit committee on an interim and annual basis should be reconsidered and clarified by the Board in light of the proposed amendment to paragraph 34 of AU 722, *Interim Financial Information*, as described in Appendix 2. We believe the proposed amendment may result in redundant and/or unnecessary auditor communications to the audit committee on an interim basis for continuing issues that are communicated as part of the annual audit. We also believe that the auditor may be unable to provide the same level of detail for interim communications as compared to the annual communications due to the limited scope of procedures performed during an interim review.

Requirements in the ISAs, Rule 2-07 of Regulation S-X, and the Extant Standards Not Included in the Proposed Standard

We noted requirements in certain ISAs as well as Rule 2-07 of Regulation S-X ("Rule 2-07") and the extant standards that are not included in the Proposed Standard. We believe that the requirements that are contained within the ISAs but omitted from the Proposed Standard are appropriate auditor communications for audits of U.S. public companies and will enhance the effectiveness of the two-way communications between the auditor and the audit committee. Including these requirements will also enhance parity of the PCAOB standards with the ISAs.

Communications from the Principal Auditor

Paragraph 10.d of the Proposed Standard requires the auditor to communicate with the audit committee the roles, responsibilities, and locations of firms participating in the audit while paragraph 10.e requires the communication of the basis for the auditor's determination that he or she can serve as principal auditor. The requirement in paragraph

49 of ISA 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)* provides specific items that should be communicated to the audit committee related to the responsibilities of the principal (group) auditor, including an overview of the type of work to be performed on the financial information of the components and an overview of the nature of the principal auditor's involvement in the work to be performed by other firms. We believe this requirement should be added.

Related Parties

We noted that the Proposed Standard does not include a communication with the audit committee specific to significant matters involving related parties. We believe this information is important for effective two-way communications with audit committees, and therefore, we recommend the inclusion of a requirement similar to paragraph 27 of ISA 550, *Related Parties*, which states that "the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties." Examples of significant related party matters are listed in paragraph A50 of ISA 550 and include matters such as non-disclosure (whether intentional or not) by management to the auditor of related parties and the identification of significant related party transactions that have not been appropriately authorized and approved.

Other Material Written Communications

Rule 2-07 requires registered public accounting firms to communicate to the audit committee other material written communications between the registered public accounting firm and the management of the issuer or registered investment company. Rule 2-07 states that other material written communications may include any management letter or schedule of unadjusted differences. We agree that certain requirements in the Proposed Standard should be consistent with Rule 2-07; however, it is not clear whether a requirement exists in the Proposed Standard that is similar to the requirement in Rule 2-07 to communicate other material communications between the auditor and management. In Release No. 33-8183, the SEC lists examples of "other material communications" including management representation letter; reports on observations and recommendations on internal controls; schedule of unadjusted audit differences, and a listing of adjustments and reclassifications not recorded, if any; engagement letter; and independence letter.

We acknowledge that the examples in Release No. 33-8183 are addressed in requirements throughout the current PCAOB standards and the Proposed Standard; however, the SEC states in Release No. 33-8183 that "these examples are not exhaustive." Therefore, we recommend that a requirement be added to the Proposed Standard for the auditor to communicate with the audit committee other material written communications between the auditor and management to capture other possible material written communications that may occur that are not addressed by other requirements. The inclusion of this requirement will also maintain consistency with the requirement in Rule 2-07.

Restricted Use of Communication

We recognize that the requirement to restrict the use of an auditor's written communication with the audit committee about the matters referred to in the Proposed Standard is located in AU 532, *Restricting the Use of an Auditor's Report* ("AU 532") and that the basis for the restriction is that the written communication is a by-product report of a financial statement audit and thus should be considered in that context. However, we believe that the requirement should be copied from AU 532 and included in the Proposed Standard so as to make it very clear that a written communication should contain a restriction on its use.

Corrected and Uncorrected Misstatements

The requirement to request management to correct uncorrected misstatements is excluded from the Proposed Standard. We believe that this might be because of the separation of management and the audit committee of a U.S. public company and the fact that a request to correct misstatements is more appropriately directed to management as opposed to the audit committee. If this understanding is accurate, then we agree with omitting the requirement from the Proposed Standard but we believe that Appendix 3 should reflect this rationale supporting its omission.

We do not believe that the corrected misstatements communicated to the audit committee should include those detected by management. The auditor may not have knowledge of all such adjustments due to the nature of a company's financial statement close process and the timing of the auditor's procedures. It may also not be clear what constitutes a "misstatement" for the purpose of such communication if management's controls identified and corrected the item under consideration on a timely basis. Such a requirement would likely result in the auditor expending significant efforts to identify misstatements that were previously identified by the company's internal controls and financial close process, and we do not believe that the communication of such misstatements by the auditor to the audit committee would significantly enhance the audit committee's oversight of a company's financial reporting.

Consultations

The requirement in paragraph 13.f. to communicate significant accounting matters for which the auditor has consulted outside the engagement team is not clear in terms of the nature and extent of detail about the consultations that need to be communicated with the audit committee. Page 11 of the Release states in relation to this requirement that "This information will benefit the financial reporting process by providing the audit committee with information about complex transactions that may be high risk or controversial." This statement leads us to believe that the intent of the Board was to require the communication of *important* consultations about significant matters rather than the communication of every consultation related to significant matters. The concept of communicating every consultation except for those with the engagement quality reviewer related to significant matters encompasses a potentially wide range of consultations, ranging from background questions that may be posed of a variety of individuals within a firm's consultation network to national office conclusions. Creating a requirement that includes this wide range of consultations will likely increase cost as well as giving rise to the risk of obscuring important matters due to the voluminous amount of information provided. We also believe that the proposed requirement may in fact have the unintended consequence of discouraging consultations from occurring at a more informational level (i.e., because of the resulting requirement to then have to keep track of, and summarize, consultations appropriately so that they can be communicated to the audit committee.) Therefore, we recommend the Proposed Standard provide further clarification as to the intent of this requirement and clarify, through discussion and illustrative examples, the types of consultations that the PCAOB intends to be covered by the scope of the requirement.

Clarification of Certain Requirements in the Proposed Standard

Paragraph 6

The requirement in paragraph 6 to record the understanding of the terms of the audit engagement in an engagement letter does not specifically state that this record of understanding needs to be obtained annually. We recognize that the requirement in paragraph 25 states that the communications in the Proposed Standard, including the engagement letter, should be made annually to the audit committee. However, because the engagement letter is a "mutual understanding of the terms of the audit engagement" between the auditor and the audit committee and not a one-sided communication from the auditor to the audit committee, we believe the requirement to provide the engagement letter annually should have more prominence in the standard. We therefore recommend specifically stating in paragraph 6 that the engagement letter be provided annually. This will emphasize the Board's statement in the Release that "the engagement letter is required to be provided annually."

Paragraph 13.a.i

The language used in paragraph 13.a.i does not seem to clearly communicate the intention of the requirement. Paragraph 13.a.i. requires the auditor to discuss with the audit committee the quality, clarity, and completeness of the company's financial statements, which includes related disclosures. The language in paragraph 11 of extant AU 380 does not include the word "quality" when describing the matters that should be discussed with the audit committee regarding the financial statements (i.e., paragraph 11 discusses only the "clarity and completeness" of the financial statements, while the Proposed Standard indicates the "quality, clarity, and completeness of the company's financial statements"). Based on the discussion in the Release related to this requirement, we do not believe it was the Board's intention to broaden the current requirement in extant AU 380. If the intention of the Board is to retain the current requirement from extant AU 380, then we recommend using the wording in paragraph 11 of extant AU 380 to avoid inadvertently expanding the extant requirement. Furthermore, we noted that the guidance in paragraph 11 of extant AU 380 which states that "objective criteria have not been developed to aid in the consistent evaluation of the quality of an entity's accounting principles as applied in its financial statements" has not been carried over into the Proposed Standard. We believe this guidance is useful in acknowledging that the quality of a company's significant accounting policies and practices is dependent on circumstances specific to the entity and that a universal set of criteria related to quality does not exist, and we therefore recommend its retention in the Proposed Standard.

Requirements Embedded in the Release Associated with the Proposed Standard

As noted in our comment letters to the Board on other Proposed Standards, we are concerned that the Release continues to use the term "should" outside of the Proposed Standard in providing additional information related to the Proposed Standard. It is not clear whether the use of the term "should" in the Release means that those statements which use the term are actually requirements that need to be performed by the auditor in addition to the requirements in the Proposed Standard. For example, the following is provided in the Release in relation to the requirement in the Proposed Standard to communicate to the audit committee in a timely manner:

> "For example, some communications, such as information regarding the audit strategy and the significant risks, *should* be made as early as possible and other matters, such as changes to the auditor's significant risks initially identified *should* be communicated in a timely manner. The auditor *should* communicate certain matters earlier than other matters, and more frequently, depending on the relative significance of the matters noted, the corrective follow-up actions by the audit committee, and other factors. For instance, the auditor *should* communicate significant difficulties with management or other matters that are adversely affecting the progress of the audit as soon as practicable to allow the audit committee to take appropriate action to enable the audit to be completed (emphasis added)."

The use of the term "should" in the Release leads us to question the purpose of the Release and whether it is intended to provide additional non-authoritative guidance related to the Proposed Standard or whether it contains additional requirements that the Board expects to be executed by the auditor. We do not believe the Release is considered authoritative as it is our understanding that the SEC only approves the wording of the Proposed Standard (i.e., the rules of the Board) and not the Release that accompanies it; therefore, we continue to believe that the use of the term "should" in the Release is inappropriate and confusing.[3]

Furthermore, we noted that the Release provides guidance about the requirements of the Proposed Standard that appears to be vital information the auditor needs to know to

[3] See SEC Release 34-61363, *Order Approving Proposed Rules on Auditing Standard No. 7, Engagement Quality Review, and Conforming Amendment*, January 15, 2010, page 4.

properly comply with the requirements in the Proposed Standard. We believe this guidance is necessary in the Proposed Standard to provide clear meaning as to the Board's intended approach in performing the requirements. We therefore recommend that the Board consider including the following items in the Proposed Standard.

a. Page 8 of Release
In relation to the requirement in paragraph 11 of the Proposed Standard, the Release states that "The proposed standard also includes a requirement for the auditor to communicate, in a timely manner, significant changes to the planned audit strategy or the significant risks initially identified *that may occur during the audit due to the results of audit procedures or in response to external factors, such as changes in the economic environment* (emphasis added)." The latter part of this statement is not included in the Proposed Standard but provides useful guidance as to what factors may cause the need for an auditor to communicate significant changes to the audit strategy.

b. Page 9 of Release
In relation to the requirement in paragraph 10.d. to communicate the roles, responsibilities, and locations of firms participating in the audit, the Release states that "Auditors may use affiliated or network firms, outsourcing arrangements, or non-affiliated firms to perform audit procedures. Communication of these arrangements to the audit committee provides information regarding the parties involved in the audit who will perform audit procedures…." The Release clarifies that the firms referred to in paragraph 10.d. include firms affiliated with the auditor's firm or included in the auditor's firm network. Because this is not specified in the Proposed Standard, the auditor may interpret the requirement to include only communications of the roles, responsibilities, and locations of firms outside his or her firm's network.

c. Page 10 of Release
In relation to the requirement of paragraph 13.a.i. of the Proposed Standard to communicate the auditor's evaluation of the quality, clarity, and completeness of the company's financial statements, which includes related disclosures, the Release states the following: "In making his or her evaluation of the overall quality of the disclosures, therefore, the auditor considers whether all appropriate disclosures are made and whether the disclosures facilitate an investor's understanding of the financial statements and related financial information." If our suggestion to use the language of paragraph 11 in extant AU 380 in place of paragraph 13.a.i in the Proposed Standard is not implemented by the PCAOB, this statement would be helpful in clarifying what items the auditor considers when assessing the quality of the disclosures and would be valuable information in implementing the requirement in the Proposed Standard.

d. Page 18 of Release
In relation to the requirement for the auditor to discuss with the audit committee any significant issues discussed with management in connection with the retention

of the auditor, the Release includes the following statement: "In determining what information to communicate to the audit committee, "retention" is not meant to limit this communication to discussions that occur shortly before reappointment, but could include discussions occurring throughout the auditor's relationship with the company." If the intention of the Board is to incorporate into the audit committee communication requirement all discussions the auditor has had with management regarding retention (which the statement in the Release seems to indicate), then the scope of the discussions to be communicated that is described in the Release should be included in the Proposed Standard.

Deloitte.

Deloitte & Touche LLP
Ten Westport Road
P.O. Box 820
Wilton, CT 06897-0820
USA

www.deloitte.com

October 20, 2010

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

Re: ***Proposed Auditing Standard Related to Communications With Audit Committees and Related Amendments to Certain PCAOB Auditing Standards (PCAOB Release No. 2010-001, March 29, 2010, Rulemaking Docket Matter No. 030)***

Deloitte & Touche LLP ("D&T") appreciates the opportunity to provide further comments to the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Auditing Standard Related to Communications With Audit Committees* (PCAOB Release No. 2010-001 ("Release"), March 29, 2010, PCAOB Rulemaking Docket Matter No. 030) (the "Proposed Standard"). D&T supports efforts to encourage and promote effective communication between auditors and audit committees. We commend the efforts of the Board to seek further input on this important Proposed Standard and for holding a roundtable on September 21 to further discuss issues that have arisen during the comment period.

The purpose of this letter is to reiterate our views and concerns expressed in our May 28 comment letter on the Proposed Standard and to express support for some of the comments made during the September 21 roundtable. Specifically, we agree with those at the roundtable who cautioned the PCAOB against creating several new requirements with respect to auditor communications with the audit committee. As explained by Mr. Dennis Beresford, "expanded requirements for auditor communications could easily lead to a checklist approach, whereby routine matters tend to drive out more substantive issues."[1]

We believe the objective behind communications between the auditor and the audit committee is to provide the audit committee with sufficient and relevant information so that it can carry out its oversight responsibilities in an effective and efficient manner. Creating more required auditor communications, however, does not necessarily make the communications to the audit committee more effective. There are several matters that are of such importance that we believe should result in required discussions with the audit committee in all instances. These topics are (1) significant disagreements with management (2) material written communications from the auditor (3) uncorrected misstatements, and (4) related-party transactions. The applicability and

---

[1] Unofficial transcript of the PCAOB's Roundtable on Communications with Audit Committees held on September 21, 2010. http://pcaobus.org/Rules/Rulemaking/Docket030/Roundtable_Transcript.pdf

importance of other currently required communications (and those added in the Proposed Standard) are largely dependent on client circumstances. Therefore, one option of making the communications more effective would be to revisit some of the current required communications (and those additional items in the Proposed Standard) and determine if certain of those items should be required in all cases, and if others should be communicated dependent upon the facts and circumstances of the engagement based on the auditor's judgment and the importance of the particular issue for a particular audit engagement.

Additionally, we understand the concerns expressed by some during the roundtable regarding varied expertise and commitment of audit committee members. We agree with Ms. Joan Waggoner that "communications between the auditors and the audit committees needs to be very flexible to reflect those very different skill sets."[2] We also believe the effectiveness of audit committees and the appropriate expertise by audit committee members will not be enhanced by creating more required auditor communications. To help improve the effectiveness of audit committees, the PCAOB should consider teaming with the National Association of Corporate Directors and the Securities and Exchange Commission (and maybe others such as the exchanges) to issue practice aids or hold workshops on best practices for audit committees. This would be a much more effective way to help audit committees improve their performance.

We welcome an opportunity to further discuss these matters with the Board and the staff. Dialogue with commenters as the Proposed Standard is evaluated and changes are considered will facilitate a more complete understanding of the comments and will ultimately improve the final standard and the auditor's ability to implement it effectively and efficiently. If you have any questions or would like to discuss these matters further, please do not hesitate to contact John Fogarty at (203) 761-3227. We thank you for your consideration of these matters.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Daniel L. Goelzer, Acting PCAOB Chairman
Bill Gradison, PCAOB Member
Steven B. Harris, PCAOB Member
Charles D. Niemeier, PCAOB Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Kathleen L. Casey, SEC Commissioner
Troy A. Paredes, SEC Commissioner
Elisse B. Walter, SEC Commissioner
James L. Kroeker, SEC Chief Accountant
Brian T. Croteau, Deputy Chief Accountant

[2] Ibid.

Eli Lilly and Company
Lilly Corporate Center
Indianapolis, Indiana 46285
U.S.A.

www.lilly.com

Date: May 28, 2010

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

Re: Rulemaking Docket Matter No. 030

Dear Board:

Eli Lilly and Company appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's) Release No. 2010-0001, *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards* (hereafter referred to as the "Proposed Standard"). We support the PCAOB's efforts to provide a more meaningful standard related to the relevance and effectiveness of communications between auditors and audit committees. A vital part of the governance structure of a large, multinational company is its audit committee. In order to adequately perform its duties, Eli Lilly's audit committee partners extensively with its auditors regarding a broad range of issues. This dialogue provides them with information necessary to make appropriate decisions related to the company. Additionally, auditors gain valuable insight from their interactions with the audit committee with respect to the company's operating environment and risk factors.

While we generally agree with the intention of the Proposed Standard to enhance the relevance and effectiveness of the communications between auditor and audit committee, we do have some specific concerns that we would like the PCAOB to consider. Below, we have provided our overall concerns with certain of the proposed communication requirements and our views to certain questions listed in the Proposed Standard:

General Comments

The Proposed Standard does not eliminate any of the current requirements, which are substantial, and expands the scope with additional requirements. Therefore, we are concerned regarding the magnitude of the Proposed Standard's communication requirements and whether certain of the requirements are considered valuable to audit committees. We suggest the PCAOB consider which communications should truly be required and the implications of additional requirements on the work of auditors, audit committees, and issuers. This could be achieved by contacting additional stakeholders of the Proposed Standard. In particular, the input of audit committee members could provide critical information as to what the true requirements around auditor communications should be, as they know the types of information of which they want to be made aware. We suggest their experience and knowledge be leveraged in the requirements of the Proposed Standard.

In addition, we suggest the PCAOB provide clear guidance that, relative to the current requirements, the Proposed Standard is not requiring additional audit procedures be performed to meet the communication requirements. We are concerned that some auditors may interpret the proposed results to require additional audit procedures. Examples are provided in the specific comments that follow. Rather than focusing on additional procedures that may simply result in a checklist approach to communication, we suggest limited requirements that increase the chance for meaningful dialogue between auditors and audit committees.

Accounting Policies, Practices, and Estimates

In general, we believe communications regarding accounting policies, practices, and estimates fall under the responsibilities of management. If management has not adequately communicated these to the audit committee, it would then be within the auditor's responsibilities to provide further insights. Additionally, in areas where significant judgment is involved or where the auditor has been asked to evaluate management's decisions, it would also be appropriate for the auditor to communicate these. We suggest that the PCAOB clarify that the intent of the standard is to continue the existing requirements, not to require additional procedures for the auditors. For example, the proposed standard mentions that auditors should evaluate how a recorded estimate relates to a range of possible outcomes. While this may be applicable in some situations, a broader interpretation could be made that a range and an evaluation thereof is required for all critical accounting estimates. The unintended consequence then could be a significant, unwarranted increase in the work of auditors. We suggest the PCAOB clarify the intent of the communications around estimates in order to avoid potential adverse interpretations of requiring additional audit procedures to meet the communication requirements.

Corrected and Uncorrected Misstatements

The current and proposed standards include requirements for the auditor to provide the audit committee with a schedule of uncorrected misstatements. While an aggregation of all uncorrected misstatements does not seem appropriate, we believe the use of materiality and professional judgment should be a consideration in determining the extent of communications around uncorrected misstatements. For example, it is typical for auditors and the audit committee to agree upon a threshold for reporting uncorrected misstatements. Uncorrected misstatements below this threshold may be either not reported at all or reported in the aggregate. Except in the areas of a control issue, we do not believe communication of these deminimus amounts would be an efficient or appropriate use of time. We suggest the PCAOB incorporate the concept of materiality and professional judgment within this communication.

Related to question 15, we believe that corrected misstatements which could result in a significant deficiency or material weakness should be communicated to the audit committee; however, we do not see any additional benefit in advising the audit committee of corrected misstatements that do not rise to these thresholds. Additionally, we believe those misstatements detected by management which relate to significant control deficiencies should be communicated to the audit committee by management, not by the auditors. These misstatements have been identified throughout the normal course of closing activities undergone by management. As they were not identified through the audit procedures, we do not believe these adjustments are appropriate to be reported to the audit committee by auditors. Furthermore, requiring this type of communication could inadvertently lead clients to be less open with their auditors.

Consultations with Others

Under the current and proposed standards, auditors are required to report to the audit committee any consultations made by management with other accountants about auditing or accounting matters. This requirement strives to prohibit the equivalent of "opinion shopping" and is appropriate. It should not then be deemed necessary to report to the audit committee a consultation by management with third-party technical resources other than another auditing firm related to the proper accounting treatment of a highly technical issue. However, a much more broad interpretation may include this action within the definition of "other accountants". To report to an audit committee every instance of accounting consultations seems neither an efficient use of time nor a necessary or worthwhile endeavor. We ask the Board to add clarifying language to help the reader understand precisely who is meant by the term "other accountants".

Regarding question 12, we do not feel the requirement regarding consultations on accounting or auditing matters should be expanded to include non-accountants. It is entirely within management's scope and responsibilities to consult with non-accountants as deemed appropriate; therefore, we do not believe expanding this communication to include non-accountants would provide any additional value to the audit committee related to the scope of the auditor's requirements.   .

Evaluation of the Communication Process

While there are certain communications required of auditors, audit committees reserve the right to request any additional information necessary to make informed decisions regarding the company. Effective communication between audit committees and auditors must go both ways. Therefore, we do not see any additional benefit of requiring an evaluation of the adequacy of this communication as this should be inherent in both the responsibilities of auditors and audit committees. If the audit committee has issues with the communications provided, they have the responsibility to ask for and the right to receive information necessary for them to perform their duties. Additionally, if the auditors do not find the communications from the audit committee adequate, they should bring these issues to the attention of management or withdraw from the engagement.

We appreciate the opportunity to express our views and concerns regarding the proposed standard. If you have any questions regarding our response, or would like to discuss our comments further, please call me at (317) 276-2024.

Sincerely,

ELI LILLY AND COMPANY

S/Arnold C. Hanish
Vice President - Finance, and
Chief Accounting Officer

Ernst & Young

Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: 212 773 3000
www.ey.com

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,

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 Standard 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.

Federation of European Accountants
Fédération des Experts comptables Européens

Office of the Secretary
PCAOB
1666 K Street N.W.
Washington D.C 20006-2803
USA

comments@pcaobus.org

21 May 2010

Ref.: AUD/HvD/HB/LA/SH

Dear Sir or Madam,

Re: FEE Comments on the PCAOB Release No. 2010-001 Rulemaking Docket Matter No. 030: Proposed Auditing Standard Related to Communications with Audit Committees

FEE (the Federation of European Accountants) is pleased to provide you with its comments on the PCAOB Proposed Auditing Standard related to Communications with Audit Committees (the Proposed PCAOB Standard).

FEE welcomes the PCAOB initiative to set a standard for auditors' communication with audit committees. It is an important part of the work of an auditor of public interest entities to have fruitful two-way dialogue with the entities audited and especially with those charged with governance of the audited entity. Guidelines for auditors on how to communicate in an effective way should therefore be beneficial for auditors in practice. However, FEE is concerned that the Proposed Standard's objective, together with the required procedures, may not serve to foster the effective two-way communication that may help to enhance the work an auditor performs.

FEE is supportive of the intention of the PCAOB to set a standard for US public companies on communication with audit committees that is based on the international approach and on a thorough analysis of the differences between PCAOB standards and the International Standards on Auditing (ISAs). As a result of increased global acceptance of ISAs, they have become the global benchmark for auditing standards. Devoting efforts to quality standards and convergence in such a significant area in audit as communication with those charged with governance of the audited entity will therefore be beneficial to all stakeholders.

FEE's comments on significant aspects related to some of the questions raised by the PCAOB in the consultation document of the Proposed PCAOB Standard are set out below. Solely for ease of reference they follow the order of the Proposed PCAOB Standard. However this does not reflect FEE's view as to their relative importance in any way.

1. Convergence

The benchmark auditing standards are the clarified International Standards on Auditing (ISAs)

FEE has been advocating the use of the (clarified) ISAs in the European Union (EU) for over ten years. In addition, the worldwide use of the ISAs has steadily expanded over the last few years, making ISAs the global benchmark auditing standards. In 2009, FEE has reconfirmed its support for ISAs in Europe in the FEE Policy Statement on International Standards on Auditing (ISAs)[1].

FEE fully supports the adoption of ISAs as the use of harmonised international auditing standards will serve to increase audit quality and enhance confidence in the reliability, comparability and consistency of financial statements.

In general, FEE believes that uniformity in auditing standards worldwide, to the maximum degree possible, is beneficial for capital market participants with cross-border interests and global activities and enhances the quality of audits based on globally accepted auditing standards at national level, including the acceptance of audit reports beyond home jurisdictions.

Therefore, FEE welcomes the PCAOB's initiative to align its standards with the clarified ISAs as a step towards the ultimate worldwide application of one set of auditing standards for capital market entities and also other entities.

Towards globally accepted auditing standards or convergence?

We acknowledge that the PCAOB issues standards separately from, and different to, those of the IAASB because the PCAOB standards need to take into account national U.S. securities law and U.S. Securities and Exchange Commission (SEC) and other PCAOB rulemaking on these laws that the PCAOB has chosen for an integrated audit approach. Therefore, some differences between PCAOB standards and ISAs are inevitable.

However, we believe that it is not conducive to international convergence in auditing standards for the PCAOB to issue auditing standards that differ from the (clarified) ISAs at a technical level for other than these US legal reasons. The (clarified) ISAs reflect the product of an intensively overseen and thorough due process involving extensive consultation at an international level, including input from regulators, such as the PCAOB. Consequently, at an international level the ISAs are the most widely accepted benchmark of high quality auditing standards.

---

1 http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%20I%20International%20Standards%20on%20Auditing%20%28ISAs%29%20I%2009043014520092 3149.pdf

FEE would encourage the PCAOB to more clearly indicate and explain the differences between the PCAOB standards and the ISAs. Such explanations would be particularly helpful for non-US practitioners, who use ISAs as their standard audit approach, but sometimes are required to conduct audits in accordance with PCAOB standards. This is not only relevant for enhancing the efficiency and effectiveness of those audits, but also for educational and quality assurance reasons.

It would also be helpful if the PCAOB were to explain in more detail how the benefits of retaining the differences in the proposed standards exceed the costs of their retention. This would facilitate the IAASB to appropriately include the PCAOB in their due process when the relevant ISAs are being considered for revision in the future.

2. The use of professional judgement and rigorousness of PCAOB standards

FEE considers that the use of professional judgement in the conduct of audits is indispensable since it enables the auditor to make informed decisions about the course of action that is appropriate in the circumstances of the audit engagement.

The requirements related to the communication with audit committees in the Proposed PCAOB Standard appear to be quite prescriptive and rules-based and, therefore, may limit the auditor's ability to exercise professional judgement in deciding on the most appropriate and efficient means and content of the communication with the audit committee and those charged with governance. Furthermore, this level of detail may serve to detract from the aim of communications, as both parties seek to comply with the "letter" of the requirements.

FEE supports a more principles-based approach to communication with the audit committee and with those charged with governance, consistent with the ISAs, by embedding the concept of professional judgement in the standard. Therefore, we believe that a number of the detailed requirements within the Proposed PCAOB Standard should be removed from the main text.

Prescriptive and rules-based requirements are particularly apparent in relation to the Proposed PCAOB Standard paragraphs 12 and 13 which we further comment on in sections 5 and 6 below.

3. Objectives

FEE supports the overall objectives of the PCAOB in proposing this new standard as FEE believes in the importance of enhancing the relevance and effectiveness of communications with the audit committee and in the importance of emphasising effective two-way communication to better achieve the objectives of an audit.

The Proposed PCAOB Standard contains four objectives which are similar, but not identical, to the objectives included in ISA 260[2]. The main differences that FEE recommends the PCAOB to reconsider are:

[2] ISA 260 on Communication with those charged with governance.

- The objective in paragraph 3a requires the auditor to establish a mutual understanding of the terms of the audit. It appears inappropriate to impose the establishment of mutual understanding upon one party – the auditor – as such an understanding requires the involvement of both parties. Therefore, it may not be possible for the auditor to achieve this objective in practice. The same applies to the requirements in paragraph 5 of the Proposed PCAOB Standard.

- Paragraph 3 sections a, b and c, address the exchange of information between the auditor and the audit committee. This paragraph specifies, as part of the objectives, that the auditor should *communicate to* the audit committee and *provide* the audit committee *with* certain information, all of which represents a one-way information flow. Paragraph 3d includes *evaluating the adequacy of the two-way communications* as a separate objective.

- ISA 260 states that one of the auditor's objectives is to *obtain information relevant to the audit from* those charged with governance and further to *promote effective two-way communication*. The ISA 260 objective appears more appropriate as it underlines the two-way communication throughout the audit process instead of a one-way communication from the auditor to the audit committee. The ISA 260 approach also assists the auditor in providing relevant and appropriate information to the audit committee which enables the audit committee to enhance the performance of its role of overseeing the financial reporting process.

Requirements of an auditing standard are designed to enable the auditor to achieve the objectives of a standard. However, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the standard to fulfil the objectives. FEE would encourage the PCAOB to consider whether the objectives stated in the Proposed PCAOB Standard are designed to enable the auditor to achieve an understanding of the requirements instead of merely summarising the requirements.

These comments relate to questions 1 and 2 raised in the PCAOB consultation document.

4. Overview of the Audit Strategy and Timing of the Audit

In obtaining information related to the audit the auditor is required to inquire of the audit committee whether it is aware of matters that may be related to the audit[3]. FEE notes that according to the preamble of the Proposed PCAOB Standard[4] the auditor should only inquire in relation to *significant* risks, not regarding all matters related to the audit. FEE would encourage the PCAOB to eliminate such inconsistency in the Proposed PCOAB Standard to reduce the risk of inconsistent or inefficient application by introducing the notion of significance in paragraph 8 of the Proposed PCAOB Standard.

These comments relate to question 5 raised in the PCAOB consultation document.

[3] Proposed PCAOB Standard paragraph 8.
[4] Preamble of the Proposed PCAOB Standard, page 4.

5. Issues Arising from the Audit – Accounting policies, Practices and Estimates

In paragraph 12a of the Proposed PCAOB Standard, a number of matters which the auditor should communicate have been included. All requirements in paragraph 12 of the Proposed PCAOB Standard relate to accounting policies and estimates that the management, rather than the auditor, should initially communicate to the audit committee. This is also highlighted in the "note" at the end of paragraph 12, stating that the auditor should determine whether all matters were adequately described, and, if not, the auditor should communicate any omitted or inadequately described matters to the audit committee.

FEE recommends that the condition of primary involvement and communication by the management to the audit committee as set out in the guidance, is transposed into the beginning of paragraph 12. This would indicate more clearly that it is only appropriate for the auditor to communicate the inadequacies in relation to these issues to the audit committee. The auditor should not submit descriptive communications to the audit committee if the management has already done so.

This would be consistent with the recent Staff Audit Practice Alert No. 5 on "Auditor Considerations regarding significant unusual transactions"[5] in which it is highlighted that the auditor should discuss his assessments and judgements with audit committees instead of merely describing the views of the management. In addition, a changed approach would also highlight the separation of the responsibilities between the management and the auditor, respectively, which is only implicitly included in the Proposed PCAOB Standard.

These comments relate to questions 8 and 11 raised in the PCAOB consultation document.

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

The PCAOB has included extensive requirements as to what the auditor should communicate to the audit committee in paragraph 13 of the Proposed PCOAB Standard. Some of these requirements seem to be more significant than others, especially the following:

- Paragraph 13a appears to duplicate part of paragraph 12 as it addresses the same issue from two different angles. In accordance with paragraph 12a the auditor is required to communicate the inadequacies in the accounting policies described by the management. A discussion of the quality, clarity and completeness of the financial statements and the consistency of the disclosures should be carried out in accordance with paragraph 13a which, therefore, also relates to the descriptions made by the management. As both paragraphs address the accounting policies and the descriptions made by the management, FEE would encourage the PCAOB to consider whether merging paragraphs 12 and 13a would make the requirements less confusing for the auditor and avoid duplicative work in practice.

[5] PCAOB Staff Audit Practice Alert No. 5: "Auditor Considerations regarding significant unusual transactions", 7 April 2010: http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf

- Paragraph 13c addresses critical accounting estimates. The paragraph appears also to duplicate part of paragraph 12b as both paragraphs require an auditor's assessment on how critical accounting estimates affect the financial statements.

  According to paragraph 13c the auditor is required to evaluate the reasonableness of the process for critical accounting estimates used by the management. In this respect, FEE would recommend that the PCAOB carefully considers that the auditor should not appear to be making decisions of behalf of the management, thus impairing the independence of the auditor.

- Paragraph 13e requires that the view of the auditor on alternative accounting treatments is expressed. As mentioned above, FEE would recommend that the PCAOB carefully considers this requirement to ensure that the independence of the auditor is not compromised by imposing management decisions upon the auditor.

- Paragraph 13f requires the auditor to communicate significant accounting matters on which the auditor has consulted outside the engagement team. This requirement appears to address the use of the work of experts which is already dealt with in paragraph 10 of the Proposed PCAOB standard. These two paragraphs appear therefore to be duplicative.

These comments relate to questions 8 and 11 raised in the PCAOB consultation document.

7. Adequacy of the Two-Way Communications

FEE regards the changes introduced by the IAASB in redrafting ISA 260 which are aimed at fostering two-way communication between auditor and those charged with governance as an important improvement which can enhance the effectiveness of the audit. As mentioned above the Proposed PCAOB Standard appears to focus on communication in relation to the completion of the audit, not prior to or during the audit. It is not apparent what kind and what level of communication should take place during the audit. We recognise that the currently *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* requires the auditor to inquire of the audit committee about the risks of material misstatement. However, we are not aware of other required communicative measures aimed at having auditors <u>promote</u> a two-way exchange of information. In our view, effective timely two-way communication may enable the auditor to gather information relevant to the audit which would otherwise not be forthcoming.

As audit committees may have information beyond initial risk assessments, in a risk-based audit approach it seems more appropriate to underline that this two-way communication should take place at appropriate points during the audit. This approach would enable the auditor to perform a more in-depth risk assessment and, where necessary, revise that assessment, which will lead to a more effective audit. Therefore, FEE would encourage the PCAOB to underline the two-way communication during the audit to a greater extent than currently envisioned in the Proposed PCAOB Standard.

These comments relate to question 18 raised in the PCAOB consultation document.

For further information on this FEE[6] letter, please contact Mrs. Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be or Lotte Andersen at +32 2 285 40 80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

[6] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be

Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

financial executives international

COMMITTEE ON CORPORATE REPORTING

May 28, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 030

Dear Board:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to share its views on the Public Company Accounting Oversight Board's ("PCAOB") Release No. 2010-001, "Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards." FEI is a leading international organization of senior financial executives. CCR is the senior technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

We support the Board's efforts to comprehensively update the interim auditing standards in regard to communications with audit committees, which is consistent with the Sarbanes-Oxley Act of 2002. We agree with the objectives noted in the release of increasing the relevance and effectiveness of communications between the auditor and the audit committee and emphasizing the importance of effective, two-way communications. We also believe that in practice, many of the proposed communications are already taking place.

However, we are concerned by and do not support some of the additional communication requirements proposed by the Board, especially those related to accounting policies, practices and estimates. We are concerned that these additional requirements seem to place the auditors in the role of management. We also believe that they are overly prescriptive and could result in increased audit costs with little or no benefit. We have set out our concerns and suggestions in the following paragraphs and believe the Board should consider them in preparing the final standard.

Accounting Policies, Practices, and Estimates

The proposed standard includes significant additional communication requirements in paragraphs 12 and 13 relating to the selection, changes, processes, and evaluation of the reasonableness of accounting policies, practices and estimates. We believe that many of these additional reporting requirements are the responsibility of management and are already embedded in the internal control and financial reporting processes of a registrant.

Management is responsible for the financial statements of the registrant. This includes the evaluation and selection of accounting policies that are appropriate for the registrant; the identification and reporting of critical accounting policies; evaluating and recording estimates; and establishing processes and internal controls to ensure the accurate reporting of matters as they relate to such policies and estimates. Auditors already have the responsibility of evaluating these selections, processes, internal controls and estimates as part of their audit of the financial statements and internal control over financial reporting. Deficiencies in management's selection and evaluation of accounting policies, processes and internal controls, and estimates are already communicated to management, with significant deficiencies and material weaknesses also reported to the audit committee.

Specifically, we believe the new proposed required communications for critical accounting estimates by management or the auditors on (1) subsequent monitoring of critical accounting estimates, (2) significant assumptions used in critical accounting estimates, (3) significant changes to assumptions or processes made by management to the critical accounting estimates, and (4) range of possible outcomes, are overly prescriptive requirements that may result in additional audit effort and information in audit committee reports that is of limited value and has the potential to dilute attention from high risk and substantive matters. Furthermore, we are concerned that these requirements will be very challenging to implement in practice, especially those related to range of possible outcomes.

We also believe that the new requirement to communicate the anticipated application of new accounting or regulatory pronouncements is already sufficiently covered through the current required disclosures in the financial statements that provide information on the applicability and effect of new pronouncements upon adoption by the registrant.

We are concerned that the additional proposed reporting requirements may result in a compliance exercise that would remove the focus from concerns and issues the auditors should cover during their discussions with the audit committee. The additional proposed requirements will place additional time burdens on both management and the audit committee of the registrant related to issues that we believe are already addressed through the current audit processes and communications that management and auditors have with audit committees. We also believe that the additional requirements could result in a meaningful increase in the audit costs without any corresponding benefit. Current requirements in AU Section 380 already address these areas in a manner we believe is efficient and productive.

Corrected and Uncorrected Misstatements

We are generally in agreement with the requirements of the proposed standard in this area. We are concerned, however, with the proposal that auditors provide the audit committee with a schedule of uncorrected misstatements relating to *disclosures*. We believe that this could result in auditor's communicating items to the audit committee that are required by GAAP but are insignificant to the financial statements as a whole or to the understanding of users of the registrant's financial statements. In practice today, disclosure questions are resolved through discussions between management and their auditors. If a significant unresolved difference of opinion remains related to a disclosure issue, existing auditing standards already require the auditor to report this disagreement between management and the auditor to the audit committee. Accordingly, we believe existing audit standards are sufficient and further that only disclosure matters of significance should be communicated by management or the auditors to the audit committee.

Additionally, in response to question 15, we don't believe that all corrected misstatements should be communicated by auditors to the audit committee. We believe it is appropriate to communicate those corrected misstatements that result in a significant deficiency or material weakness to the audit committee, but that it isn't appropriate or necessary to expand such reporting beyond what is already required under Auditing Standard No. 5. We also don't believe it is necessary for auditors to report corrected misstatements that were detected by management to the audit committee as these may result from simply the effective functioning of internal control over financial reporting of the registrant. Misstatements detected and corrected by management should only be required to be reported to the audit committee by management and/or by the auditors in the event that they relate to a significant deficiency or material weakness in internal control over financial reporting.

Form and Content of Communications

We believe that all required audit committee communications should be in writing. Auditors should include all items in a written communication in sufficient detail for members of the audit committee to understand and to enable audit committee members and the registrant to refer to in subsequent periods if necessary. We believe that any item that is important enough to be brought to the attention of the audit committee should be recorded in sufficient detail to avoid possible misunderstanding in the future.

Auditor Consultations Outside of the Engagement Team

The proposed standard would require an auditor to communicate to a company's audit committee any significant accounting matters for which the auditor has consulted outside the engagement team. This could include discussions with the firm's national office, industry specialists or consultations with external parties. We are concerned that this broad proposal could have the unintended effect of stifling meaningful consultations and discussions between an audit firm and its national office or industry specialists. Further, the proposed requirement may reduce other more important communications from the engagement team to the audit committee. We believe that the auditor should be able to utilize their sound professional judgment to discuss only those matters with the audit committee that it believes are material to the company or otherwise appropriate to be discussed. Specifically, we believe that (i) communications between the engagement team and other individuals at the audit firm should not be covered by this proposed standard and (ii) this requirement should be limited to matters that are qualitatively or quantitatively material to the company. Additionally, in response to question 12, we do not believe that the auditors' communications of management consultations should be expanded, for reasons similar to those provided above

*** * * * * * * * ***

We appreciate the PCAOB's consideration of these matters and welcome the opportunity to discuss any questions you have with respect to our comments.

Sincerely,

Arnold C. Hanish
Chairman, Committee on Corporate Reporting
Financial Executives International

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (850) 224-2727 • FAX (850) 222-8190

May 7, 2010

Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Via internet: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 030
Communications with Audit Committees

Dear Board Members:

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants (the "Committee") has reviewed and discussed PCAOB Rulemaking Docket Matter No. 030, "Communications with Audit Committees" (hereinafter, the "proposed standard"). The Committee has the following comments:

Objectives of the Auditor

1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?

The Committee believes letters (a), (b), and (c) are appropriate, but that letter (d) is not appropriate. Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit is very subjective. Such a requirement puts the auditor in an awkward situation as the auditor is figuratively only seeing one side of the mirror, the communications the auditor has made. What the auditor does not know is the adequacy of the communications from the audit committee. This assessment will create needless tension between the auditor and audit committee and could lead to the auditor requiring a representation letter from the audit committee. By adding this type of formality to the communications between the auditor and the audit committee, the proposed standard would actually hinder communication, rather than support it. Valuable communication between the auditor and audit committee can occur informally and should not be hindered by a standard.

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?

The Committee agrees that the objectives are adequately articulated. The Committee also believes the articulation of the objectives should focus on the outcome, particularly in the level of output expected in regards to the adequacy of the two-way communication with the audit committee, since without more guidance, significant diversity in practice will exist.

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?

The Committee believes it is appropriate to require that an engagement letter be prepared annually. Such a requirement fuels healthy discussion on the specifics of the engagement letter and the nature of the auditor's responsibilities on a regular basis.

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

The Committee believes that no other matters should be added to an engagement letter other than what the proposed standard requires. The investor is sufficiently protected by the fact the auditor is expressing an opinion and thus subjecting him or herself to the possible consequences of that action, particularly since the engagement letters of audits of public companies are not permitted to have indemnification wording.

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?

The Committee believes the requirement of the auditor to inquire of the audit committee is appropriate due to (1) the fact the audit committee likely has unique insight into management, and (2) such dialogue contributes to a healthy dialogue between the auditor and the audit committee.

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?

The Committee believes inasmuch as the requirements apply to pre-audit communications, the requirements are appropriate. However, the Committee believes the following requirements are arbitrary and too subjective:

1. The requirement to communicate significant changes to the planned audit strategy
2. The auditor's determination of whether persons with specialized skill or knowledge are needed to apply the planned audit procedures

1. By instituting a requirement to communicate significant changes to the planned audit strategy, the proposed standard will interfere with the conduct of the audit as the auditor will spend an excessive amount of time determining what is and what is not a significant change to the planned strategy and what is the appropriate time to communicate.

2. Regarding the determination of whether persons with specialized skill or knowledge are needed to apply the planned audit procedures, the Committee notes existing standards allow an auditor to obtain expertise. The need to communicate consultations or the use of other firms, particularly if just for a brief dialogue, should be left to the auditor's judgment. The way the proposed standard is worded would result in a diversity of practice among auditors and may potentially dilute the whole communication process with the audit committee with potentially needless information about brief dialogues with other accountants, even if in the same firm.

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?

The Committee believes that while the proposed standard is sufficiently clear as to which types of arrangements should be communicated to the audit committee related to the roles, responsibilities, and locations of firms participating in the audit, such a communication should not be required. Since many firms make use of affiliates for items such as an inventory observation all the way through audits of entire subsidiaries, the significance to the audit committee would reasonably vary and communicating immaterial arrangements would clutter communications with the audit committee. The Committee believes that if the audit area is material and is being subcontracted, the proposed standard should require the auditor to "consider" communicating the arrangement to the audit committee.

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)?

The Committee believes the proposed standard is sufficiently clear regarding the auditor's communication responsibilities with respect to accounting policies and practices.

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

The Committee believes the required communications to an audit committee should be as integrated as possible. From the audit committee's standpoint, it is communication to the auditor, regardless of the body requiring the communication. The requirements from the SEC should be incorporated by reference; thus if the SEC guidance changes, the PCAOB's proposed standard would automatically change and avoid a situation where there are two-similarly worded communications (one SEC, one PCAOB) going to the audit committee causing possible information overload that dilutes the effectiveness of the communication.

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

The Committee believes the definition of critical accounting estimates is appropriate as the definition focuses on subjective items that would likely be of the most interest to the audit committee.

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?

The Committee believes the communication requirements regarding critical accounting estimates are appropriate. Communications of estimates that are material due to the levels of subjectivity and judgment necessary, with a material impact, should be communicated to the audit committee.

.

Management Consultations with Other Accountants

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

The Committee acknowledges the potential benefits of expanding audit committee communications to include consultations with non-accountants on accounting or auditing matters as this would facilitate discussions between the auditor and the audit committee. However, the length to which auditors should go to verify the information obtained should be specified in the proposed standard. Will auditors be required to test the information (for example would the auditor be required to examine invoices, or would management's representations be sufficient?) If testing is required, a potentially significant amount of work will be added to the auditor's procedures that likely would not add support to the opinion on the financial statements.

Going Concern

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

The Committee believes the requirement in the proposed standard is clear. However, the requirement for the auditor to assess management's plans is not appropriate. The auditor is responsible for opining on the financial statements as a whole and under current standards, is responsible for determining whether there is a need in the auditor's report for an additional paragraph indicating there is substantial doubt a company can sustain operations for a reasonable period of time not greater than a year. This proposed standard to assess management's plans, regardless of whether or not a going concern opinion is issued forces the auditor into the role of valuation expert and soothsayer.

Corrected and Uncorrected Misstatements

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

The Committee believes that, overall, the requirements are appropriate, particularly the requirement that the communication indicate that future periods may be misstated. What the Committee does not feel is appropriate is the requirement to communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial including qualitative factors. Such a requirement takes away from the statement that emphasizes that <u>management</u> has determined the uncorrected misstatements are immaterial individually and in the aggregate. Accounting literature (such as guidance on the GAAP hierarchy and on subsequent events) has leaned recently toward emphasizing the responsibility of management; this proposed standard would place too much emphasis on the auditor's determination. While the goal of the overall standard to improve the auditor's communication with the audit committee is a desirable one, such improved communication should not come at the expense of management's communication with the audit committee. Also, a variety of factors enter into the determination of the immateriality of uncorrected misstatements. The auditor is responsible for providing an opinion, if possible, on the financial statements and is not required to disclose every factor that entered into decisions made in the audit. As such, the auditor should not be required to disclose the reasons why he or she determined the uncorrected misstatements to be immaterial.

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

The Committee believes that all corrected misstatements, including those detected by management, should be communicated. Such a communication will allow the audit committee to obtain a sense of the quality of financial information provided to the auditor at the start of an engagement. Such information will help illustrate to the audit committee the quality of management's accounting, the timeliness of that accounting, and possibly, if applicable, part of the reason for the length of the audit.

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?

The Committee agrees with the wording in the proposed standard that allows the auditor to communicate many matters orally or in writing. Auditors should be allowed to appropriately cater the presentation to the audit committee to effectively communicate. The Committee also agrees with the requirement that oral communication be appropriately documented.

Timing

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

The Committee believes the proposed standard's requirements regarding the timing of the auditor's communications as the proposed standard leaves appropriate room for interpretation by the auditor and avoids a bright-line requirement.

Adequacy of the Two-way Communication Process

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

The Committee believes the requirement does not promote effective two-way communication. As noted in the Committee's response to Question 1, evaluating the adequacy of the two-way communications between the auditor and the audit committee is very subjective and may actually hinder communication, rather than support it. The requirement should be removed from the proposed standard.

Other Communication Requirements

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

The Committee believes the other communication requirements are appropriate and sufficiently clear. The Committee believes the proposed standard should include the following communication requirement:

- Management's unwillingness to sign the representation letter.

While the proposed standard focuses on the auditor's communication with the audit committee, by requiring the auditor to communicate management's unwillingness to sign the representation letter, the audit committee's communication with management will be reinforced which will likely foster healthy discussion for all three parties on the content of the representation letter.

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?

The Committee believes the significant difficulties in paragraph 21 of the proposed standard are appropriate. We recommend the following matter should be included as a significant difficulty (refer to the Committee's response to Question 19):

- Management's unwillingness to sign the representation letter.

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 of the company under audit?

The Committee does not believe that any of the proposed requirements for auditors to communicate to audit committees are inappropriate based on size or industry of the company under audit.

Appendices

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

The Committee does believe that the information in Appendices A-C is sufficiently clear and does not believe any additional matters are necessary other than additional clarification to the requirements of Question 12.

The Committee appreciates the opportunity to share our views and concerns and to comment on PCAOB Release No. 2010-001. Members of the Committee are available to discuss any questions you may have regarding this communication.

Very truly yours,

FICPA Accounting Principles and Auditing Standards Committee

Committee members coordinating this response:

Steven Morrison, CPA
Laura Prevaratil, CPA, CFE

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (850) 224-2727 • FAX (850) 222-8190

October 13, 2010
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Via email: comments@pcaobus.org

Reference No. PCAOB Rulemaking Docket Matter No. 030 – Proposed Auditing Standard, "Communications with Audit Committees"

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants (the "Committee") has reviewed and discussed the above Proposed Auditing Standard ("the Proposed Standard"). We appreciate the opportunity to respond to the Proposed Standard. Our comments are outlined below. These comments specifically relate to the Questions for Respondents in each Section of the Proposed Standard.

A. Objectives of the Auditor

1. Yes, the Committee believes the objectives are consistent with present practice. They are broad enough to encompass most present practices with auditor communications with the audit committee.
2. Yes, the Committee believes the objectives are sufficiently articulated. However, the Committee believes that the outcomes that should be achieved should be judgmental based on the joint discussions amongst the audit committee and the auditors.

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

3. Yes, the Committee believes that preparation of an engagement letter on an annual basis is appropriate as there may be changes in accounting standards, and changes in the client's business and general economic conditions, that may require changes in the terms of each year's audit engagement.
4. The Committee believes that more information regarding audit committee responsibilities should be required in the audit engagement letter. These items are largely based on changes to the responsibilities of the audit committee derived from the Sarbanes Oxley Act, such as the review and acceptance of financial reporting, and the communication with audit team by the audit committee

C. Obtaining Information Related to the Audit

5. Yes, the Committee believes that it is totally appropriate. There may be other issues that arise from the risk assessment considerations that are discussed with the audit

committee. However, the Committee does not believe that the Proposed Standard should be prescriptive as to what those procedures should be.

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

6. Yes, the Committee believes that the requirements to provide information on the auditor's audit strategy and timing of the audit are appropriate. However, as in our response to the previous question, the Committee does not believe that the Proposed Standard should be prescriptive as to information to be provided on the audit strategy. The Committee believes that a summary of the audit plan, as well as a discussion of audit areas that will be of particular emphasis during the audit, should be included in the guidance. The remainder of the discussion should be left to the judgment of the audit partner, so as to avoid a checklist approach to the discussion of audit strategy. The Committee also believes that the guidance should include that the audit team should communicate certain matters to the audit committee at an appropriate time so as not to jeopardize the effectiveness of audit procedures.
7. The Committee believes the Proposed Standard should be more descriptive of examples that the PCAOB is contemplating in this area, such as matters that will be discussed with an audit firm's national office.

E. Accounting Policies, Practices, and Estimates

8. Yes, the Committee believes that the proposed requirements are sufficiently clear in the Proposed Standard.
9. Yes, the Committee agrees that it would be helpful to include the SEC required communications regarding accounting matters, as omission of the same would require reference back to a different set of auditing standards.
10. Yes, the Committee believes the definition is appropriate, as it is the same definition as used by the SEC, and would not require reference to a different set of standards.
11. Yes, the requirements are qualitative based, so they are appropriate in furthering one key objective of the standard which is to further the two way discussions between the auditor and the audit committee.

F. Management Consultations with Other Accountants

12. Yes, the Committee believes the requirement should be expanded to include such consultants as actuaries and valuation specialists.

G. Going Concern

13. Yes, the Committee believes the communication requirement on going concern is clear.

H. Corrected and Uncorrected Misstatements

14. Yes, the Committee believes the requirements regarding the communications for uncorrected misstatements are appropriate.
15. Yes, the Committee believes that corrected misstatements detected by management **during the course of the audit** should be communicated to the audit committee, as they may be an indicator of deficiencies in financial closing procedures, and one

important criterion is that the misstatements be detected by management on a timely basis.

I. Other Matters – no questions included for respondents

J. Form and Content of Communications

16. The Committee believes that there should not be a prescriptive standard regarding the communication of certain matters in writing. The choice of written or oral communications of these matters should be judgmental based on the preference of the audit committee.

K. Timing

17. Yes, the Committee believes that the requirements on the timing of the auditor's communications are appropriate. The Committee does not believe that only certain matters be communicated on an annual basis. Again, the Committee does not believe a prescriptive standard in this matter is warranted.

L. Adequacy of Two Way Communication Process

18. Yes, the Committee believes that the requirement does promote effective two way communications. The Committee believes that more information on this requirement is needed in the Proposed Standard. Examples should include auditor communication with the audit committee on other non-financial statement matters such as earnings releases, Form 8-Ks, quarterly information, business performance information, and non-GAAP financial information.

M. Other Communication Requirements

19. The Committee believes the requirements are appropriate, and that other matters should not be prescriptive and left to the judgment of the audit committee and audit partner.
20. The Committee believes the matters in paragraph 21 are appropriate as they encompass all of the considerations related to the nature extent and timing of audit procedures.
21. No, the Committee does not believe the requirements are inappropriate.

N. Appendices

22. The Committee believes the information included in the appendices is sufficiently clear. As discussed in the Committee's response to question 4, the Committee believes that more information regarding the responsibilities of the audit committee should be included in an audit engagement letter.

Again, the Committee appreciates this opportunity to share its views and comments on the Proposed Standard. Members of the Committee are available to discuss any questions you may have regarding this communication.

Sincerely,

Steven Wm. Bierbrunner, CPA Chair

FICPA Accounting Principles and Auditing Standards Committee

Committee Members Coordinating this Response:

Robert P. Bedwell, CPA

Laura Prevratil, CPA

Grant Thornton

May 28, 2010

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

Audit – Tax – Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200
F 312 565 4719
www.GrantThornton.com

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 Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board or PCAOB) *Proposed Auditing Standard Related to Communications with Audit Committees, and Related Amendments to Certain PCAOB Auditing Standards.* As a member of the Center for Audit Quality (CAQ), we participated in the drafting of the CAQ's letter of comment in response to the proposed standard. On an overall basis, we support the comments in the CAQ's letter but wish to separately provide our comments and recommendations, including our responses to the Board's specific questions.

We support the Board's desire to enhance and emphasize the importance of effective two-way communications between the auditor and the audit committee. Not only are effective two-way communications an essential component of an audit, they are necessary for the audit committee to achieve its oversight responsibilities to protect the public interest. However, we believe that the prescriptive nature of the proposed standard, particularly as it relates to communicating significant and critical accounting policies and practices, will have the unintended consequence of less effective communications. We agree that many of the matters to be communicated are appropriate, relevant, and useful to the audit committee, but the Board must clearly distinguish the auditor's responsibilities from those of management and the audit committee. It is not feasible or appropriate to require the auditor to communicate all of the matters listed on every audit and review engagement, particularly when the communication responsibility primarily rests with management. This approach may lead to rote communications that have the effect of obfuscating more critical discussion points.

We continue to support the need for the Board to conform to the extent possible to the standards established by the International Auditing and Assurance Board (IAASB) and to consider the work of the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants. We believe that maintaining consistency with the standards of the

IAASB and ASB, while also addressing the particular needs of issuers, enhances the effectiveness, quality, and uniformity of audits.

Objectives of the auditor

The following includes our responses to the Board's specific questions related to the auditor's objectives. Overall, we are supportive of the proposed objectives. Nevertheless, we have a few recommendations that we believe will further clarify the auditor's responsibilities.

1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?
   For the most part, we believe that the objectives of the auditor in the proposed standard are appropriate. However, similar to International Standard on Auditing (ISA) 260, *Communication with Those Charged with Governance*, we suggest including an additional objective for the auditor to obtain from the audit committee information that is relevant to the audit. We believe this objective is necessary for the auditor to recognize the importance of, as well as to promote, effective two-way communications with the audit committee. The objective would also provide a basis for the auditor's evaluation of the adequacy of such communications. Further, although the Board recognizes the importance of inquiring of the audit committee in the release and includes a specific requirement to do so in the proposed standard, excluding the ISA objective from the proposed standard can imply that the Board believes that it is not an essential element of the audit. We note that the Board's views on this matter were not included in Appendix 3, which compares the proposed standard with the corresponding standards of the IAASB and ASB.

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?
   We prefer aligning the language used in the objectives with ISA 260. Although the objectives stated in the proposed standard are outcome based, we believe the way they are articulated could be clearer and more practical, as discussed further in our response to question 6. Also, the ISA objectives are relevant to issuers and non-issuers alike, and we see no need to depart from those objectives. However, in clarifying the objectives in the proposed standard, we suggest the following revisions:

   - Referring to the "overall" audit strategy in paragraph 3(b) to refine the auditor's responsibilities and address the concerns expressed in our response to question 6.

   - Referring to the "oversight of the company's" financial reporting process in paragraph 3(c) to be clear that the auditor's communications are focused on matters that are important to merit the audit committee's attention, thereby encouraging more meaningful discussions.

   - Using the phrase "to support the opinion to be expressed in the auditor's report" in lieu of the phrase "to support the objectives of the audit," to more clearly indicate that ineffective communications do not provide the auditor with sufficient appropriate audit evidence to form an opinion.

Establish a mutual understanding of the terms of the audit

We concur with the elimination of AU sec. 310, *Appointment of the Independent Auditor*, and the inclusion of the requirements to establish a mutual understanding of the terms of the audit engagement together with the auditor's other audit committee communication responsibilities. The following includes our responses to the Board's specific questions related to the use of an audit engagement letter.

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

   In consideration of the audit committee's oversight responsibilities, including the appointment and retention of the auditor, we believe it is appropriate for the auditor to establish a mutual understanding of the terms of the audit engagement on an annual basis. However, in consideration of this question and the statements made in the release, it is not clear whether the Board intends to require a new engagement letter on an annual basis. Today, there are alternative methods (for example, an "evergreen letter") for establishing such an understanding that would seem to meet the proposed requirement. The Board should clarify its views on this matter within the proposed standard.

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

   In addition to the auditor's and management's responsibilities, we believe that the engagement letter, for an audit and a review of interim financial information, should include the audit committee's responsibilities to provide the auditor with information relevant to the audit (see our response to question 22). We also believe it is equally important for management to acknowledge the terms of the audit engagement, as the primary responsibility for the financial statements rests with management.

   With respect to Appendix C, which includes matters required to be communicated in the audit engagement letter, we have the following observations:

   - We believe it is not necessary for the engagement letter to include with such specificity the required auditor communications related to internal control deficiencies; although we acknowledge that this is an existing requirement. The inclusion of such information overshadows other key communications that are not required by the proposed standard to be included within the engagement letter.

   - We also believe that the audit engagement letter should include management's responsibility to provide unrestricted access to persons within the company from whom the auditor determines it necessary to obtain audit evidence. We consider this to be an important addition from ISA 210, *Agreeing the Terms of Audit Engagements.*

Obtaining information related to the audit

The following includes our response to the Board's specific question related to inquiries of the audit committee.

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?
   We support including a specific requirement to inquire of the audit committee about matters related to the audit within the proposed standard. We believe that the requirement would support the additional objective discussed in our response to question 1 for the auditor to obtain from the audit committee information that is relevant to the audit. However, we also believe the requirement needs to be placed in the appropriate context; otherwise, it seems overly broad and misplaced. In this regard, we propose the following:

   - Including within the proposed standard the analysis provided in Appendix 3 under "Obtaining Information Related to the Audit," which clearly indicates that the requirement "complements the requirement in the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*."

   - Clarifying that the inquiry pertains to other matters of which the audit committee is aware that would affect the overall audit strategy, including the scope, timing, and direction of the audit, to align the inquiry with the auditor's related communication in paragraph 9 of the proposed standard (see our response to question 6).

   - Including, as examples of other matters to inquire of the audit committee, the guidance provided by paragraph A14 of ISA 260, to the extent the guidance is applicable to audits of issuers and not otherwise addressed by PCAOB standards.

Overview of the audit strategy and timing of the audit

The following includes our responses to the Board's specific questions related to the auditor's communications of the overall 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?
   As proposed, we do not agree with the requirements in paragraphs 9 and 11 for the auditor to communicate to the audit committee matters related to the audit strategy and significant changes thereto. To meet the requirements in the proposed standard, the auditor would need to perform risk assessment procedures, identify significant risks, develop an appropriate response to those risks, and then hold discussions about these matters with the audit committee. Although this may seem reasonable to the Board, we are concerned that exhaustive communications related to the audit strategy and the auditor's risk assessments can compromise audit quality and effectiveness because the audit committee is not autonomous of management. Also, the communications are impractical. The proposed

standard can only be complied with if the auditor and audit committee have multiple meetings scattered throughout the audit, including the one after the auditor's risk assessment. It is not feasible to mandate this on the auditor or the audit committee.

The Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, describes the "overall" audit strategy, which pertains to the planned scope and timing. We believe that communicating the overall audit strategy to the audit committee provides the appropriate level of communication. Also, we note that paragraphs A11 and A13 of ISA 260 provide useful guidance that could be included in the proposed standard to further clarify the nature of the communications. Further, our response to question 5 indicates that the required inquiry of the audit committee should relate to the auditor's communication of the overall audit strategy and that the inquiry could include the matters addressed in paragraph A14 of ISA 260. We believe that these changes to the proposed standard would strengthen the effectiveness of the two-way communications between the auditor and the audit committee.

With respect to paragraph 10, we question the need for the requirements to communicate certain specific matters, as proposed, on an annual basis for every engagement. For instance, it is very common for the auditor to utilize persons with specialized skill or knowledge on every audit engagement, such as an information technology specialist. Our view is that the audit committee may wish to be informed of the auditor's use of such persons in response to an identified significant risk, but not routinely on all engagements. We have the same view about the requirements in paragraphs 10(b) and 10(c) to communicate the auditor's consideration and use of the internal audit function, company personnel, or other third parties. Also see our response to question 7 regarding the communication requirements in paragraphs 10(d) and 10(e).

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?

   Audit committees may not universally desire or need exceptionally detailed information of the sort that seems to be mandated by paragraph 10(d); therefore, we believe the auditor's communication should be limited to the fact that the auditor expects to use the work of other auditors. However, we also believe that the auditor's expected use of other auditors would be discussed in conjunction with the auditor's ability to serve as the principal auditor, which is a matter that the audit committee would need to consider prior to appointing or retaining the auditor as the principal auditor. Consequently, we suggest paragraphs 10(d) and 10(e), as proposed, be removed from the proposed standard in their entirety or further clarified. This aside, in response to the Board's question, the requirement to communicate the roles, responsibilities, and locations of firms participating in the audit is not clear without reading the release. We have previously suggested that the Board eliminate the practice of interpreting the requirements of its standards in the release. Although we find the Board's analysis helpful, information that is essential in applying the requirements, or requirements themselves, should be contained within auditing standards to help eliminate differences in practice.

Accounting policies, practices, and estimates

We have reservations regarding the communication requirements related to accounting policies, practices, and estimates. As stated in the release, a primary objective of the proposed standard is to "enhance the relevance and effectiveness of the communications between the auditor and the audit committee." We believe that simply including numerous additional requirements related to significant and critical accounting policies, practices, and estimates does not accomplish this objective.

Generally, many of the communication requirements relating to significant accounting policies and practices, as well those relating to critical accounting estimates, are the responsibility of management. We also believe that, in exercising effective oversight, the audit committee has a duty to proactively discuss these matters directly with management. Further, the audit committee should be familiar with the significant and critical accounting policies, practices, and estimates, as disclosed both in the company's financial statements and Management's Discussion and Analysis (MD&A). A well informed audit committee would enhance the quality and effectiveness of the two-way communications with the auditor, and consequently, the auditor's communications would pertain to the auditor's views on matters that are of utmost importance to warrant the audit committee's attention.

Although we recognize that, consistent with extant standards, the note in paragraph 12 allows the auditor to rely on certain management communications, we request the Board to reconsider the auditor's communication requirements in light of management's and the audit committee's responsibilities. The auditor need not be required to communicate matters that are to be communicated by management, nor accounting policies, practices, and estimates that are disclosed in the company's financial statements and MD&A. Focusing the requirements on the auditor's views regarding the quality of these matters could avoid boilerplate communications and prevent audit costs from rising, while promoting more meaningful and robust communications with the audit committee. Our responses to the Board's specific questions that follow provide more specific recommendations.

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)?

   The proposed standard appears to be consistent with current requirements as they relate to the difference between a significant accounting policy and a critical accounting policy. However, in reference to our general comments above, we believe that the matters covered by the requirement in paragraph 12(a) should be communicated by management. Also, we do not understand the auditor's communication responsibility with regard to paragraph 13(b)(iii); particularly, the requirement is not clear with respect to what is expected to be communicated, how the auditor would consider anticipated future events in determining critical accounting policies and practices, and why this is relevant to the audit committee.

   With respect to paragraph 13(f), as drafted, we disagree with the requirement to communicate significant accounting matters where the auditor has consulted outside the engagement team. We are uncertain about the matters expected to be communicated in connection with this requirement. In addition, we believe the requirement will be difficult to operationalize because the nature and extent of consultations outside the engagement team that relate to accounting matters vary considerably. Although a consultation may relate to a significant accounting matter, the consultation per se may not be significant. Accordingly, if this requirement is to be maintained, we believe it should be limited to consultations with the national office, or a similar risk management function, on difficult or contentious financial reporting matters.

9. Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?
   Although the proposed standard appears to be consistent with the communication requirements in Rule 2-07(a)(1) and (a)(2) of Regulation S-X, the proposed standard does not include all of the requirements in the Rule. A statement that more clearly indicates that Rule 2-07 requires the auditor to communicate all critical accounting policies and practices, as well as certain other matters, may be useful in footnote 12 of the proposed standard. With respect to the communication of alternative treatments, we believe that a footnote referencing Rule 2-07(a)(2) should also be added to paragraph 13(e) of the proposed standard. Further, it is unclear, in consideration of the amendment to AU sec. 722, *Interim Financial Information*, whether the Board intends to extend the communication requirements related to critical accounting policies and practices to a review of interim financial information, as Rule 2-07 applies to an audit.

10. Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?
    We appreciate that the Board has defined a critical accounting estimate consistent with the U.S. Securities and Exchange Commission's (SEC) rules and regulations for disclosure in MD&A. A reference to those rules and regulations would further facilitate the auditor's understanding of what is expected to be communicated. The Board may consider working with the SEC to more clearly articulate the definition included in Appendix A of the proposed standard so that critical accounting estimates are distinctly differentiated from other material estimates in the financial statements. This may include incorporating previous SEC remarks on this matter.

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?
    As previously mentioned, we believe that many of the communication requirements relating to critical accounting estimates are the responsibility of management, including communications regarding management's process and monitoring, significant assumptions, the reasons for any changes to assumptions, and the range of possible outcomes. The auditor can supplement management's communications by providing the audit committee with the auditor's views about the quality and reasonableness of management's selection, application, and disclosure of critical accounting estimates, as well as concerns regarding potential bias in management's estimates. We believe such communications would provide

more insight to the audit committee, as well as promote more effective communications with the auditor.

With respect to paragraph 13(c), we believe that the proposed standard should not require the auditor to communicate the auditor's evaluation of the reasonableness of management's process to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates. First and foremost, the auditor does not perform a separate evaluation of management's process or conclude on the reasonableness of a critical accounting estimate apart from the audit of the financial statements taken as a whole. Also, the communication requirement is redundant with other communication requirements. For instance, if management's process was not reasonable, the auditor may communicate, depending on how the matter is resolved, a control deficiency, a modification of the opinion, or a difficulty encountered in performing the audit. We believe that our recommendation in the previous paragraph would sufficiently address the matters in paragraph 13(c).

Management consultations with other accountants

The following includes our response to the Board's specific question related to management's consultations about accounting and auditing matters.

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

We believe that the basis for requiring the communication related to management's consultations with other accountants about accounting or auditing matters primarily pertains to "opinion shopping" and the requirement in AU sec. 625, *Reports on the Application of Accounting Principles*, for the reporting accountant to consult with the continuing accountant. Although we believe it is management's responsibility to communicate the nature of the consultation to the audit committee, this is a significant matter where the auditor's views about the consultation need to be communicated. Therefore, we agree with maintaining the requirement in paragraph 15 of the proposed standard, provided the requirement is modified to require the communication of the auditor's views to the audit committee and to more clearly apply when the reporting accountant has consulted the auditor.

Although management's consultations about accounting or auditing matters with non-accountants would also be relevant to the audit committee's oversight of the company's financial reporting process, we believe that a separate requirement for the auditor to communicate such consultations is not necessary. Again, management should discuss these matters with the audit committee; however, there is no basis for determining that the auditor would be directly consulted about such matters or that the auditor would be aware of all management consultations with non-accountants. Further, if management consulted with non-accountants about an accounting or auditing matter of which the auditor is aware and that the auditor believes is significant to the audit committee's oversight of the financial reporting process, the auditor would be required to communicate the matter in accordance with paragraph 22 of the proposed standard. It would be appropriate for the auditor to communicate the auditor's views about management's use of third-party providers as it relates to significant or critical accounting policies and practices.

Going concern

The following includes our response to the Board's specific question related to the communications related to going concern.

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

    As currently drafted, we do not fully agree with the communication requirements related to going concern. We believe the requirement in paragraph 16(a) to communicate the conditions and events that indicate there could be substantial doubt about the company's ability to continue as a going concern, in addition to the information that mitigated the auditor's doubt, seems to be primarily based on paragraph .03a of AU sec. 341, *An Entity's Ability to Continue as a Going Concern*. Although this paragraph indicates that the auditor would perform additional procedures to obtain audit evidence that mitigates the auditor's doubt, it is unlikely that the auditor would come to a conclusion that the auditor's doubt is mitigated without considering management's own evaluation and plans, as contemplated by paragraph .03b of AU sec. 341. Accordingly, we believe that it is inappropriate to infer otherwise in paragraph 16(a) and that the requirement in paragraph 16(b), on its own, is sufficient.

    At this time, however, we suggest the Board either maintain the extant communication requirements or align those requirements more closely with ISA 570, *Going Concern*. This will provide the Board with additional time to consider the Financial Accounting Standards Board's standard setting activities in this area. We believe management's responsibilities related to the going concern assumption will become more transparent, and the auditor's responsibilities in AU sec. 341, including those relating to communications with the audit committee, will need to be aligned accordingly.

Corrected and uncorrected misstatements

The following includes our responses to the Board's specific questions related to the auditor's communication of corrected and uncorrected misstatements.

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

    Management has the primary responsibility for evaluating, quantitatively and qualitatively, the materiality of uncorrected misstatements and communicating its conclusions to the audit committee. We believe the requirement in paragraph 18 of the proposed standard for the auditor to also communicate to the audit committee the basis for the auditor's determination that uncorrected misstatements were immaterial (essentially, the auditor's concurrence with management's conclusions) is appropriate, except that we believe the communication of the qualitative factors considered by the auditor will become a boilerplate disclosure of the qualitative characteristics of materiality. We believe the auditor should be required to communicate such qualitative factors only if the auditor believes they are significant to the auditor's determination of immateriality and consideration of management's own conclusions.

Paragraph 18 of the proposed standard also requires the auditor to communicate corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications such misstatements might have on the financial reporting process. We believe this requirement should be eliminated as it is duplicative of the auditor's required communications related to deficiencies in the company's internal control over financial reporting.

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

We believe the Board should not require the auditor to separately communicate corrected misstatements detected by management. Depending on what the Board considers to be a corrected misstatement, the auditor may not be able to differentiate between adjustments made in the period-end financial reporting process and other journal entries to correct misstatements detected by management, and the auditor may not be informed by management of all such adjustments, which could number in the hundreds, if not thousands. If the Board receives feedback from audit committee members expressing their views that this information is essential to their oversight of the company's financial reporting process, we believe management, not the auditor, should have the responsibility to communicate such information to the audit committee.

Form and content of communications

The following includes our response to the Board's specific question related to the form and content of communications to the audit committee.

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?

We support the requirement in paragraph 23 of the proposed standard to communicate to the audit committee either orally or in writing. We believe it provides appropriate flexibility for the auditor to determine the form of communication, in consideration of the matters to be communicated and the audit committee's preferences. Also, requiring that certain matters identified in the proposed standard be communicated in writing may reduce the effectiveness of the two-way communications.

Paragraph 23 also requires the auditor to document the communications, whether communicated orally or in writing, in sufficient detail for an experienced auditor, having no previous connection with the audit to understand the communications made. We believe the Board should clarify its expectations related to the auditor's documentation of the communications. For example, if the communications were made in writing, whether in a formal letter or a presentation, the requirement implies documentation beyond the written communication, whereas we believe the formal letter or presentation is sufficient to document the communication.

Timing

The following includes our response to the Board's specific question related to the timing of communications to the audit committee.

17. Are the requirements in the proposed standard on the timing of the auditor's communications appropriate? Should only certain matters be communicated annually? If so, which ones?
    For an audit of financial statements, we agree with the requirements to communicate to the audit committee in a timely manner, on an annual basis, and prior to the issuance (or release) of the auditor's report, provided the communication requirements are relevant to the current audit. The proposed standard should not impose requirements that would require the auditor to communicate the same matters from year to year, as also indicated in our response to question 6.

    With respect to reviews of interim financial information, we also agree that the communications should be made before the company files its interim financial information with the U.S. Securities and Exchange Commission (SEC). However, the extant standard recognizes that there may be practical difficulties in doing so and provides for such situations. We believe this may become even more prevalent based on the additional interim communication requirements imposed by the proposed standard in conjunction with the related amendment to AU sec. 722.

    In consideration of the additional requirements, we are further concerned that the interim communication requirements are ambiguous by merely referencing the proposed standard, which is written from the perspective of an audit. We acknowledge that proposed interim communication requirements are similar to the extant requirements and that guidance is provided with regard to the communication of "changes" during a review; however, we believe the interim communication requirements should be more transparent, particularly with respect to the requirements in a recurring and initial review. In this regard, the Board should take the opportunity to more clearly differentiate between the annual and the interim communication requirements, including the auditor's responsibility to evaluate the effectiveness of the two-way communications. It would be helpful to reference the specific paragraphs in the proposed standard that apply in a review of interim financial information.

    As a final matter, we bring to the Board's attention some inconsistencies between the proposed requirements and the release. The release includes additional requirements related to the timing of communications that are not included in the proposed standard. We believe that the Board should not use the release to further interpret the requirements. Also, the amendment to AU sec. 722 indicates that the communication for a review of interim financial information should be made before the company files its interim financial information with the SEC. The release, on the other hand, refers to a filing with a regulatory agency, such as the SEC. We are comfortable with the proposed requirement in the amendment to AU sec. 722. However, we believe the release could create issues for companies that may have filing deadlines with other regulatory agencies that do not coincide with the SEC filing.

Adequacy of the two-way communication process

The following includes our response to the Board's specific question related to the two-way communication process.

18. Does the requirement to evaluate the adequacy of the communication process promote effective two-way communications? Is more information on this requirement needed?
    The requirement to evaluate the adequacy of the communication process does not necessarily promote effective two-way communications. Nevertheless, we believe two-way communication is fundamental to an audit. Whether the audit committee is forthright in its communications to the auditor will influence the auditor's risk assessments and may also impair the auditor's ability to obtain sufficient appropriate audit evidence to form an opinion.

    We believe the requirements in paragraphs 26 and 27 of the proposed standard are sufficient, except with respect to the Note in paragraph 27. Although we acknowledge that the Note creates a link between the evaluation in paragraphs 26 and 27 of the proposed standard and the evaluation of the control environment in paragraph 25 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements*, we believe the Note is not strong enough and could be further clarified. We believe the evaluation in paragraphs 26 and 27 directly influences the auditor's evaluation of the control environment, particularly as it relates to the effectiveness of the audit committee's oversight of the company's financial reporting process. The statement in the Note that the auditor "also should include the evaluation of the results of tests of controls related to the control environment regarding the audit committee" does not adequately describe the relationship between these requirements. For instance, we believe that the proposed standard should be clear that if the audit committee's communications to the auditor are ineffective, the auditor should consider this deficiency as it relates to the overall effectiveness of the audit committee's oversight of the financial reporting process.

    Further, under PCAOB standards, the auditor is required to communicate ineffective audit committee oversight to the board of directors, regardless of whether the auditor is performing an integrated audit or a financial statement only audit. Likewise, in a situation in which the auditor concludes that the two-way communications are not adequate, we believe the auditor should be required to communicate that conclusion to the full board of directors, rather than simply consider whether the communication is necessary, as currently required by paragraph 28.

Other communication requirements

The following includes our responses to the Board's specific questions related to the other communication requirements.

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

    We agree with the other communication requirements, except for the requirement in paragraph 14 related to other information. Although the requirement is consistent with extant standards, it could be modified to apply to audits of issuers. We believe the auditor should be required to only communicate identified material inconsistencies and material misstatements of fact and the adequacy of management's related response. The Board may also consider amending paragraph .05 of AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*, which currently requires the auditor to discuss material misstatements of fact with the "client," rather than the audit committee.

    With respect to the requirement in paragraph 19, we suggest the Board include a reference to paragraph .11 of AU sec. 508, *Reports on Audited Financial Statements*, which identifies the circumstances requiring an explanatory paragraph or other explanatory language in the auditor's report. We also recommend the Board obtain feedback from audit committees as to whether they believe it is necessary to obtain the proposed wording of the auditor's report in all circumstances, such as for consistency references or reporting on supplementary information. Many of the matters covered by paragraph .11 of AU sec. 508 are also addressed by other communication requirements in the proposed standard. In addition, the report may contain the same modifications from year to year.

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?

    Overall, we believe the matters identified as being significant difficulties in paragraph 21 of the proposed standard are appropriate. We suggest, however, that paragraph 21(e), which deals with management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern, be addressed in conjunction with the requirements in paragraph 16.

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 of the company under audit?

    Although the nature and depth of the communications may vary based on the type of company, the audit committee's interest and sophistication, and the circumstances of the particular engagement, the communication requirements in the proposed standard can be considered fundamentally appropriate, regardless of the company's size or industry. However, as previously expressed, we believe the proposed standard should not require the auditor to communicate all of the matters identified in the proposed standard for every engagement. Also, in revising the proposed standard based on comments received, we request the Board to consider the governance structure related to employee benefit plan audits and how it may affect the auditor's communications.

Appendices

The following includes our response to the Board's specific question related to the Appendices.

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

    We have no comments on the Appendices, other than those included in response to the Board's other questions. With respect to our response to question 4, Appendix C should be modified to include the audit committee's responsibilities, as part of its oversight of the company's financial report process, to inform the auditor of matters of which the audit committee is aware that would affect the overall audit strategy, including the scope, timing, and direction of the audit, which would include matters such as:

    - Views about the risk of fraud, including identified or suspected fraud.
    - Awareness of complaints or concerns regarding accounting or auditing matters.
    - Awareness of violations of laws, regulations, or contracts.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

Grant Thornton LLP

Gary Holstrum
One Beach Drive SE, Suite #1205
St. Petersburg, FL 33701-3954
Phone: 727-867-8751
Email: holstrum@tampabay.rr.com
Web: www.garyholstrum.com

October 21, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington DC 20006 – 2803
Email address: comments@pcaobus.org

PCAOB Rulemaking Docket Matter No. 030

I am pleased to have the opportunity to comment on PCAOB Release No. 2010-0001, "Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards" and on some of the suggestions offered in the September 21, 2010, Roundtable on the topic. To put my comments in perspective, I served as PCAOB Associate Chief Auditor and Director of Research from 2004 through 2006 and as a Consultant to the Office of Chief Auditor for one year prior to that and two years following that, which some may argue should preclude me from commenting. I have had no affiliation with the PCAOB since January 2009 and wish to offer some comments that represent my personal views and should not be attributed to the Board on the PCAOB staff.

I have followed this project from its inception and strongly believe the proposed standard represents a significant step in the right direction. I wish to offer a few suggestions for consideration.

1. ENHANCING COMMUNICATION RICHNESS AND AVOIDING CHECKLIST MENTALITY

All of the suggested communication items discussed in the proposed standard seem appropriate. However, the key to effective two-way communication is to utilize appropriate means for communicating and discussing these items without creating information overload for the audit committee members or a "checklist mentality" for the auditor. An excellent suggestion made during the Roundtable was to concentrate on the richness of the communication (versus the leanness of communication associated with a checklist). (See the Roundtable comments of Dr. Lisa Gaynor, who was a member of the Research Synthesis Team on Auditor Communications with Audit Committees).

2. NEED TO ADDRESS BOTH AUDITORS AND AUDIT COMMITTEES

Effective two-way communication requires both effective auditors and effective audit committees. Although the PCAOB does not have authority over audit committees, it would seem appropriate to recognize (perhaps in the explanatory language of the release rather than in the body of the standard) that achieving the ultimate objective sought through auditor communications with audit committees requires that both parties need to be effective. The PCAOB has responsibility for addressing issues related to auditor effectiveness, but the issue of improving audit committee effectiveness also needs to be addressed. Although audit committee effectiveness has been improved in recent years, many audit committees lack the necessary levels of competence, independence, and power needed to function at the appropriate level.

3. SOME RESULTS OF RESEARCH MAY BE INTEGRATED INTO THE STANDARD OR SUGGESTIONS FOR BEST PRACTICES

The Auditing Section of the American Accounting Association established a team of researchers to prepare a synthesis of existing research that was relevant to auditor communications with audit committees. The results were shared with the staff of the PCAOB Office of Chief Auditor and published. A list of the key findings of this research synthesis is shown in the Appendix of this letter (under separate cover).

4. COMMENTS ON SPECIFIC ITEMS
   a. Paragraph 5. You may wish to consider including responsibilities of the audit committee as part of the suggested engagement letter. This is important because the audit committee may receive information (from management, internal audit, whistleblowers, or others) that is relevant to the auditor and should be communicated to and discussed with the auditor.
   b. Paragraph 12. The importance of two-way communication could perhaps be enhanced by changing "communicate to" (which entails

one-way communicate) to "communicate to and discuss with" (which entails two-way communication). The phrase "communicate to" suggests "leanness" of communication and may encourage a checklist mentality, while the phrase, "communicate to and discuss with" suggests a much richer form of two-way communication

5. COMMUNICATION REGARDING BROADER FINANCIAL REPORTING ISSUES

If audit committees are effectively performing their roles, they are responsible for financial reporting issues and areas that extend beyond the audited financial statements and reviewed quarterly information. It would seem helpful for the standard to address the desirability of two-way communication between the auditor and the audit committee regarding these broader financial reporting areas, without implying that these broader areas needed to be subject to audit attestation. (See Roundtable comments of J. Michael Cook).

I look forward to your moving forward with this proposed standard and hope these comments are helpful.

Sincerely,

Gary L. Holstrum, Ph.D., CPA, CFE, CFF
(Former PCAOB Associate Chief Auditor and Director of Research)

APPENDIX TO HOLSTRUM COMMENT LETTER
ON PCAOB Rulemaking Docket Matter No. 030

TABLE 1
Implications of Research Findings for PCAOB Standard on Communications and Relations with the Audit Committee

Financial Reporting Quality
● FRQ1: Given the significant impact of the audit committee and the board in reducing the likelihood of fraud and restatements, it is advisable that there be frequent communications between the auditor, the audit committee, and the board.
● FRQ2: Communications between the audit committee and the auditor should include discussions of areas susceptible to earnings management.
● FRQ3: The auditor and the audit committee should discuss factors that are not included in the financial statements that might drive managers to make aggressive accounting choices, such as analyst forecast data.
Internal Controls
● IC1: The nature and extent of communication between the auditor and the audit committee should vary based on whether the control weakness/deficiency relates to entity- or account-level controls.
● IC2: Firm-specific factors (e.g., financial distress, client size) should influence the communication about internal control issues between the auditor and the audit committee and/or require the auditor to communicate directly with the board on matters related to internal control.
● IC3: The audit committee and the auditor should pay attention to accruals quality when material internal control weaknesses or deficiencies are identified.
● IC4: Auditors' observations with respect to the effectiveness of the audit committee in discharging its responsibilities should be directly communicated to the board of directors.
● IC5: Given the important role played by the internal audit function in enhancing internal controls and quality financial reporting, there should be required communication between the audit committee and the external auditor on the quality of the internal audit function.
● IC6: The audit committee should take a proactive role in promoting an atmosphere to protect whistleblowers including discussing this process with the auditor.
External Auditor Performance
● EAP1: It is important for the auditor to communicate to the audit committee not only all relationships with the client and the nature of all services, but also if and how a proposed nonaudit service will be beneficial to the audit.
● EAP2: The auditor should report all consequential issues and proposed adjustments to the audit committee, regardless of whether they are resolved with the client.

● EAP3: The auditor should describe to the audit committee the process used for resolving contentious issues.
● EAP4: The auditor should report the nature of the partner-CFO relationship and explain the reason(s) for proposing a change of partner prior to the rotation period mandated by the Sarbanes-Oxley Act.
● EAP5: The auditor should not only communicate the proposed level of audit and nonaudit fees to the audit committee, but also indicate how the fees were determined, with explicit consideration of achieving quality services. One avenue for disclosing this information is in the engagement letter.
● EAP6: Mandating the requirement for an engagement letter conforms to current best practices. It might also be useful to consider explicitly outlining the responsibilities of the audit committee in the engagement letter along with those of management and the auditor.

Other Issues

● OI1: The audit committee and the auditor should pay more attention to the Management's Discussion and Analysis (MD&A), and they should evaluate each of the components of the MD&A as well as look at the convergence of the MD&A with external information.
● OI2: The complexity of information being conveyed, the potential issues of conflict, and the need for a formal record or precise language should determine whether communication should be written and/or oral. Using combinations of communication forms may be preferable in many circumstances.

Source: Cohen, Jeffrey; Lisa Milici Gaynor; Ganesh Krishnamoorthy; and Arnold M. Wright. "Auditor Communications with the Audit Committee and the Board of Directors: Policy Recommendations and Opportunities for Future Research," Accounting Horizons (Vol. 21, No. 2, June 2007, pp. 165-187).

ILLINOIS CPA SOCIETY

May 28, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society ("Committee") is pleased to comment on the Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards.

The Committee is a voluntary group of CPAs from public practice, industry, education, and government. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

Following are the Committee's responses to the questions included in the Appendix:

1. Are the objectives of the auditor in the proposed standards appropriate? If not, why? Should other matters be included in the objectives?

   We agree that the objectives for this standard are appropriate. They address the intent of the standard to strengthen the auditor communications with the audit committee. We recognize that the level and extent of two-way communication between the auditor and the audit committee will depend on the circumstances and parties to the audit. However, we agree that effective dialogue, communication and understanding between the auditor and audit committee is critically important.

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?

   We believe the objectives are reasonably articulated. The committee believes that further information on intent and outcomes with respect to two-way communication would be beneficial. In that respect, guidance that would help the auditor assess the level of understanding and/or comprehension of the communications between the parties would be of particular benefit.

ILLINOIS CPA SOCIETY

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

   We feel it is appropriate for an engagement letter to be prepared annually since this will eliminate any chance of misunderstandings related to engagement terms. In addition, since audit committee members may change, an annual engagement letter is appropriate.

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

   We feel the engagement letter items to be adequate.

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?

   The proposed requirement to inquire of the audit committee is appropriate. Another suggestion would be to inquire as to the financial risks or concerns the audit committee has related to the Company.

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?

   The audit strategy and timing would be a useful discussion. The auditor should be able to utilize judgment in how much information is communicated to the audit committee in order not to jeopardize or bias certain audit procedures.

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?

   Paragraph 10 refers to additional communications that should be made with respect to those participating in the audit. The list provides assistance, but is not precise in assisting the auditor in determining what specialists or entities should be considered in the disclosure. The auditor frequently relies on specialists in performing the audit, including those internal and external to the audit firm. It is not clear if both of these expert areas are in scope. Additionally, it is not entirely clear whether disclosure of the use of other firms is intended to capture those of a non-affiliated nature or those that a part of a CPA firm national, global or competency structure. Additionally, would suggest that there is greater

ILLINOIS CPA SOCIETY

clarification around the requirement regarding the affirmation of the auditor they he/she can serve as the principal auditor. Such clarification would address whether that requirement is intended to cover competency, independence, etc. and is it designed to address the firm name that is signing the audit report or the individual audit partner in charge of the engagement.

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)?

    We would like further clarification related to section 12(a)(ii). The section discusses the required communication related to "anticipated" application of new accounting or regulatory pronouncements. The impact of the changes should be calculated by the Company and it seems unreasonable to require the auditor to "anticipate" the impact.

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

    We feel this is helpful.

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

    It is appropriate.

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?

    We would like additional clarification regarding the "information that supports or challenges such changes" to significant assumptions or processes discussed in 12(b)(iii).

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

    We do not feel it would be beneficial to require consultations with outside parties. This information may be included when the auditor feels it appropriate but should not be required. In addition, we would prefer the Board to reconsider the requirement of any communications by the auditor of consultations with other accountants. During a time when the accounting rules become more complex and

ILLINOIS CPA SOCIETY

technical, we feel that it is a good practice for entities to reach out to other accountants as experts to help them navigate the accounting rules. We feel the requirement to inform the audit committee of knowledge of discussions with other accountants to be outdated and of limited utility. This should only be communicated if the auditor has suspicion that the Company is engaged in "opinion shopping."

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

    The communication requirement is clear.

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

    We do not feel it would be appropriate to provide the audit committee with the auditor's basis for determining the uncorrected misstatements were immaterial. The auditor has the requirement to make an assessment as to the materiality of the uncorrected misstatements and the audit committee should make that determination independently of the auditor's assessment. Since the financial statement are the Company's (inclusive of the audit committee's) the assessment is the responsibility of the Company independent of the auditor's assessment.

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

    We don't feel corrected misstatements identified by management should be communicated to the audit committee. In practice, management generally provides the auditor with a preliminary financial statement or trial balance subject to certain adjustments as the Company finishes their process which allows the auditor to begin the audit. It becomes difficult to then establish the proper time period to begin the communications process if management makes an adjustment to a preliminary trial balance.

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?

    We believe that oral communications is appropriate in certain circumstances and should be allowed.

ILLINOIS CPA SOCIETY

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

    We believe that all items should be communicated annually and only items that change during the interim period be communicated at that point in time.

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

    We believe that more information on a formal evaluation of the communication process is appropriate. We see the benefits of effective two-way communication but do not believe that a documented evaluation of what exists provides incremental benefit.

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

    These other requirements are clear.

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?

    Another difficulty could be limited access to management during the audit process.

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 of the company under audit?

    We noted items above that may not be appropriate for smaller or less complex entities.

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

    These appendices are clear.

ILLINOIS **CPA** SOCIETY

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Kevin V. Wydra, CPA
Chair, Audit and Assurance Services Committee

James Gerace, CPA
Vice Chair, Audit and Assurance Services Committee

ILLINOIS CPA SOCIETY

APPENDIX A
AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2010 – 2011

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public practice. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

Large: (national & regional)

James J. Gerace, CPA	BDO Seidman LLP
William P. Graf, CPA	Deloitte & Touche LLP
Howard L. Gold, CPA	LarsonAllen LLP
Michael R. Hartley, CPA	McGladrey & Pullen LLP
Jon R. Hoffmeister, CPA	Clifton Gunderson LLP
James R. Javorcic, CPA	Mayer Hoffman McCann
Michael J. Pierce, CPA	McGladrey & Pullen LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Medium: (more than 40 professionals)

Jennifer E. Deloy, CPA	Frost, Ruttenberg & Rothblatt, P.C.
Andrea L. Krueger, CPA	Corbett, Duncan & Hubly, P.C.
Stephen R. Panfil, CPA	Bansley & Kiener LLP
Marites U. Sy, CPA	E.C. Ortiz & Co, LLP

Small: (less than 40 professionals)

Scott P. Bailey, CPA	Bronner Group LLC
Julian G. Coleman, Jr., CPA	Horwich Coleman Levin LLC
Sharon J. Gregor, CPA	Selden Fox, Ltd.
Loren B. Kramer, CPA	Kramer Consulting Services, Inc.
Ludella Lewis	Ludella Lewis & Company
Richard D. Spiegel, CPA	Steinberg Advisors, Ltd.

Industry:

Janis D. Potter, CPA	MTL Insurance Co.
Brian D. Wetters, CPA	BP

Education:

James C. Westland, CPA	University of Illinois Chicago

Staff Representative:

Paul E. Pierson, CPA	Illinois CPA Society

INSTITUT DER WIRTSCHAFTSPRÜFER

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)2 11 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)2 11 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

Mr. Martin F. Baumann
Associate Chief Auditor
Public Company Accounting Oversight Board
c/o Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803
USA

By E-mail: comments@pcaob.org

May 28, 2010

Dear Mr. Baumann,

Re.: PCAOB Rulemaking Docket Matter No. 030
PCAOB Release No. 2010- 001, March 29, 2010
Proposed Auditing Standard Related to Communications with Audit Committees
And Related Amendments to Certain PCAOB Auditing Standards

We would like to thank you for the opportunity to comment on the PCAOB's Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to PCAOB Standards (hereinafter collectively referred to as the "proposed standard"). We are commenting on this proposed standard because it is directly relevant to the members of the German Wirtschaftsprüfer profession that audit the financial statements of SEC-registrants or their subsidiaries, and because PCAOB standards do influence standards setting elsewhere, including that of the International Auditing and Assurance Standards Board (IAASB). We submit our comments as follows:

Alignment with Auditing Standards Promulgated by the IAASB

As we have previously commented in a number of letters to the PCAOB, we welcome the updating of the PCAOB's interim standards, and particularly welcome the efforts made to align the proposed standards with the ISAs as a measure towards the international convergence of auditing standards needed for international capital markets. We would certainly encourage the PCAOB to continue doing so, and even to increase its efforts in this regard.

Indeed, our main area of concern in respect of this proposed standard revolves around the issue of compatibility with the respective IAASB standards dealing with communications between an auditor and those charged with governance, which we discuss in more detail below.

Fostering Effective Two-way Communication

The IAASB has recently revised ISA 260 "Communication with Those Charged with Governance" and developed a new auditing standard, ISA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", both of which cover communications between the auditor and those charged with governance of the entity subject to audit.

One particular aspect the IDW considers to be especially helpful in potentially enhancing audit quality is the move away from the so called "one-way" approach of the predecessor version of ISA 260 whereby an auditor communicates certain matters arising from the audit of financial statements to those charged with governance in order to assist them in fulfilling their governance role. The new approach, whilst retaining this aspect, is also aimed at fostering a constructive working relationship between auditors and those charged with governance. It is conceivable that those charged with governance will possess information to which the auditor may otherwise not, or not readily, become privy. Effective two-way information of this nature may potentially help enhance the quality of the audit. Therefore the revised ISAs aim to promote a more balanced two-way exchange of information such that when those charged with governance have additional information relevant to the audit (e.g., their views on risks affecting the entity, knowledge pertaining to possible fraud involving collusion), the auditor will become privy to this and the quality of the audit will potentially be enhanced (e.g., risk responses can be more effective, procedures can be sensitized to the potential for fraud involving collusion).

Whilst we recognize that there are necessarily certain differences between "those charged with governance" as used in the ISAs and the "audit committee" dealt with in the proposed standards, we would expect that being a committee of the board of directors, the audit committee would posses a detailed knowledge of the entity. The PCAOB, however, does not appear to view the propensity for the audit committee to provide information to the auditor as particularly significant in the proposed standard, since other than the one requirement of paragraph 8 for 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, this aspect is less prevalent in the standard than is the case of ISA 260. The proposed standard concentrates primarily on the auditor imparting specified information to the audit committee.

For example, in respect of risk assessment, we recognize that the currently Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk would also require the auditor to inquire of the audit committee about the risks of material misstatement. However, we are not aware of other required communicative measures aimed at having auditors promote a two-way exchange of information beyond this initial inquiry and that of paragraph 8 mentioned above. Indeed, paragraph 9 of the proposed standard requires the auditor discuss the significant risks identified (by the auditor) during risk assessment procedures, without suggesting that two-way discussions could be useful, particularly if further information has become available to the audit committee or the committee believes the auditor's assessment may be incomplete or incorrect. In our view, if it is to be effective, such a two-way exchange should not be constrained to initial inquiries and subsequent one-sided reporting of the auditor's own risk assessment.

In addition, the requirement of paragraph 26 as to the adequacy of the two-way communication appear to revolve around matters communicated to the audit committee and their reactions thereto, rather than any additional information the audit committee may impart to the auditor. This seems incongruent with the requirement in paragraph 27 for the auditor to evaluate the effects of inadequate two-way communication on the auditor's assessment of risk and ability to obtain appropriate audit evidence.

Furthermore, it is unclear to us how, based on the remainder of the proposed standard, an auditor may reach a determination that the two way-communication was so inadequate as to warrant the measures to be considered in paragraph 28, which include modification of the auditor's opinion on the basis of a scope limitation and withdrawal from the engagement.

Formulation of Objectives

Comparison of the objectives of the proposed standard with those of ISA 260, whilst revealing similarities, also reveals significant differences in approach. Paragraph 9 (b) and (d) of ISA 260 specify the following two objectives:

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

- *"To obtain from those charged with governance information relevant to the audit ", and*
- *"To promote effective two-way communication between the auditor and those charged with governance".*

Paragraph 3d. of the proposed standard merely includes:

- *"Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit"*.

Our concern is twofold. Firstly, in relation to fostering two-way communication as discussed above, the proposed standard's objectives are inadequate in comparison with those of ISA 260. Also, as we explain below, this objective is, in any case, not supported by requirements sufficient to ensure such evaluation could conclude that the two-way communications were indeed adequate to support the objectives of the audit. Secondly, the wording of paragraph 3 is not akin to that of true objectives; rather it reads as a list of requirements. The auditor needs to be able to use objectives as a sort of "benchmark", such that having complied with the requirements of a standard, he or she can ask the question "have the objectives been met?". Where this is not the case, the auditor would determine further audit work to be performed to meet the objective, or where the objective cannot be so met, determine the impact on the audit and ultimately the auditor's report.

Prescriptive Nature of the Proposed Standard as to Communication Content

We note that specific information required to be communicated by the proposed standard exceeds but does not necessarily appear to equate with that specified in Section 204 of the Sarbanes-Oxley Act of 2002 (SOX) for an auditor to report to the audit committee. SOX Section 301 provides that the audit committee oversee the auditor's work (including resolution of disagreements between management and the auditor regarding financial reporting), and also provides that the audit firm shall report directly to the audit committee, although without detailing the informational content of such reporting. We therefore presume that the PCAOB intention is that the information specified in the proposed standard is, when taken as a whole, aimed at enabling the audit committee to fulfill this responsibility under Section 301 of SOX.

INSTITUT DER WIRTSCHAFTSPRÜFER

In our opinion, the level of detail within the requirement paragraphs is, however, overly prescriptive, in particular, in comparison to the corresponding more principles-based requirements of ISA 260. The PCAOB has not made a convincing case that all such differences arise from the US legal environment.

In our view, it may be counterproductive to construe the role of the audit committee in overseeing the auditor's work as necessitating a list of specific information designed to provide evidence that the auditor has performed certain routine quality control measures and specific, often routine procedures. Yet the matters identified in the standard seem to imply a move towards this "checklist" mentality, which, we are concerned, will encourage auditors to produce copious reports in an attempt to "cover their backs". In contrast, we believe it is the *significant* matters and audit findings that need to be communicated. There is a danger that auditors and audit committees may become overly focused on adhering to the required informational exchange as set forth in the proposed standard and "fail to see the wood for the trees". As a result important information – irrespective of which party is communicating it – may be overshadowed such that its significance is not readily apparent to the recipient.

Such overprescription may also be detrimental to an effective two-way exchange of information, since, if a matter is not listed in the requirements of the standard it may not be communicated at all. Furthermore, as we have commented on a number of previous occasions, overprescription discourages auditors from excising their professional judgment appropriately, and this may not be conducive to enhancing audit quality.

If you have any further questions about our comments, we would be pleased to discuss our comments with you.

Yours very truly,

Gillian G. Waldbauer

Klaus-Peter Feld
Executive Director

Gillian G. Waldbauer
Technical Manager

541

KPMG LLP
757 Third Avenue
New York, NY 10017

Telephone 212-909-5600
Fax 212-909-5699
Internet www.us.kpmg.com

May 28, 2010

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

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

Dear Mr. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2010-001, "*Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*," that includes the proposed standard, "*Communications with Audit Committees.*"

We support the Board's objectives reflected in the proposed standard to (1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee; and (2) emphasize the importance of effective, two-way communications between the auditor and the audit committee. A well-informed audit committee may be better able to carry out its role of overseeing the financial reporting process and the external auditor. We support the continued strengthening of existing requirements, as established by the Sarbanes-Oxley Act of 2002, for auditor communications with the audit committee. We offer the following comments for consideration by the Board in finalizing the provisions of the proposed standard.

This letter is organized by first providing general observations and comments on the proposed standard as a whole, followed by comments on specific issues in an Attachment. Our general observations discussed below are organized based on the following:

- Objectives of the Standard
- Interaction of Certain Proposed Requirements with Existing PCAOB Standards
- Management's Responsibility for Communications with the Audit Committee
- Accounting Policies, Practices and Estimates and the Evaluation of the Quality of a Company's Financial Reporting
- Communications Resulting From Interim Reviews
- Release Text

Objectives of the Standard

The PCAOB has outlined the objectives of the proposed standard to focus the auditor on the following (paragraph 3 of the proposed standard):

- Communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee;
- Communicating to the audit committee an overview of the audit strategy and timing of the audit;
- Providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and
- Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit

We generally believe that these objectives are appropriate for promoting effective two-way communications between the audit committee and the auditor.

We note that paragraph 8 of the proposed standard requires the auditor to inquire whether the audit committee is aware of matters that may be relevant to the audit; however, we do not believe that this requirement is adequately emphasized in the auditor objectives. Given the importance of such communications to the audit, we believe that this requirement should be included as part of the objectives of the auditor. Paragraph 9(b) of the International Auditing and Assurance Standards Board's (IAASB) International Standard on Auditing (ISA) No. 260, *Communication with Those Charged with Governance* (ISA 260) and paragraph 7(b) of the Auditing Standards Board's (ASB) Statement on Auditing Standards (SAS) No. 114, *The Auditor's Communication with Those Charged with Governance* (SAS 114) recognize this communication as an objective, and we recommend the Board consider incorporating this as part of the overall objectives to the proposed standard.

Office of the Secretary
Public Company Accounting Oversight Board
May 28, 2010
Page 3

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 the Board consider whether a more appropriate objective would be for the auditor to *promote* effective two- way communications with the audit committee. We believe that such an objective would help emphasize to auditors the important role communications with the audit committee has to the successful conduct of the audit committee's oversight responsibilities as well as to the successful planning and conduct of the audit. We also believe that this objective is consistent with the proposed requirement in the standard for the auditor to evaluate the effectiveness of the two-way communication.

Interaction of Certain Proposed Requirements with Existing PCAOB Standards

We support the Board's consideration of the work of other standard-setters in the standard-setting process and recognize that the requirement in paragraphs 26 through 28 of the proposed standard related to the auditor's evaluation of the adequacy of two-way communications with the audit committee is consistent with the requirements in analogous standards of ISA 260 and SAS 114. However, we note that other PCAOB standards and proposed standards include consideration of the audit committee as part of the auditor's process in identifying and assessing the risks of material misstatement and, for an integrated audit, the auditor's consideration of the effectiveness of a company's internal control over financial reporting. While it would appear that the evaluation required by the proposed standard would be an input into the auditor's procedures under other PCAOB standards and proposed standards, we believe that the Board should consider more clearly linking how the evaluation requirement relates to the consideration of the audit committee in accordance with the other PCAOB standards and proposed standards.

For example, a few areas where we believe such clarification would be helpful are outlined as follows:

- Paragraphs 25 and 26 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5), contain explicit requirements for the auditor to evaluate the effectiveness of the audit committee as part of the consideration of entity-level controls, including the control environment and the period-end financial reporting process.

- Paragraph 34 of PCAOB Interim Auditing Standards AU Section 319, *Consideration of Internal Control in a Financial Statement Audit*, requires the auditor to consider the audit committee as part of obtaining an understanding of a company's control environment.

- Paragraphs 23 and 24 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, require the auditor to consider whether the audit committee" understands and exercises oversight responsibility over financial reporting and internal control" as part of obtaining an understanding of the control environment and identifying and assessing risks of material misstatement.

We believe linking the requirements between the standards (e.g., through annotating the proposed standard to include cross references to existing and proposed standards) would provide the auditor with additional perspective regarding the impact its evaluation of the effectiveness of the audit committee has, including its communications with the auditor, on the planning and conduct of the audit.

Management's Responsibility for Communications with the Audit Committee

While the PCAOB permits the auditor to consider management's communications to the audit committee for certain communications related to accounting policies, practices and estimates, we do not believe that the PCAOB has adequately emphasized that the auditor's role, particularly in areas related to a company's financial reporting, should be focused on providing an objective perspective on management's judgments involved in the preparation of the company's financial statements. In this regard, we believe that the auditor's starting point in determining the nature and extent of its communications with the audit committee should be its consideration of management's communications.

We are concerned that without such an emphasis throughout the standard, combined with the detailed communication requirements, the auditor may provide significant information that is duplicative to that provided by management or already existing in a company's financial statement disclosures or management's discussion and analysis. This may result in the unintended effect of diluting the information provided, which may reduce the usefulness of the information to the audit committee and potentially encourage more boiler plate communications. All of these possible outcomes would be contrary to the PCAOB's objective of facilitating more effective two-way communications between the auditor and audit committee. The following represent examples within the proposed standard that highlight this concern:

- While the Note at the end of paragraph 12 allows the auditor to consider management's communications to the audit committee when determining the nature and extent of its communications with the audit committee related to a company's accounting policies, practices and estimates, we believe that such a consideration may be appropriate for other matters included within the proposed standard. For example, management may communicate to the audit committee matters related to a company's ability to continue as a going concern (paragraph 16 of the proposed standard) as well as other matters arising from the audit that are significant to the oversight of financial reporting, such as complaints or concerns raised regarding accounting or auditing matters (paragraph 22).

- Paragraph 12(b)(iii) requires the auditor to communicate to the audit committee "a description of the reasons for the changes [to assumptions or processes made to critical accounting estimates]." As currently written, we do not believe that this requirement recognizes that this communication should be management's responsibility.

- 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." However, we are concerned that such a requirement of the auditor may result in a significant increase in information provided to the audit committee at a level of detail that may dilute the impact of such information, as well as may result in significant increases in auditor effort without a corresponding significant 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 believe the requirement as drafted may also result in auditors and management expending significant amounts of time reconciling views around the ranges associated with the corresponding estimates – even after the auditor has already concluded that the recorded amount is reasonable– a process that may not be necessary in each circumstance in order to enhance the discussion of such matters with the audit committee. In addition, in some circumstances, such an exercise to reconcile ranges would be beyond what is required by the auditor in accordance with paragraph 40 of PCAOB Interim Auditing Standards AU Section 328, *Auditing Fair Value Measurements and Disclosures* and paragraph 10 of AU Section 342, *Auditing Accounting Estimates*, when evaluating management's estimates.

Accordingly, we recommend that the Board revise the proposed standard to:

- recognize that the communication of accounting policies, practices and estimates is management's responsibility, and that management would be in the best position to communicate such matters to the audit committee;

- require the auditor to discuss with the audit committee the adequacy of management's communication or, to the extent that such information is included in annual report disclosures, then require the auditor to discuss with the audit committee the adequacy of such disclosures; and

- require the auditor to communicate to the audit committee those accounting policies, practices and estimates where management omitted or inadequately described those matters, or where the auditor is unable to ascertain whether management's communications were adequate.

Accounting Policies, Practices and Estimates and the Evaluation of the Quality of a Company's Financial Reporting

Paragraphs 12 and 13 of the proposed standard require the auditor to communicate information related to a company's accounting policies, practices and estimates. We have provided comments related to paragraphs 12 and 13 in our general observations under "Management's Responsibility for Communications with the Audit Committee," and "Release Text," and specific comments in our Attachment. Although we understand the Board's intent in including the communication requirements of paragraphs 12 and 13, we believe the requirements, as currently written, are difficult to comprehend and apply and may lead to the unintended consequence of inconsistent application by different auditors. For example, the requirements in paragraph 12 focus on information related to a company's accounting policies and practices, however, there are references to “significant accounting policies,” “accounting policies, practices, and estimates” and “critical accounting estimates.” Paragraph 13 focuses on the auditor’s evaluation of the quality of a company’s financial reporting, however, there are also references to both “significant accounting policies and practices” and “critical accounting policies and practices.” While the terms “critical accounting estimate” and “critical accounting policies and practices” are defined in the proposed standard, it is difficult to understand the intended differences in communication requirements between these items and “significant accounting policies and practices” and “accounting policies, practices and estimates.” We recommend the Board consider revising the organization of paragraphs 12 and 13 to improve the structure and increase the clarity of the Board’s communication requirements.

Communications Resulting From Interim Reviews

Item (e) in page 4 of Appendix 2 of the proposed standard details amendments to paragraph 34 of PCAOB Interim Auditing Standards AU Section 722, *Interim Financial Information* (AU 722) to conform this guidance to requirements in the proposed standard. The proposed amendment states the following:

“When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Proposed Auditing Standard, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee. For example, the accountant should communicate a description of the process used by management to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole. Management may communicate, as part of its communications to the audit committee, certain matters identified in paragraph 12 of Proposed Auditing Standard, *Communications with Audit Committees,* regarding accounting policies, practices and estimates, in which case the accountant should determine whether all the matters were adequately described and, if not, the accountant should communicate any omitted or inadequately described matters to the audit committee.”

As currently written, we believe the amendments imply that *any* matters described in the proposed standard, as they relate to interim financial information, would be required to be communicated to the audit committee at each interim period. We believe this would result in the communication of matters that are duplicative to those made by the auditor through its annual communication requirements and could be repetitive from period to period. This may also result in the unintended effect of diluting the information provided, which may reduce the usefulness of the information to the audit committee and potentially encourage more boiler plate communications. The following represent examples within the proposed standard that highlight this concern:

- The proposed amendment above includes an example related to the auditor's communication of a description of management's process to develop critical accounting estimates. We believe that such communication, at each interim period, would result in redundant and/or unnecessary auditor communications to the audit committee.

- 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." In addition to our concerns noted above under "Management's Responsibility for Communications with the Audit Committee," 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. This would be especially true in the case of an initial interim review.

We recommend the Board reconsider the proposed amendments to paragraph 34 of AU 722 by narrowing the communication requirements to only those matters that are considered significant, and/or those matters that have significantly changed when compared to the communications made by the auditor as part of the annual audit. Additionally, because certain communication requirements in paragraphs 12 and 13 of the proposed standard require communications that require a significant level of detail, we recommend the Board allow the auditor to communicate matters at a level of detail commensurate with the scope of procedures performed by the auditor as part of its review of interim financial information.

KPMG

Release Text

As we have noted in our comment letter on the Board's Release No. 2009-007, "*Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards*," we are supportive of the Board's efforts to increase the transparency of the standards-setting process, including efforts to provide its perspective on the differences between its proposed standards and those of the IAASB and ASB, as well as its consideration of comments received. However, we are concerned that in some situations, 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 text. Interpreting standards through release text can result in potential confusion over the requirements within the related standard and result in inconsistent application by the auditor. In addition, given that the release text is not ultimately part of the final standard, any interpretive guidance contained within it may not be given the same consideration by the auditor and other interested parties. As a result, we encourage the Board, to the extent it believes clarifications need to be made within the release text accompanying a standard, to provide such guidance within the final standard as opposed to the accompanying release text.

We have included the following examples where it appears the Board is interpreting aspects of the standard within the release text:

- *Overview of the Audit Strategy and Timing of the Audit* – Paragraph 10(d) of the proposed standard requires the auditor to communicate the "roles, responsibilities, and locations of firms participating in the audit." The corresponding section within the release text on page 9 makes clear that the Board believes this communication should include participation of *affiliated* or *network* firms. We note that since this expectation is not explicit in the proposed standard, it could be misunderstood such that only firms that are outside of a firm's network need to be disclosed pursuant to this requirement.

- *Establish a Mutual Understanding of the Terms of the Audit* – Page 6 of the release text indicates that the engagement letter is required to be "*provided annually*" yet in paragraph 6 of the proposed standard, there is no indication that the engagement letter is required to be provided annually. We acknowledge that paragraph 25 of the proposed standard requires that all communications pursuant to the standard should be made annually; however, the release text could be interpreted such that the use of "evergreen" letters is precluded. We suggest that the

KPMG

Board clarify its intent in order to minimize any potential misunderstanding. See an additional specific comment in our Attachment.

- *Issues Arising from the Audit* – Paragraph 12(a)(ii) of the proposed standard requires the auditor to communicate the "anticipated applications by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on a company's financial reporting." Page 8 of Appendix 3 notes that the auditor may include in this discussion any views it has developed related to the potential impact of the application of such pronouncements on a company's financial reporting process, including changes to processes or systems, that would not otherwise be disclosed by the company in the financial statements. Page 10 of the release text clarifies that this communication requirement is intended to go beyond the requirements for management under SEC Staff Accounting Bulletin No. 74, *Disclosure Regarding Accounting Standards Issued but Not Yet Adopted* (SAB 74). However, the language within the proposed standard appears to be consistent with the requirements of SAB 74, which we believe is appropriate. We recommend that the proposed standard be consistent with, and not exceed, the requirements of SAB 74. This would allow the audit committee and the auditor to determine the appropriate depth of discussion of the potential impact accounting and regulatory pronouncements may have on a company's financial reporting process.

****

We appreciate the Board's careful consideration of our comments, and fully support the Board's efforts with regards to the overall improvements to the audit committee communication requirements. If you have any questions regarding our comments or other information included in this letter, please do not hesitate to contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com or Glen L. Davison, (212) 909-5839, gdavison@kpmg.com.

Very truly yours,

KPMG LLP

cc: PCAOB Members and SEC Commissioners

PCAOB
Daniel L. Goelzer, Acting Chairman
Bill Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC
Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
James L. Kroeker, Chief Accountant

KPMG

ATTACHMENT

#	COMMENT
	Significant Issues Discussed with Management Prior to the Auditor's Appointment or Retention
1	Paragraph 4 of the proposed standard requires that the auditor discuss with the audit committee "any significant issues discussed with management in connection with the appointment or retention of the auditor, including discussions regarding the application of accounting principles and auditing standards." We also note that page 18 of the release text provides that the communications pursuant to this requirement are not intended to include only discussions that occur around the time of the auditor's reappointment, but could include discussions throughout the audit engagement period. An auditor typically has discussions with management throughout the engagement period related to the application of accounting principles and auditing standards. Given the communication requirements currently included in the proposed standard related to accounting policies, practice and estimates, it is unclear whether this requirement is intended to provide any incremental communications and if so, the nature of those communications. Without additional clarity, we are concerned that the auditor may be required to provide additional information regarding accounting or auditing matters that may not be meaningful to the audit committee's oversight, potentially complicating communications and detracting from the effectiveness of the two-way communications. As such, we believe the Board should clarify the intent of this requirement and at a minimum, clarify that the auditor should communicate any discussions related to these matters that the auditor deems significant and that have occurred since the auditor's last appointment.
	Establish a Mutual Understanding of the Terms of the Audit
2	Paragraph 5 of the proposed standard states that a mutual understanding of the terms of the audit should be established including communicating the objective of the audit, the responsibilities of the auditor and the responsibilities of management within the audit engagement letter. Given the important role that the audit committee plays in the oversight of a company's financial reporting, we suggest that the Board also require that the responsibilities of the audit committee be documented within the audit engagement letter. Outlining the audit committee's responsibility within the audit engagement letter, in addition to the responsibilities of the auditor and of management, would help establish a mutual understanding of all parties' roles and how they relate to the audit of the company's financial statements.
	Overview of the Audit Strategy and Timing of the Audit
3	Paragraph 8 of the proposed standard 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." Additionally, this paragraph references paragraph 53(b)(3) of the Proposed Auditing Standard, *Identifying and Assessing Risks of Material* Misstatement, which "requires the auditor to inquire of the audit committee, or its chair, whether the audit committee is aware of tips or complaints regarding

	the company's financial reporting…" We believe the Board should emphasize that this requirement is not limited to matters that arise from complaints or concerns raised regarding accounting or auditing matters for which the audit committee is aware. We believe this could be accomplished by modifying the requirement as follows: "The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit including, *but not limited to, non-compliance of laws and regulations, knowledge of illegal acts or potential illegal acts and* complaints or concerns raised regarding accounting or auditing matters."
4	Paragraph 10(a) of the proposed standard requires the auditor to communicate "whether persons with specialized skill or knowledge are needed to apply the planned audit procedures or evaluate the audit results." We note that audit teams routinely include internal tax and information technology specialists as part of the audit team. It is not clear whether these individuals were intended to be included in this communication. However, we do not believe that including these individuals would provide the audit committee with meaningful information given the prevalence of such individuals on the audit team and recommend the Board consider excluding them from the requirement.
5	Paragraph 10(d) of the proposed standard requires the auditor to communicate the roles, responsibilities, and locations of firms participating in the audit. As written, the requirement is unclear as to whether firms "participating in the audit" is intended to exclude insignificant locations that are not considered in the scoping of a group audit (e.g. locations that are insignificant to the audit but where the auditor conducts a statutory audit). We note that currently the audit committee is required to pre-approve the scope of services provided by the auditor and generally would be aware of such situations pursuant to its approval process. As such, providing all locations pursuant to this requirement could result in unnecessary duplication and could potentially be burdensome (especially for larger engagements with multiple locations). Therefore, we believe the Board should consider whether the proposed requirement should include only those locations that were included within scope for the audit.
6	Paragraph 10(e) of the proposed standard requires the auditor to communicate the basis for the auditor's determination that he or she can serve as principal auditor. For the majority of audits, this conclusion does not require significant judgment and as such, could encourage boiler plate communications to the audit committee that do not enhance its oversight responsibilities. We recommend the Board consider requiring such communications only in situations where more than insignificant portions of the audit are performed by other auditors. We note that paragraph 49 of ISA No. 600, *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)* provides useful guidance for communicating the principal auditor's involvement with other auditors that appear to be consistent with the objective of the proposed communication requirement.

KPMG

Accounting Policies, Practices, and Estimates	
7	Paragraph 12(a)(ii) of the proposed standard 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 believe it is unclear what "regulatory pronouncements" is referring to. As stated previously in our general observations, we believe mirroring the auditor's communication requirements with those provided in SAB 74 is appropriate.
8	Paragraph 12(a)(iii) of the proposed standard requires the auditor to communicate the methods used by management to account for significant and unusual transactions. Paragraph 7 of PCAOB Interim Auditing Standards AU Section 380, Communications with Audit Committees (AU 380) states, "the auditor should also determine that the audit committee is informed about the methods used to account for significant unusual transactions." Additionally, recently issued PCAOB Staff Audit Practice Alert No. 5, Auditor Considerations Regarding Significant Unusual Transactions, uses the terminology "significant unusual transactions." We believe the Board should use terminology within the proposed standard that is consistent with existing PCAOB standards and guidance.
9	Paragraphs 13(a) and 13(b) of the proposed standard propose communication requirements related to both a company's significant accounting policies and practices and critical accounting policies and practices. Paragraph 7 of AU 380 requires the auditor to communicate certain information related to significant accounting policies. SEC Rule 2-07 of Regulation S-X (SX 2-07) requires the auditor to communicate all critical accounting policies and practices. We believe that the Board intended the communication requirements in paragraph 13(a) and 13(b) to be consistent with, and not exceed, the requirements of AU 380 and SX 2-07 based on the Board's discussion on page 10 and 11 of the release text. Specifically, the Board stated on page 11 of the release text that the "proposed standard includes requirements that are consistent with those in SX 2-07." However, the following is an example of a communication requirement that appears to be incremental to SX 2-07: • Paragraph 13(b)(iii) of the proposed standard requires 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 related to a company's critical accounting policies and practices." We believe that this proposed requirement is incremental to the requirements of SX 2-07 as it relates to the auditor's consideration of "anticipated future events" that may affect the assessment of whether certain policies and practices are considered critical. Also, without additional guidance related to how an auditor should anticipate future events and determine whether they are relevant and / or likely to impact a company's current policies or practices, we are concerned that the auditor, management and the audit committee may spend unnecessary time and effort discussing matters that may not be meaningful and / or relevant to the audit committee's oversight responsibilities.

KPMG

	We recommend that the Board clarify that paragraphs 13(a) and 13(b) are intended to be consistent with, and not exceed, the requirements of AU 380 and SX 2-07. However, if the Board intends to prescribe communication requirements that exceed the existing requirements of AU 380 and SX 2-07, the Board should provide further clarification regarding any communications that are incremental to existing requirements.
Management Consultations	
10	Question #12 in the release text regarding paragraph 15 of the proposed standard asks whether this requirement 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. We do not believe the proposed standard should be expanded to include management consultations with non-accountants. Such a requirement may imply that the auditor has more knowledge about consultations management undertakes than is the case. This could result in the unintended consequence of auditor's performing procedures to determine whether such consultations have occurred in order to communicate them to the audit committee. We do not believe that such an effort, combined with the fact that such communications may not be relevant to the audit, will provide a commensurate benefit to the audit committee's oversight.
Going Concern	
11	Paragraph 16 of the proposed standard requires the auditor to communicate certain matters related to the consideration of a company's ability to continue as a going concern. We support the intended objectives of this requirement. As written, however, we believe there are some inconsistencies in the proposed construction of the paragraph that may lead to confusion in complying with the requirement. As such, we propose the following alternative construction for your consideration: "If the auditor believed, prior to considering management's plans intended to mitigate conditions and events that indicate there could be substantial doubt about a company's ability to continue as a going concern, there was substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, the auditor should communicate the following: • The conditions and events that caused the auditor to believe that there was substantial doubt about the entity's ability to continue as a going concern; • The auditor's consideration of management's plans to overcome the conditions and events, management's ability to implement the plans, and whether such plans mitigated the auditor's doubt;

KPMG

	• The effects, if any, on the financial statements, and on the adequacy of the related disclosure; and • The effects, if any, on the auditor's report." We believe that this alternative construction reflects the auditor's performance requirements pursuant to PCAOB Interim Auditing Standards AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AU 341), and will lead to more consistent application of this communication requirement. If the Board determines not to revise paragraph 16 as we propose, we recommend that the Board address, at a minimum, the following specific concerns related to the requirements in paragraph 16: 1. Paragraph 16(a) 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 the threshold "could" may result in an unintentional change from the current requirement in AU 341 for the auditor to obtain information if the auditor believes that there is substantial doubt about the entity's ability to continue as a going concern. 2. Paragraph 16(b)(i) requires the auditor to communicate the "auditor's assessment of management's plans to overcome the conditions and events and management's ability to implement the plans." We recommend that the word assessment be changed to consideration to be consistent with AU 341. 3. Remove "if any" in paragraph 16(b)(iii). If the auditor has concluded there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, we believe that there would be an effect on the auditor's report.
Corrected and Uncorrected Misstatements	
12	Question #15 in the release text asks whether the proposed standard should require all corrected misstatements, including those detected by management, be communicated to the audit committee. Management may identify a number of adjustments to its financial statements as part of the financial statement close process and correct the financial statements accordingly. We are concerned that an auditor may not have knowledge of all of such "misstatements" due to the nature of a company's financial statement close process and the timing of the auditor's procedures. Establishing such a requirement would likely result in auditors expending significant efforts to identify misstatements that were previously captured by the company's internal controls, and do not believe that the knowledge of such misstatements would significantly enhance the audit committee's oversight.

KPMG

13	Paragraph 18 of the proposed standard requires the auditor to communicate the implications that corrected misstatements might have on the financial reporting process. It appears that this requirement relates to the auditor's consideration of the impact a misstatement may have on an auditor's consideration of a company's internal control over financial reporting. Given the communication requirements related to significant deficiencies and material weaknesses for integrated audits in AS 5, and PCAOB Interim Auditing Standards AU Section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AU 325) for non-integrated audits, we recommend the Board clarify how the proposed requirement relates to those included in AS 5 and AU 325. Additionally, we believe the Board should restrict this requirement to those corrected misstatements that are considered significant. Otherwise, the auditor might be required to communicate numerous insignificant misstatements simply because management chose to record them in the current period. We believe this could be accomplished by modifying the requirement as follows: "The auditor also should communicate those *significant* corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications such *significant* corrected misstatements might have on the financial reporting process."
14	The Note accompanying paragraph 18 states, "The auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit." We recommend the Board include references to Staff Accounting Bulletin No. 99, *Materiality* and Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* as part of this communication requirement.
Departure from the Standard Auditor's Report	
15	Paragraph 19 of the proposed standard states, "When the auditor expects to modify the opinion in the auditor's report or to include an explanatory paragraph in the report, the auditor should communicate with the audit committee the reasons for the modification or explanatory paragraph and the proposed wording of the report." We believe the Board should consider excluding from the communication requirements those standard report modifications related to consistency explanatory paragraphs (e.g. situations where the auditor's report discloses the adoption of a new accounting principle). We do not believe such matters should be subject to specific communication requirements given that such matters are subject to other communication requirements contained within the proposed standard and will be clearly disclosed in the financial statements (which are subject to audit committee review).
Difficulties Encountered in Performing the Audit	
16	Paragraph 21(b) of the proposed standard states the auditor should communicate significant difficulties encountered during the audit including an unnecessarily brief time within which

KPMG

	to complete the audit. We suggest the Board consider using "inappropriately" rather than "unnecessarily" in the above requirement. We believe such a change would more clearly articulate the situations in which an auditor should provide such a communication to the audit committee.
Form and Content of Communications	
17	Question #16 in the release text regarding paragraph 23 of the proposed standard asks whether the proposed standard should require that all or just certain matters be communicated to the audit committee in writing. We believe 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.
Adequacy of the Two-Way Communications	
18	Paragraph 27 of the proposed standard requires that "If the auditor determines that the two-way communications have not been adequate, the auditor should evaluate the effects, if any, on his or her assessment of the risks of material misstatement and on his or her ability to obtain sufficient appropriate audit evidence, and should take appropriate action." This requirement relates to an auditor's action as a result of his/her interactions with the audit committee as opposed to a communication requirement. As such, we recommend the Board consider whether it would be more appropriate to incorporate any such additional guidance within other PCAOB standards that focus on the auditor's assessment of and response to risk.
19	Paragraph 28 of the proposed standard states that the auditor should consider taking the following actions if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved: a. Communicating with the full board of directors; b. Modifying the auditor's opinion on the basis of a scope limitation; or c. Withdrawing from the engagement. In situations in which the auditor determines that the two-way communications are not effective, we believe it would be rare that the auditor would not inform the company's full board of directors. Therefore, we recommend the Board elevate the requirement to communicate with the full board of directors to "should" as opposed to "should consider" to more appropriately describe the auditor's requirement, while retaining the requirement for the auditor to consider modifying its auditor's opinion and withdrawing from the engagement if it is not satisfied with the response from a board of directors.

Lord & Benoit
Shining Light on Section 404 Compliance

J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, DC 20006-2803

Re: PCAOB Release No. 2010-001 Rulemaking Docket Matter No. 030
"Proposed Auditing Standard Related to Communications with Audit Committees and related Amendments to Certain PCAOB Auditing Standards"

Dear Mr. Seymour and Board Members:

Lord & Benoit, LLC appreciates the Board reopening the comment period on the proposal until Oct. 21, 2010 regarding the Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards.

We are supportive of the Board's efforts to strengthen the communications between auditors and audit committees especially as they relate to protecting the interests of investors. Our premise statement throughout mostly refers to two general concepts… *the audit committee must not only be well-informed of accounting and disclosure matters,* ***but also matters of internal controls*** *over financial reporting****.***

Our viewpoints are best amplified by all of the governing boards, policy makers and regulators which is tha that,

> *"The audit committee provides oversight to the effectiveness of internal control over financial reporting AND financial statement preparation*[1]".
>
> *and…*
>
> *The board's [or Audit Committee's] role is one of governance, guidance and oversight. For publicly listed companies, the board's responsibilities may be*

[1] COSO's 2006 Guidance, Internal Control over Financial Reporting – Guidance for Smaller Public Companies

One West Boylston Street
Worcester, MA 01605
508.853.6404 (T)
508.770.1120 (F)

mandated by law, listing-exchange requirements or charter [such as Sarbanes-Oxley Act Section 404(a)][2]".

For background purposes, I have served on the AICPA Peer Review Acceptance Board in MA for ten years and performed nearly 500 Peer Reviews of CPA firms over the past 20 years. I was also appointed to serve on the most recent Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) Monitoring Project Taskforce[3] representing the interests of smaller companies.

I also am the author of the *Lord & Benoit Reports*[4], was the first evaluator to use the 2006 COSO Guidance for Smaller Public Companies, *the* inventor of Virtual SOX taught on the AICPA Technology website, and research contributor to the SEC Subcommittee Internal Controls Subcommittee to the Advisory Committee on Smaller Public Companies, SEC Concept Releases, SEC Interpretive Guidance Regarding Management's Report on Internal Control Over Financial Reporting, and SEC/PCAOB Internal Control Roundtables.

We thank the Board for considering our comments on this important issue. And we would be please to discuss any of these matters in further detail as well, either at BobB@LordandBenoit.com or by calling (800) 404-7794 x204.

Sincerely,

Robert Benoit

Robert Benoit
President
Lord & Benoit, LLC

[2] COSO's 2009 Guidance on Monitoring Internal Control Systems [emphasis or clarification added]
[3] However please not that the opinions expressed herein are my own and may not be the opinions of the COSO Board or Taskforce.
[4] Lord & Benoit research has been referenced by the SEC Commissioners and staff, PCAOB Board members, AICPA, IIA, COSO, RIA, CCH, Wall Street Journal, all Big 4 firms and over other 200 newspapers, magazines, legal, educational and trade journals.

Objectives of the Auditor

Question 1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?

> *We recommend that part (c) which states "providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process", be expanded "to include the auditors objectives, responsibilities and observations made with respect to the company's management assessment of internal controls over financial reporting[5]" This should enhance evaluating the adequacy of the two-way communications between the auditor and the audit committee and their respective responsibilities to obtain an understanding of and assess the effectiveness of internal control objectives, including those in the audit, through consideration of the importance of accounting policies, practices and use of estimates used to prepare the financial statements.*

Establish a Mutual Understanding of the Terms of the Audit

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

> *With regards to the requirement to document the understanding with the audit committee of the services to be performed, we recommend adding language concerning internal controls over financial reporting. The 2009 COSO Guidance on Monitoring Internal Control Systems articulates that although management has the primary responsibility for the effectiveness of an organization's internal control system, the Board or Audit Committee's role is one of oversight in governance and guidance in internal controls over financial reporting. We believe these requirements should be set forth in writing.*
>
> *The engagement letter should also document the understanding of responsibilities of both parties (auditor and Audit Committee) when and if a a management assessment (also called a monitoring or separate evaluation), as required by professional standards, has not performed satisfactorily, such as by following the SEC Interpretive Guidance Regarding Management's Report on Internal Control Over Financial Reporting, which is mandated by law, listing-exchange requirements or charter.*

[5] Particularly for those filers that are considered non accelerated filers not subject to auditor attestation of internal controls.

For instance, would the PCAOB Board consider the omission of documenting and testing internal control considered an illegal act under Section 10A[6] reportable to the shareholders of the company? Or does the omission soley a communication between the auditors and the Audit Committee?

We believe adding these to the engagement letter "would enhance investor protection" and provide clarity in the event of non compliance.

Obtaining Information Related to the Audit

Question 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?

In addition to items listed in the proposed Auditing Standard, Identifying and Assessing Risks of Material Misstatement, we suggest the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement resulting from the entity's documentation and assessment of internal controls over financial reporting.

COSO's 2006 Guidance[7] contains some useful attributes regarding the role of the board of directors. It says, "The board of directors understands and exercises oversight responsibility related to financial reporting and related internal control. The following three questions relate to the attributes of that principle relate to the board's oversight role regarding monitoring.

The following are our recommended questions:

1. *Monitors Risk — Has the audit committee (or a competent and objective evaluator within management or outside party) actively evaluated and monitored risks of management override of internal control and considers risks affecting the reliability of financial reporting?*

2. *Oversees Quality and Reliability — Has the audit committee provided oversight to the effectiveness of internal control over financial reporting by ensuring a management assessments of internal controls over the financial statement process was properly documented and tested?*

3. *Oversees Audit Activities — Has the audit committee overseen the work of internal auditors and its responsibilities for meeting internal control related*

[6] Section 10A of the Securities Exchange Act of 1934, *Audit Requirements*, which include investigation of information that indicates illegal acts may have occurred and, upon the satisfaction of certain criteria, reporting illegal acts to management, the Board of Directors, and the SEC.
[7] *, See COSO's 2006 Guidance, page 23*

regulatory requirements, such as Sarbanes-Oxley Act Section 404(a) as necessary?

We suggest requiring these communications, which are consistent with both professional standards and the Proposal to help encourage greater dialogue between the auditor and the audit committee regarding the risks of material misstatement and other matters relevant to both the audit and management's assessment of internal controls.

Overview of the Audit Strategy and Timing of the Audit

Question 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?

With regard to audit strategy, we suggest the Proposal include guidance (or perhaps better clarify) regarding internal control responsibilities for audits of non accelerated filers, which do not require auditor attestation of internal controls over financial reporting.

Professional standards have always required auditors to obtain a sufficient understanding of an entity's internal controls, now including auditor walkthroughs of internal control procedures. This is to obtain a level of assurance that internal accounting control procedures are being applied as prescribed so that the auditor is assured of the validity of underlying evidence. In accordance with AU 319.02, the auditor is to obtain an understanding of internal control sufficient to plan the audit by performing procedures to understand the design of controls relevant to an audit of financial statements and determine whether they have been placed in operation.[8]

*PCAOB Auditing Standard No. 5 - An Audit of Internal Control over Financial Reporting states that the audit procedures must be **integrated** with An Audit of Financial Statements. The Board firmly believes that those objectives should be met for the auditor to verify that he or she has a sufficient understanding of the points within the processes where misstatements could occur and to properly identify the controls to test."*[9]

We recommend greater clarity be given to the fact that auditor attestation requirement has been removed for non accelerated filers, but that management's assessment has not been eliminated. And that auditors have a responsibility to perform a walkthrough of company level controls, including monitoring, which is the ongoing monitoring by management of internal controls over financial

---

[8] http://www.aicpa.org/download/members/div/auditstd/AU-00319.PDF
[9] PCAOB Auditing Standard No. 5 p. 9

reporting for all filers with years ended after Dec 15, 2007. For greater clarity on this last section please see answers to Question 8 on the next page.

AS 5 additionally notes that "Incorporating the auditor's fraud risk assessment – required in the financial statement audit – into the auditor's planning process for the audit of internal control should promote audit quality as well as better integration.[10] *Related to that is AU 316.20 and .21 (originating from SAS 99) which states that the auditor should inquire of management about "programs and controls the entity has established to mitigate specific fraud risks the entity has identified, or that otherwise help to prevent, deter, and detect fraud,* ***and how management monitors those programs and controls****.*

We believe additional guidance should be provided here with regards to situations where an effective monitoring evaluation is not performed or performed properly.

Or in those cases where a management assessment was properly documented and tested, inquiries should be considered to include whether management has reported to the audit committee or others with equivalent authority and responsibility on how the entity's management assessment of internal controls over financial reporting serves to prevent, deter, or detect material misstatements due to fraud."[11]

Accounting Policies, Practices, and Estimates

Question 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)?

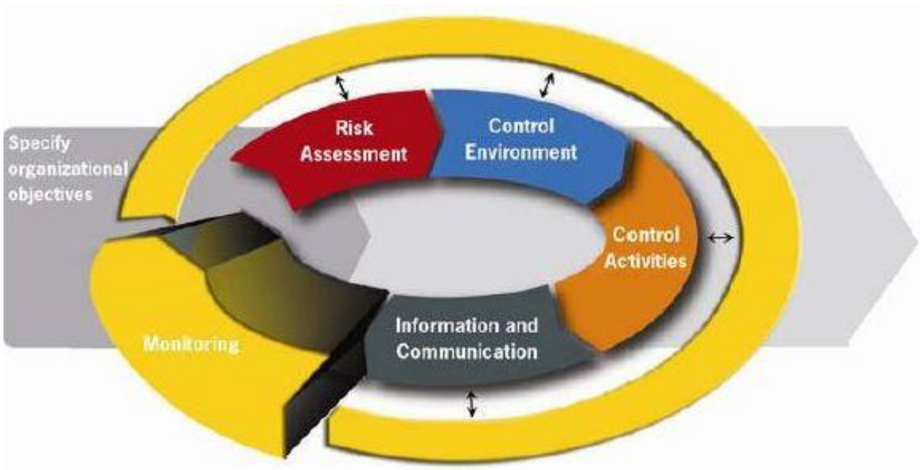
The 1992 COSO Framework states that "monitoring ensures that internal control continues to operate effectively." COSO's 2006 Guidance enhances our understanding of monitoring by articulating that monitoring (one of the five elements of the COSO framework) includes both ongoing monitoring and a separate evaluation. These enable management to determine whether the other components of internal control continue to function over time.

Our point here is that if an entity has not performed an ***effective*** *monitoring by a competent and objective party, the monitoring cannot be reported by management to the Audit Committee (and stakeholders) as effective. And because we are not aware of any other control agent besides the outside auditor, that the Proposal regarding auditor's communication responsibilities should be*

[10] *Ibid.*, p.7
[11] http://www.pcaobus.org/standards/interim_standards/auditing_standards/au_316.html

expanded to include communication of inadequate accounting policies and practices. Or possibly Section 10A provisions.

The following is an example of monitoring the monitoring. The monitoring (as an evaluation or management assessment) is reviewing the ongoing monitoring element of the COSO Guidance[12] (ongoing monitoring by management).



Monitoring Applied to the Internal Control Process
Figure 1

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

AICPA CAQ Alert articulated the intended consequences of non-compliance with the management assessment standards, namely, that the failure by management (and its Board who has ultimate oversight responsibility) to complete the evaluation and provide the report as required by Item 308T(a), the company would not be timely or current in its Exchange Act reporting. This would result in the company not being eligible to file new Form S-3 or Form S-8 registration statements and the loss of the availability of Rule 144. Because the filing of the Form 10-K constitutes the Section 10(a)(3) update for any effective Forms S-3 or S-8, the company also would be required to suspend any sales under already effective registration statements.

Additionally, let's say management had not performed an effective monitoring of its internal controls, in the form of a separate evaluation, and by a competent and objective evaluator, as required by both regulatory standards and professional standards, yet communicated to its audit committee that it did in fact do an assessment. In the course of obtaiing and understadnding of the entity's internal controls, outside auditors would in fact become aware that an effective assessment was not done. In communications between auditor and audit

[12] COSO's 2009 Guidance on Monitoring Internal Control Systems

committee, can this in fact be ignored? Can the auditor allow the entity to conclude that internal controls were effective if they did not perform the testing? Can the report to the public conclude they abided by the COSO framework, if they did not document its MONITORING (also called SOX Section 404(a))? .

At a minimum, we believe the proposed standard should require this communication to the audit committee and perhaps be extended to outside parties. We believe Guidance should be developed for the auditor in the event of such a breach in SEC related accounting matters. Our understanding is that such a breach falls under the requirements that of Rule 2-07 of Regulation S-X for the auditor to communicate critical accounting deficiencies in its policies and practices, not only directly to the audit committee, but alternative treatments to investors, as permissible under SEC and PCAOB guidelines for illegal acts, Section 10A.

Other Communication Requirements

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

We believe the proposed standard regarding "Other Information in Documents Containing Audited Financial Statements" should retain the requirement for the auditor to communicate to the audit committee the auditor's responsibility for other information presented in documents containing audited financial statements ***but should be expanded*** *upon by including the management assessment of internal controls over financial reporting.*

Our interpretation of AU section 550, is that auditors should provide reasonable assurance that management's documentation and testing of internal controls over financial reporting was performed in a reasonable manner consistent with the acceptable framework chosen by management (which is typically the Committee of Sponsoring Organizations of the Treadway Commission). Not a full attestation, but at least considering whether it is materially inconsistent.

SEC's RIN 3235-AI54 states that, "The rules also require these officers to certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the issuer's internal controls; they have made certain disclosures to the issuer's auditors and the audit committee of the board of directors about the issuer's internal controls." [13]

Therefore, it appears that the auditor performing the prescribed course of action stated above, would likely be required to understand whether a company had assessed their internal controls over financial reporting without explicitly testing

[13] http://www.sec.gov/rules/final/33-8124.htm

the entire control environment. The auditor would examine evidential matter, including documentation, to provide reasonable support for management's assessment of the effectiveness of the company's internal controls to mitigate financial statement fraud. And this documentation would normally be a part of an issuer's entire ICFR self assessment.

An instruction to new Item 308 of Regulations S-K and S-B and Forms 20-F and 40-F reminds registrants to maintain such evidential matter.[14]

[14] http://www.sec.gov/rules/final/33-8238.htm#P229_61599

Mayer Hoffman McCann P.C.
An Independent CPA Firm

11440 Tomahawk Creek Parkway
Leawood, Kansas 66211
913-234-1900 ph
913-234-1100 fx
www.mhm-pc.com

June 2, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 030

Gentlemen,

Mayer Hoffman McCann P.C. (MHM) appreciates the opportunity to comment on the Board's proposed auditing standard on communications with audit committees. Following are our comments on the specific questions which the Board requested feedback.

Objectives of the Auditor

We support the Boards objectives regarding communication of the auditors' responsibility and providing timely observations from the audit process to the audit committee.

As more fully described below in the section entitled "Adequacy of the Two-way Communication Process", we believe the objective of "evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit" would be highly subjective and may not enhance the audit process. This objective may be better achieved through the issuance of PCAOB staff guidance for both auditors and audit committees.

Establishing a Mutual Understanding of the Terms of the Audit

MHM supports the Board's proposal that the terms of the engagement be documented and provided on an annual basis to the audit committee. The engagement letter should clearly identify the responsibilities of audit committee, management and the auditor. We support that this communication should outline the responsibilities of the above mentioned parties for performance of the audit as well as for the quarterly reviews.

MHM does not believe that the engagement letter is the appropriate means for enhancement of investor protection. However, we do support a requirement for the engagement letter to clearly state the estimated time commitment of Partners and Managers to high risk areas.

<u>Obtaining Information Related to the Audit</u>

MHM agrees with the Board as to the need for robust substantive discussions between the auditor and audit committee regarding significant matters including those involving accounting or auditing matters, irregularities and fraud. We believe that the audit committee, as part of their governance duties and responsibilities for overseeing the auditor and the audit process, should initiate discussions with their auditors regarding their knowledge of the following matters:

- Significant accounting estimates emphasizing those that are sensitive or complex
- Unusual or complex transactions which the company completed outside their routine or standard processes of the company
- Disclosure of outside experts used for accounting, tax, valuation, control or systems in the current period, and the effects of those projects on the financial statements

MHM also believes that the audit process could be strengthened by having the audit committee in their governance responsibility for the audit process provide written representation to the auditors (or as an alternative as a certification included in the 10-K or 10-Q) of significant matters which occurred during the audit period and confirmation of certain actions required of the audit committee in carrying out its role in the financial reporting and governance process. Examples of the types of representations that the audit committee could provide include:

- Whether or not the audit committee was aware of any fraud allegations (either from its fraud hotline or any other source),
- Whether the audit committee agreed with management's conclusions regarding significant estimates and the related assumptions used in reaching those conclusions
- Whether the audit committee placed reliance on outside experts in reaching such conclusions regarding significant estimates or subjective areas and their agreement as to sufficiency of the objectivity and qualifications of the experts employed by management,
- If management chose not to employ experts (when outside experts would be used in similar circumstances), that the audit committee agreed that management possessed the appropriate expertise and that outside experts were unnecessary,
- Whether the audit committee believes that management has provided them information, in sufficient detail and on a timely basis, to allow them to effectively carry out their oversight role over financial reporting as an audit committee.

We believe that requiring these types of representations from audit committees to auditors would have a significant positive impact in achieving the Board's goal of fostering more open and robust communication between the auditor and the audit committee because the shared responsibility of both groups would stimulate a dialogue on the significant areas affecting the financial reporting process.

Overview of the Audit Strategy and Timing of the Audit

MHM supports the proposed required communication of the audit strategy to the audit committee for the matters concerning the auditor's use of people with specialized skills on behalf of the engagement team, as well as the roles of participating firms or offices and the basis for auditor's determination for serving as the principal auditor. We agree that the auditor should also communicate the planned use of the company's internal audit personnel, company personnel and or third parties working on the behalf of management.

However we are concerned regarding the proposed standard communication requirements regarding network affiliations. We believe that this requirement may create an artificial barrier and a further concentration of audit firms available to registrants with global operations. MHM believes that this requirement would place local, regional and national firms who have network affiliations at a disadvantage to the large International Firms for their lack of singular branded audit name recognition.

Accounting Policies, Practices and Estimates

MHM supports the proposed standard retaining the provisions of *"AU Section 380: The Auditor's Communication with Those Charged with Governance"* for the auditor to communicate the auditor's evaluation of the quality, not just the acceptability, of the company's significant accounting policies, as well as the practices and the quality of disclosure related to the company's accounting policies and practices. MHM does support a dialogue with audit committees concerning accounting policies, disclosures, and alternatives; however, we believe that these judgments are the responsibility of the company's management and that of the audit committee. We believe the proposed standard could potentially confuse the fact that management is responsible for the financial statements.

MHM supports the Board's position in the proposed standard requiring the auditor to communicate or determine that management has adequately communicated to the audit committee the application of new accounting or regulatory pronouncements which are not yet effective, but which may, upon adoption, have a significant effect on the company's financial reporting. However, we believe the proposed language stating "the auditor may develop a view regarding changes to processes or systems that could impact the financial reporting process that would not be included in management's disclosures in the financial statements, but which the auditor may wish to communicate to the audit committee" is beyond the scope of the attest engagement.

The proposed standard's requirement for the auditor to communicate to the audit committee significant accounting matters on which the audit team has consulted outside the engagement team is a position MHM believes will reduce consultations between audit teams and subject matter experts and will therefore be harmful to audit quality. We also do not see how this improves communication between the audit committee and the auditor.

MHM believes that the Board should provide staff guidance to assist audit committees with the types of transactions or situations which the Board believes the audit committee should discuss with experts.

In addition, the proposed standard introduces the terminology of "critical accounting estimate" which the Board has defined similar to the SEC; however, the proposed standard introduces new requirements for the auditor to evaluate management's communication and discussion with the audit committee regarding critical accounting estimates. While we commend the Board in their efforts to improve governance and understanding of risk between management and the audit committee, we do not believe that this responsibility should be the role of the auditors. MHM also believes that terminology introduced by the Board in the proposed standard would create confusion for audit committee members, especially those members who may serve on smaller market capitalization companies. In addition we would request that the Board work with SEC and the AICPA's Auditing Standards Board to provide consistent and similar terminology in regulatory and standard setting matters.

Management Consultations with Other Accountants

We support the Board's efforts to expand the requirements regarding management consultations beyond that of other accountants but also include attorneys and consulting firms who provided consultation on accounting and auditing matters. We believe as a practical matter that the communication with outside parties regarding accounting and auditing are a governance function and should be required to be brought to the auditors' attention by the audit committee and management. MHM further believe that investors' interests would be best served by having this information disclosed in the proxy statement in addition to the fees paid to the auditor.

Going Concern

MHM believes that determination of going concern is a management responsibility, and believes that the Board should defer action on this topic until the Financial Accounting Standards Board and the International Accounting Standards Board converge on this issue.

Corrected and Uncorrected Misstatements

MHM supports the Board proposal that the audit committee be provided with the same information regarding uncorrected misstatements relating to accounts and disclosure, as is presented to management. MHM also supports the proposed requirement that the audit committee have access to all corrected misstatements even those detected by management. We believe this will allow the audit committee to understand potential risks in the financial statement close process.

We do not believe that the proposed standard's requirement that the auditor communicate their basis for determining that the uncorrected misstatements were immaterial should be the only information provided to the audit committee on these uncorrected misstatements in accounts and disclosures. The audit committee should also evaluate management's position on these items as well, since the primary responsibility for the fair presentation of the financial statements resides with management.

Form and Content of Communications

MHM is supportive of the Board's effort to support and enhance effective two-way communication between the audit committee and the auditors. We believe that certain matters such as independence, engagement terms, audit plan, summary of uncorrected misstatement and such should be communicated in writing. We would caution against the need for all communication to be in written format. If the goal is effective communication which includes open and robust dialogue to improve the quality of the audit and provide greater protection to investors, the Board should not dictate the form of communication.

Timing

MHM agrees with the Board's assessment that communication with the audit committee is a vital part of the audit process. We believe that certain matters such as independence, summary of uncorrected misstatements in accounts and disclosures, as well as control deficiencies should be communicated annually in writing to the audit committee.

Adequacy of the Two-way Communication Process

We are supportive of the Board's position that effective two-way communication between the auditor and the audit committee may help to strengthen the audit process. However, we believe this could be best achieved by the Board issuing staff guidance, rather than requiring the auditor to make a formal evaluation of the process. We do not see how the performance of an evaluation alone will effect meaningful change. In addition, the Board has not provided any mechanism or incentive to improve a situation that is considered by the auditor to be inadequate. Is it the Board's intent that an inadequate communication process between the auditor and audit committee be reported as a significant deficiency or material weakness in controls or in the company's SEC filings? Also, what happens if the auditor communicates such an inadequate two-way communication process and the audit committee either disagrees or is not interested in making any changes? Should the auditor be expected to resign from such a situation? It is unclear as to what results or actions would be expected to be undertaken if a situation is determined to be inadequate. It is for these reasons that we believe that a requirement for such an evaluation will be ineffective and have little impact in achieving the Board's objective of improving the quality of the communications between auditor and audit committee.

Other Communication Requirements

The proposed standard requiring the auditor to communicate to the audit committee significant difficulties encountered in dealing with management is a position which we believe would enhance the audit process and provide the audit committee with effective insight to perform their governance responsibilities.

Mayer Hoffman McCann P.C. is grateful for the opportunity to provide input on this matter. Should the Board have any questions regarding our responses or if we can provide further assistance regarding this issue, please do not hesitate to contact us.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to either Rich Howard (949-450-4402) or Ernie Baugh (423-870-0511).

Sincerely,

Mayer Hoffman McCann P.C.

Mayer Hoffman McCann P.C.

MAZARS

Paris La Defense, October 21, 2010

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street, N.W.
Washington, DC 20006, USA
Attention: J. Gordon Seymour, Secretary, and the Members of the Board

Re: PCAOB Release No. 2010-001 March 29, 2010 - PCAOB Rulemaking Docket Matter No. 030 - Proposed Auditing Standard on Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards

Dear Sirs,

Mazars is a unique integrated partnership with a global reach. It operates as one integrated international partnership in 56 countries with more than 12.500 professionals, leaded by more than 600 partners, with 16 additional countries where Mazars is present through correspondents and joint ventures (see Mazars 2009 annual report together with its more recent updates, its 2009 IFRS joint-audited consolidated financial statements, and all the annual reports published since 2005 on http://www.annualreport.mazars.com/eng/).

Mazars is one of the founding members of 'Praxity', an alliance of 109 firms operating in 72 countries with more than 24,500 professional, the world's largest alliance of independent accounting firms.

Mazars provides a complete range of audit, accountancy, tax, legal and advisory services, designed to create added-value. Mazars was founded with certain core values: Independence, Competence; Intellectual and Ethical Rigour and Integrity; Sense of Service and Responsibility; Continuity; Respect for Individuals and Diversity.

We are pleased to submit this comment letter in response to the invitation to comment from the PCAOB on its proposed auditing standard on communications with audit committees. Mazars is very supportive of the PCAOB's efforts to update its auditing standards on communications with audit committees.

Audit committees play pivotal roles in the corporate governance process and the buck stops at their desks when the time comes to appoint, compensate, and oversee the work of external auditors. A robust, substantive, and effective two-way communications between the audit committees and external auditors are ingredients that contribute greatly to achieve the objective of the audit and thus to protect the investors.

We commend the Board for the transparency of its rule deliberation process and for considering the work of the IFAC IAASB.

MAZARS

More specifically, Mazars would also encourage the Board to not lose sight of the potential impacts on its proposed standard of:

- The recently adopted (and pending SEC's approval) Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Conforming Amendments to PCAOB Standards,
- The commonalities between the clarified work of the ASB and IFAC IAASB, in particular the IFAC IAASB ISAs 260 and 265,
- The recently issued European Commission two Green Papers , on respectively *Corporate governance in financial institutions and remuneration policies* and *Audit Policy: Lessons from the Crisis*.

Lastly, Mazars would also propose that the SEC and the PCAOB grant sufficient and reasonable transition periods (to domestic and foreign private issuers) before the effective implementation dates of the finally adopted and approved standard. This would permit all of the related parties (management, audit committee, external auditors, investors, etc) to be adequately and timely informed.

We respectfully submit our detailed comments below.

1. **Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives? – Page 6**

   Mazars believes that the 4 objectives of the auditor as proposed are appropriate.

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? – Page 6**

   We believe that the objectives should focus on the outcome that should be achieved; otherwise, audits may tend to focus on the form rather than the content. This may lead to "boilerplate" communication which may not fully meet the intended objectives of the standard.

3. **Is it appropriate for the proposed standard to require that an engagement letter be prepared annually? If not, why? - Page 7**

   Mazars agrees with this PCAOB's proposed standard that a requirement for the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee must be coupled with a requirement that the auditor records this understanding in a written audit engagement letter that he/she must provide to the audit committee annually. This is a critical document which sets out a mutual understanding.

   Given the dynamic business environment in which most public companies operate, not providing this annually may result in misunderstandings between the audit committee and the auditors due to changes such as new audit committee members, change in scope of work, recent changes in the company's business, regulatory changes, etc.

4. **Are there other matters that would enhance investor protection that should be added to an engagement letter? If so, what other matters should be included in an engagement letter? – Page 7**

   Mazars is of the opinion that a financial reporting framework is relevant to the issuers and consequently should be part of the engagement letter as supported by ISA 260. Such disclosure enhances communication and thus improves investor protection in the long run.

   Also, as the auditors' communication with audit committees is a critical element in the audit process and audit committees have been given certain significant responsibilities, the engagement letter should include both the auditors and the audit committee's responsibilities.

   This way, all parties involved in the audit process, auditors, management and the audit committee, have a clear understanding of their roles and responsibilities and full transparency of each other's roles and responsibilities.

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? – Page 8**

   Mazars supports robust and substantive two-way discussions between the external auditors and the audit committee throughout the engagement period. Inquiry of the audit committee is a vital part of this ongoing and transparent communication and should remain in the standard.

   Perhaps it's appropriate for the auditors to discuss with the audit committee their background, relationship with the audit client and independence and objectivity vis-à-vis the audit client. This is particularly relevant in developing countries where a high degree of relationship or interrelationship exists among companies, board members and audit committee members.

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? – Page 9**

   Mazars agrees with the appropriateness of the requirements to provide information on the auditors' audit strategy and timing of the audit.

   Mazars also believes that certain key engagement quality review (EQR) matters such as the provision of concurring approval of issuance and evaluation of the engagement team's assessment of, and audit responses to significant risks identified by the engagement team, including fraud risks should be accounted for in the audit strategy.

   Finally with the PCAOB's recent adoption[1] of its auditing standards related to the auditor's assessment of and response to risk, Mazars would support requiring the auditor to provide information, as part of the audit strategy, on ways he/she delt with assessed risks and responses to these assessed risks. This is also in synch with the PCAOB's recently published report on audit deficiencies in areas that were significantly affected by the economic crisis.

[1] On August 5, 2010, the PCAOB adopted a suite of eight auditing standards related to the auditor's assessment of, and response to, risk in an audit. These standards, if approved by the SEC, will become effective for audits of fiscal periods beginning on or after December 15, 2010.

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? – Page 9**

   The types of arrangements related to the roles, responsibilities, and locations of firms participating in the audit that should be communicated to the audit committee are not sufficiently described. Mazars proposes that the references to the qualifications and competencies of the participating firms be added. The types of supervision, review, and approval process of the work of the other firms can also be mentioned.

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)? – Page 13**

   The proposed requirements regarding the auditors' communication responsibilities with respect to accounting policies and practices are sufficiently clear.

9. **Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters? – Page 13**

   Yes, the inclusion of the SEC required audit committee communications is helpful.

10. **Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee? – Page 13**

    Yes, this definition appears appropriate.

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? - Page 13**

    Yes, the communication requirements regarding critical accounting estimates as described appear appropriate.

12. **Should this requirement be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms? – Page 14**

    Mazars agrees with the idea of expanding the communication requirements to include technical consultations (on accounting, auditing or legal matters) by management. Technical consultations by management are critical to the auditors work. Auditors must review them and state whether they agree or disagree with them. Anyhow, they should be communicated to the audit committees.

    The degree and frequency of the use of technical consultations may also say something to the audit committee about the availability of in-house competency and qualification of management or the complexity of the subject matter treated.

13. Is the communication requirement on going concern clear? If not, how could the requirement be clarified? – Page 14

The communication requirement on going concern as proposed appears clear.

14. Are the requirements appropriate regarding the communications for uncorrected misstatements? – Page 15

The requirements regarding the communication for uncorrected misstatements appear appropriate. However, Mazars proposes that references to the application of SAB 99[2] and SAB 108[3] be added when assessing misstatements.

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

Mazars proposes that all corrected misstatements including those detected by management be brought to the attention of the audit committee. This provides the audit committee with important information about the quality of the books and records provided to the auditor's upon the commencement of the audit.

Without this communication, the audit committee may not be aware of the quantity, magnitude and reason behind of the late corrections made by management which may indicate additional weaknesses in internal controls or management's ability to timely close the books.

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? – Page 16

Mazars believes that the requirement of the existing standard that allows the auditors to communicate many matters orally or in writing is adequate.

Mazars agrees with this amendment: "*The auditor is required to document the communications, whether communicated orally or in writing, in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of this proposed standard.*"

Mazars also agrees with the reference to the audit documentation requirements of AS 3.

---

[2] SAB 99 - Guidance in applying materiality thresholds to the preparation of financial statements filed with the Commission and the performance of audits of those financial statements

[3] SAB 108 - Guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment

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

Mazars believes that overall the requirements in the proposed standard on the timing of the auditor's communication is appropriate. Audit engagement circumstances should dictate the appropriate timing for communications.

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

Mazars agrees with the requirement that the auditors assess the adequacy of the communication process. This does promote effective two-way communications.

Assessing the adequacy of the communication process may also have an effect on the outcome of the audit. For example, if the audit committee is neither engaged, nor interested in communicating adequately, or if its engagement is not effective, this increases the risks related to the control environment and thus, auditors would be required to address these risks. If these control environment risks cannot be adequately addressed due to their severity or magnitude, auditors should resign from the engagement before the issuance of the audit report.

19. Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any? – Page 20

These other communication requirements are appropriate and sufficiently clear.

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? – Page 20

These matters included as significant difficulties in the proposed standard appear appropriate. Perhaps it's appropriate to include the quality of the accounting information provided as this often has a direct impact on the level of additional effort needed by the auditor. This is particularly applicable to smaller reporting companies.

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 of the company under audit? – Page 20

Mazars does not believe that any of the requirements included in the proposed standard are inappropriate for auditors to communicate to audit committees based on the size or industry of the company under audit.

MAZARS

This proposed standard should be based on one of the premises of AS 5. Per paragraph 13 of AS 5, "*the size and complexity of the company, its business processes, and business units, may affect the way in which the company achieves many of its control objectives. The size and complexity of the company also might affect the risks of misstatement and the controls necessary to address those risks. Scaling is most effective as a natural extension of the risk-based approach and applicable to the audits of all companies. Accordingly, a smaller, less complex company, or even a larger, less complex company might achieve its control objectives differently than a more complex company.*"

Consequently, required communications between auditor and audit committee should also be cognizant of the size and complexity of operations of the company under audit.

Mazars would also propose that cost-benefit analysis be part of the equation when drafting this proposed standard. Throughout this comment process, the PCAOB should ponder whether the benefits of this required communication outweigh its costs and how it is ultimately going to help the investors.

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter? - Page 21

Mazars believes that the information included in Appendices A - C to the proposed standard is sufficiently clear. However, Mazars would like to propose that, as part of the two-way communication between audit committee and external auditors, references be made to the management representation letter, or at least main topics and issues, which is another required documentation.

We hope that our comments above will be useful and we remain available for further considerations. Please feel free to contact us again if you deem it necessary to discuss our submission further.

Yours sincerely,

P/O

Wendy Stevens
WeiserMazars Quality Assurance

Denis Usher
Mazars US Desk

Jean-Luc Barlet
Mazars Chief Compliance Officer

McGladrey & Pullen
Certified Public Accountants

3600 American Blvd West
Third Floor
Bloomington, MN 55431
O 952.835.9930 F 952.921.7704

May 26, 2010

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

RE: PCAOB Rulemaking Docket Matter No. 030

Dear Office of the Secretary:

McGladrey & Pullen, LLP appreciates the opportunity to comment on the PCAOB's *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*. McGladrey & Pullen is a registered public accounting firm serving middle-market issuers. We support the PCAOB's efforts to continue to strengthen the communications between auditors and audit committees. It is essential that the requirements in this standard be unambiguous. It also is important that there be a clear distinction among the responsibilities of the auditor, management, and the audit committee. We have the following comments on the proposed standard, which we believe would help to clarify certain sections of the proposed standard and enhance its application in practice.

Objectives

The objectives of the auditor as stated in paragraph 3 are primarily focused on the auditor's communications *to* the audit committee. However, we note that the requirement, as stated in paragraph 8, to inquire of the audit committee whether it is aware of matters that may be related to the audit cannot be correlated with any of the existing objectives in paragraph 3. We believe it is important to include an objective for the auditor to obtain from the audit committee information related to the audit, similar to the objective stated in paragraph 9.b. of International Standard on Auditing 260, *Communication with Those Charged with Governance.* We suggest incorporating such an objective with the existing objectives by revising objective 3.b. of the proposed standard to read as follows: "Inquiring of the audit committee as to whether it is aware of matters that may be related to the audit, and communicating to the audit committee an overview of the audit strategy and timing of the audit."

Additionally, we observe that certain of the communication requirements placed upon the auditor by this standard are of the type that should be initially communicated by management to the audit committee as part of the entity's internal control over financial reporting. To maintain a clear distinction among the responsibilities of the auditor, management, and the audit committee, we believe the auditor's starting point in determining the nature and extent of its communications to the audit committee should be its consideration of management's communications to the audit committee. We suggest revising objective 3.d. of the proposed standard to read as follows: "Evaluating the adequacy of the two-way communications between management and the audit committee and between the auditor and the audit committee to support the objectives of the audit."

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 the scope of these required discussions with the audit committee is too broad, and should be limited to those discussions that the auditor believes to be a significant factor in the current appointment or retention of the auditor. Also, in paragraph M. on page 18 of the release, the Board stated, "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." We believe the communication should be limited to those discussions held since the last appointment or reappointment as auditor. To incorporate both of these parameters in the standard, we suggest that paragraph 4 be revised to read as follows: "The auditor should discuss with the audit committee any issues discussed with management prior to the auditor's initial appointment or subsequent to the last appointment or reappointment as auditor that the auditor believes to be a significant factor in the current appointment or reappointment."

Establish a Mutual Understanding of the Terms of the Audit

Paragraph 5 requires the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee, including communicating to the audit committee the responsibilities of the auditor and the responsibilities of management. We believe that the requirements in paragraph 5 should be expanded to include communicating to the audit committee its responsibilities related to the audit of the company's financial statements. If this requirement were added to paragraph 5, then Appendix C, "Matters Communicated in the Audit Engagement Letter," would need to be revised to include matters such as the following:

d. Audit committee's responsibilities:
    1. The audit committee is responsible for providing oversight to the company's financial reporting.
    2. The audit committee is responsible for informing the auditor of matters that may be related to the audit, including for example, knowledge of known or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters.
    3. The audit committee is responsible for adequate communications with the auditor, including, but not limited to the following:
        i. Appropriate and timely actions taken in response to matters raised by the auditor;
        ii. Open communications with the auditor;
        iii. A willingness to meet with the auditor without management present; and
        iv. Probing issues raised by the auditor.

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 believe that the last clause of this requirement could perhaps limit the audit committee's response to the inquiry. We suggest that paragraph 8 be expanded to read as follows: "The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit including, for example, knowledge of known or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters."

Audit Strategy and Timing of 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. The related discussion of this requirement (in paragraph D. on page 9 of the release) indicates the Board expects this communication to include disclosure of participation by affiliated and network firms. We believe the Board's interpretive guidance in the release should be included in the standard itself, instead of in the release, to avoid any miscommunication. We suggest rewording paragraph 10.d. to read as follows: "…The roles, responsibilities, and locations of firms participating in the audit, including affiliated and network firms, outsourcing arrangements, and non-affiliated firms used to perform audit procedures."

Accounting Policies, Practices, and Estimates

Paragraph 12 requires the auditor to communicate certain matters to the audit committee regarding accounting policies, practices, and estimates. We believe it is the responsibility of management to communicate these matters to the audit committee, and the auditor's starting point in determining the nature and extent of its communications to the audit committee should be its consideration of management's communications to the audit committee. We recommend modifying the standard such that the auditor would be required to:

- Evaluate the nature, extent, and reasonableness of management's communication with the audit committee regarding the matters in paragraph 12 related to accounting policies, practices, and estimates; and
- Communicate to the audit committee any information in paragraph 12 related to accounting policies, practices, and estimates that was not communicated by management to the audit committee.

In addition, we have the following comments related to the specific requirements regarding the accounting policies, practices, and estimates to be communicated:

- Paragraph 12.a.ii. requires the 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. Although the application of regulatory pronouncements may be something that management communicates with the audit committee, we do not believe it is a communication that should be evaluated by the auditor. We believe the wording of paragraph 12.a.ii. should be aligned with that of SAB 74 so as to read as follows: "The potential effects of adoption of accounting pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting. "
- Paragraph 12.a.iii. requires the communication of the methods used by management to account for significant and unusual transactions. We note that recently issued PCAOB Staff Audit Practice Alert No. 5 uses the terminology *significant unusual transactions.* To eliminate any confusion in terminology, we suggest paragraph 12.a. iii. be revised to refer to significant unusual transactions, instead of significant and unusual transactions.

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

Paragraph 13.a.ii. requires the auditor to communicate to the audit committee the results of the auditor's evaluation of the quality of the company's significant accounting policies and practices, including a discussion of the "consistency of the company's disclosures and of its selection and application of significant accounting policies and practices" (emphasis added). The meaning of this paragraph is unclear to us. Please clarify whether this requirement means that the auditor should discuss the consistency of the company's financial statement disclosures with its actual application of significant accounting policies and practices.

Paragraph 13.b.iii. requires the auditor to communicate to the audit committee how current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical. We are unclear as to how an auditor should anticipate future events and determine whether they are relevant and/or likely to affect a company's current policies or practices.

Management Consultations with Other Accountants

When the auditor is aware that management consulted with other accountants about auditing or accounting matters, paragraph 15 requires the auditor to communicate to the audit committee his or her views about significant matters that were the subject of such consultation. Question 12 on page 14 of the release asks whether this requirement should be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms. We believe this requirement should not be expanded because (a) auditors would not necessarily be in a position to know about consultations management had with consulting firms or law firms; (b) such consultations may be in the normal course of business; and (c) such consultations may be privileged.

Going Concern

Paragraph 16(a) 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). Paragraph 3(a) of AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* of the PCAOB's interim standards requires the auditor to consider whether the results of audit procedures performed identify conditions or events that indicate there could be substantial doubt about the entity's ability to continue as a going concern. In addition, in such situations, it may be necessary for the auditor to obtain additional evidence that mitigates the auditor's doubt. As proposed under paragraph 16(a) of the standard, the trigger point for auditor communication with the audit committee appears to be the auditor's initial evaluation under the requirements of paragraph 3(a) of AU Section 341.

Since auditors are not required in all situations to perform additional procedures to obtain evidence to mitigate the concern, we are concerned that using the threshold "could" may result in the auditor communicating his/her consideration in situations where the auditor does not have a significant doubt about the company's ability to continue as a going concern. We do not believe communications around such situations provide the audit committee with meaningful information. Paragraph 3(b) of AU Section 341 requires that if the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented. We believe that the trigger point for requiring auditor communication with the audit committee should be when the requirements of paragraph 3(b) of AU Section 341 are applicable.

Corrected and Uncorrected Misstatements

We believe this subsection should be reorganized such that paragraph 17 only addresses corrected misstatements and paragraph 18 only addresses uncorrected misstatements. In addition, since the "note" associated with paragraph 18 includes a "should" requirement, we suggest it become part of paragraph 18 directly, instead of being a note to the paragraph. If these two suggestions are considered together, this subsection could be revised to read as follows:

> Corrected and Uncorrected Misstatements
>
> 17. The auditor should 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.
>
> 18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that was presented to management.[21] The auditor should communicate to the audit committee the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative[22] factors considered. In addition, the auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial

statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.

Question 15 on page 15 of the release asks, "Should all corrected misstatements including those detected by management be communicated to the audit committee?" We believe the standard should not be revised to include the communication of corrected misstatements detected by management. If the company's internal controls over financial reporting detect and correct misstatements, such corrections need not be reported to the audit committee as this would indicate that the related controls are effectively designed and operating.

Form and Content of Communications

Question 16 on page 16 of the release asks whether all or certain matters should be required to be communicated to the audit committee in writing. We do not believe it would be appropriate to require all matters to be communicated to the audit committee in writing. Certain matters are best communicated in writing, others are better communicated through a robust discussion with the audit committee, while some may, in the auditor's opinion, require both oral and written communication. We believe the requirement as stated in paragraph 23 of the proposed standard is appropriate.

Adequacy of the Two-Way Communications

Paragraph 28 requires the auditor to consider taking certain actions if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved. We believe that the auditor first should consider the audit implications of inadequate two-way communications, including determining whether the inadequacy in communication constitutes a control deficiency, a significant deficiency or a material weakness. Also, in an integrated audit conducted pursuant to PCAOB Auditing Standard No. 5 if there are deficiencies that, individually or in combination, result in one or more material weaknesses, the auditor must express an adverse opinion on the company's internal control over financial reporting. This is inconsistent with the requirement in paragraph 28.b.

In addition, if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved, we believe it would be rare that the auditor would not inform the company's full board of directors. Therefore, we recommend the PCAOB elevate the requirement to communicate with the full board of directors to "should" as opposed to "should consider".

As previously noted in our comments regarding the objectives of the standard on page one of this letter, we believe the standard should also address the auditor's evaluation of the adequacy of the two-way communications between management and the audit committee. In making this evaluation, the auditor should consider the audit implications of inadequate two-way communications, including determining whether the inadequacy in communication constitutes a control deficiency, a significant deficiency or a material weakness. If the PCAOB agrees with this recommendation, the proposed standard should be revised to include a paragraph directing the auditor to evaluate the adequacy of two-way communications between management and the audit committee. The purpose of the auditor's evaluation would be to assess the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting as required under existing PCAOB standards.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to either Robert Dohrer (919.645.6819) or Bruce Webb (515.281.9240).

Sincerely,

McGladrey & Pullen, LLP

McGladrey & Pullen, LLP

NACD
NATIONAL ASSOCIATION OF CORPORATE DIRECTORS

May 18, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Rulemaking Docket Matter No. 030

Gentlemen:

On behalf of the board of directors of the National Association of Corporate Directors (NACD), we are pleased to submit these comments on the PCAOB's exposure draft dealing with "Communications with Audit Committees." NACD is the only national membership organization created by and for directors, providing solutions and resources that empower boards to be more effective. The board of directors of NACD speaks out on important corporate governance matters affecting directors as appropriate.

In that regard, we have reviewed the April 23, 2010 comment letter on this PCAOB proposal submitted by our fellow board member Dennis Beresford and endorse Mr. Beresford's positions. To emphasize some of his views, we wish to make the following summary points about the PCAOB project.

1. Effective communications between independent auditors and audit committees are a very important part of the financial reporting and audit process. Thus, we certainly support the intent underlying this proposal. However, we are not aware of any strong demand from audit committee members for an increase in the formal communications that would be mandated by a new standard. Indeed, we are concerned that requiring a large number of new requirements might actually work to inhibit existing effective informal communications between auditors and audit committees.

2. We do agree that external auditors should be required to send an engagement letter to the audit committee and should also be required to communicate details about the audit strategy, related risks, and timing of the audit. Beyond those two matters, it is not clear to us that the many remaining new requirements are obvious improvements to the current audit standards that have been in place for many years. We are particularly concerned about the extensive new communication requirements dealing with estimates, which strike us as matters better dealt with between management and the audit committee.

3. It is absolutely critical that all required communications be in writing. To add a large number of new ones and allow that they be accomplished through conversation invites considerable misunderstanding rather than effective communication.

In summary, we hope that you do not interpret a relatively small number of comments as either agreement with your proposals or lack of interest. Rather, we encourage PCAOB to make greater efforts to reach out to corporate board members to ascertain what new communication requirements are needed and desired. There is a fine balance to be struck between fostering and documenting auditor-audit committee communication on the one hand and creating an overly bureaucratic process on the other which could have the unintended consequence of impeding communication. NACD would be pleased to arrange face-to-face meetings between PCAOB staff members and groups of public company directors. Therefore, we respectfully request that the comment period be extended 45 days to allow us to be of assistance.

Sincerely,

Barbara Hackman Franklin
Chairman, NACD

Kenneth Daly
NACD President and CEO

new york state society of
NYSSCPA
certified public accountants

Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

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

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
NYSSCPA
certified public accountants
Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

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

From the Auditing Standards Committee:

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
Theo Vermaak

NYSSCPA 2009 – 2010 Board of Directors

NYSSCPA 2009 – 2010 Accounting & Auditing Oversight Committee

NYSSCPA 2009 – 2010 Auditing Standards Committee

NYSSCPA 2009 – 2010 SEC Practice Committee

Anthony S. Chan, *Chair*
Michele B. Amato, *Vice Chair*
Eric H. Altstadter
Patricia A. Baldowski
John A. Basile
Douglas J. Beck
David Bender
Timothy Boehmer
Jeffrey M. Brinn
Thomas E. Caner
Henry G. Clark
Burgman E. Connolly
Rossana Ferraro
John P. Fodera
Leon J. Gutmann
Edward J. Halas
Michael J. Halkias
Elliot L. Hendler
Xianghua Huang
Steven Kreit
David J. Lamb
Steven R. Leidenfrost
Nancy Leo
Moshe S. Levitin
Helen R. Liao
Robert P. Marggraf
Jonathan T. Marks
Thomas P. Martin
Corey L. Massella
Mitchell J. Mertz
Muhammad F. Padela
Rita M. Piazza
Peter J. Pirando
Arthur J. Radin
John P. Rushford
Paul Rykowski
Stephen A. Scarpati
Andrew Schneider
Robert E. Sohr
Fredric S. Starker
Theo Vermaak
George I. Victor
Liren Wei
Philip H. Weiner

NYSSCPA Staff

Ernest J. Markezin
William R. Lalli

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 auditors 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.

P B T K
PIERCY BOWLER
TAYLOR & KERN
Certified Public Accountants
Business Advisors

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

Transmitted by e-mail to: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 030

We are pleased to respond again in this letter to the Board's proposed new auditing standard (the "proposed standard) regarding communications with audit committees and related matters that is contained in its Release No. 2010-001 (the Release) of March 29, 2010.

We regret that due to the demands of our practice, we found the 60-day comment period too brief to enable us to draft a comprehensive letter of response directly addressing in detail all the questions posed in the Release. Accordingly, our comments below are limited to those that we believe are responsive to our most significant concerns about the proposed requirements embodied in the Release.

While we agree, in principle, with the objectives of auditor communications with audit committees, as articulated in the proposed standard, we find the overall tone of its specific requirement, as suggested in the comments of others recorded to date, to be one of inappropriately shifting primary responsibilities from management and/or the audit committee to the auditors.

For example, it clearly should be management's responsibility, not the auditors', to inform the audit committee to an extent determined to be adequate by the audit committee of the effects on the financial statements of management's decisions regarding the selection of accounting methods from available alternatives, the methods used for accounting estimates, and sensitivity of estimates to changes in assumptions. Further, it should not be the auditors responsibility to dictate to audit committees what they should be interested in to further their oversight objectives (nor should it be the responsibility of those who set auditing standards), but rather auditors should remain more passively prepared to respond to appropriate questions from audit committees. The auditor should strive to preserve an ability (a) to evaluate objectively the effectiveness with which management and the audit committee interact and communicate with one another by not taking active responsibility to direct such activity and (b) to report perceived weaknesses in such processes and address them appropriately in setting audit scope.

Moreover, although we believe the audit committee rightfully has a responsibility to assess and continually reassess the auditors' professional competency, the committee should not be encouraged by mandatory, detailed auditor communications to second guess audit strategy and scope decisions (including with respect to staffing), which should remain primarily the responsibility of the auditor, not the audit committee. We believe the final standard should contain cautionary language to this effect regarding communicating with audit committees matters of audit strategy and scope, which language should emphasize the need to protect such judgments to exposure to the risk of circumvention by management.

20th ANNIVERSARY 2010

6100 Elton Avenue, Ste. 1000 • Las Vegas, Nevada 89107 • 702-384-1120 • fax 702-870-2474 • pbtk.com

Thank you for this opportunity to comment. We hope the Board finds our comments useful in its deliberations on this important matter.

Very truly yours,

Howard B. Levy, Sr. Principal and Director of Technical Services
Piercy Bowler Taylor & Kern, Certified Public Accountants

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
400 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236 4000
Facsimile (973) 236 5000
www.pwc.com

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.

PRICEWATERHOUSECOOPERS

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

PRICEWATERHOUSECOOPERS

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.

PRICEWATERHOUSECOOPERS

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

PRICEWATERHOUSECOOPERS

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.

* * * * *

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,

PricewaterhouseCoopers LLP

Attachment

PRICEWATERHOUSECOOPERS

APPENDIX

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.

PRICEWATERHOUSECOOPERS

APPENDIX

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.

Arthur
Siegel

179 East 70th Street
Apt. 3A
New York, NY 10021
Phone: (212) 327-0794
Fax: (212) 737-3823
E-mail: asiegs@ix.netcom.com

April 16, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington DC 20006 – 2803

To Whom it May Concern:

<u>PCAOB Rulemaking Docket Matter No. 030</u>

I appreciate the opportunity to comment on the Board's proposal on communications with audit committees. My background is described at the end of this letter. My comments and suggestions follow:

<u>Question 1</u>

The objectives of the proposal are all desirable and I compliment the Board for undertaking this project.

<u>Question 8-11</u>

I believe management has the primary responsibility to communicate the information about accounting methods, etc. to the audit committee. I could argue that the failure by management to communicate and gain approval from the audit committee for such matters represented a material weakness in the company's system of internal control. For the purpose of this proposal however, my suggestion is that the auditor be required to provide the specified information only when he determines that it has not been provided by management.

I also believe it is unnecessary and inadvisable for the auditor to be required to advise the audit committee when he has consulted outside the engagement team. The auditor is already required to communicate judgmental and other important matters, and whether or not the matter was discussed with someone else is not necessarily important to the audit committee. My concerns are twofold. First, the requirement to disclose such consultations could act as a deterrent – as a sign of weakness – and therefore could discourage a necessary process. Of course if the engagement team thought it were important to advise the committee that others had been consulted, it would be free to do so. Second, the question of when a consultation occurred could become a matter of debate (and we don't need additional literature to define such an event). For example, what if a manager calls a friend in the national office to do a "sanity check" on his thinking on a matter? What if someone in a foreign office calls his local firm's national office on a foreign translation, or US GAAP question? As a member of an audit committee I expect to be advised of difficult accounting and auditing issues and of their resolution. And I certainly reserve the right to inquire as to which people in the firm were consulted on the matter if I think this is important. But I do not need that kind of information volunteered for a whole host of issues and it might distract me from the more important matters.

Question 16

I believe all required communications by the auditor to the audit committee should be in writing. It is the best way to ensure that the messages intended to be transmitted are clearly received. Oral communications are too often misinterpreted, misunderstood or recalled incorrectly. The matters required to be communicated in this proposal are important enough to justify any additional effort to put them in writing.

Other comments

The phrase "an unnecessarily brief time within which to complete the audit" might be easier to apply if "inappropriately" replaced "unnecessarily."

My background

I am a retired partner of Price Waterhouse. During my last thirteen years as a partner I served as head of the accounting consulting group in our National Office and then as Vice Chairman in charge of the firm's Audit Practice. Prior to my National Office service I was an engagement partner in the firm's Boston office.

My professional activities included service as chairman of the AICPA's SEC Practice Executive Committee and as a member of FASB's EITF, FASAC and other task forces.

When I retired from Price Waterhouse I became the Executive Director of the newly-formed Independence Standards Board and was the primary author of ISB 1, *Independence Discussions with Audit Committees*.

Since the closing of the ISB I have been a board member and chairman of the audit committee of an SEC registrant and have served as an expert witness and consultant on various accounting and auditor independence issues.

* * * * *

Please contact me if my comments require clarification

Sincerely,

CC: Mr. Martin Baumann

SOCIETY OF CORPORATE SECRETARIES
& GOVERNANCE PROFESSIONALS

521 FIFTH AVENUE • NEW YORK, NY 10175 • P 212.681.2000 • F 212.681.2005 • WWW.GOVERNANCEPROFESSIONALS.ORG

June 1, 2010

Office of the Secretary

Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Proposed Auditing Standard Related to Communications with Audit Committees
Rulemaking Docket Matter No. 030

Ladies and Gentlemen:

We are pleased to have the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Release No. 2010-001 "Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards" (the "Proposing Release"). By way of background, the Society of Corporate Secretaries & Governance Professionals (formerly The American Society of Corporate Secretaries) ("we" or the "Society") is a professional association, founded in 1946, with over 3,100 members who serve more than 2,000 issuers. Our members are generally responsible for their companies' compliance with the securities laws and regulation, corporate law and stock exchange listing requirements. The majority of Society members are attorneys, although our members also include accountants and other non-attorney governance professionals.

General Comment

The Society supports the Board's efforts to strengthen communications between audit committee members and auditors. We believe that most of the new requirements are appropriate and will help improve the information available to the audit committee. We also believe that many of the requirements are already reflected in the best practices of audit firms and public companies. However, we do want to take this opportunity to express some of our concerns or disagreements with portions of these proposals.

As an initial matter, we are concerned that the new requirements, when taken as a whole, may imply a requirement that audit committee members demonstrate expertise in auditing. We believe that this implied expertise goes beyond the existing audit committee member financial literacy or audit committee financial expert requirements. Currently, companies listed on the New York Stock Exchange and Nasdaq stock market are required to have all members of their audit committee be financially literate. The listing standards also require that at least one member of the audit committee must have accounting or related financial management expertise. In addition, public companies are required to disclose whether or not the committee includes an "audit committee financial expert."

Despite these qualifications, directors do not necessarily have expertise with respect to an auditor's performance of the annual audit. If the Proposing Release is finalized in its current form, we question whether the objectives of the proposed Auditing Standard can be met to the extent that audit committee members do not demonstrate a level of auditing expertise when communicating with the auditor. We are also concerned that audit committee members may be subject to potential increased liability if they do not have such auditing expertise. We would therefore suggest that the final release make clear that it is not the Board's intent to create a new auditing expertise qualification for audit committee members.

Questions 1 and 2

In response to the Board's inquiry as to whether the objectives of the auditor specified in Section 3 of the proposed Auditing Standard are appropriate and adequately articulated, we believe that the objectives are appropriate and well articulated, with the exception of Item (d), "Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit," which we discuss under Question 18 below.

Question 3

In response to the Board's inquiry with respect an annual engagement letters, we support the proposed new requirement that an engagement letter be prepared annually setting forth a mutual understanding of the terms of the audit engagement. We believe that such practice is already the norm for most public company audit committees.

Question 6

In response to the Board's inquiry regarding the proposed requirements to provide information on the auditor's audit strategy and timing, we support the proposed new requirement that the auditor communicate to the audit committee an overview of the audit strategy and any significant risks identified by the auditor, as well as the timing of the audit. We believe that such communication should be provided to the audit committee as early in the year as is reasonable in order to allow the audit committee to monitor progress during its regularly scheduled meetings.

Question 8

Section 13(f) of the proposed Auditing Standard would require an auditor to communicate to a company's audit committee any significant accounting matters for which the auditor has consulted outside the engagement team. The Proposing Release explains that this could include discussions with the auditor's national office or industry specialists, or consultations with external parties when the firm does not have a national office. The Proposing Release further states that this information "would benefit the financial reporting process by providing the audit committee with information about complex transactions that may be high risk or controversial."

The Society supports efforts to increase meaningful communications between the auditor and the audit committee. However, we believe the proposed requirement is too broad and are concerned that the broad language in Paragraph 13(f) is unnecessary and will have unintended consequences. In particular, we believe that (i) communications between the engagement team and other individuals at the audit firm (including the firm's national office or industry specialists at the firm) should not be covered by this requirement and (ii) the requirement should be limited to matters discussed with external parties that are material to the company.

In the normal course, engagement teams consult with their national office or industry specialists at the firm on a variety of issues. These consultations may be with regard to specific items in connection with an audit or more general discussions about evolving issues with regard to the financial reporting process. These communications are invaluable to engagement teams as they exercise their due professional care in performing their audits in accordance with the standards established by the PCAOB, and they serve to keep both the engagement team and management informed on significant items that may or may not have an impact on the company. Moreover, they are consistent with the fact that the audit committee's engagement of the auditor is not limited to the engagement team -- i.e., the audit committee has approved the engagement of the audit firm and therefore assumes that the engagement team is consulting as appropriate with other professionals at the firm.

To be clear, engagement teams often communicate to audit committees about significant accounting matters for which the auditor has consulted the national office or industry specialists at the firm. However, not every significant accounting matter discussed by the engagement team with other individuals at the audit firm merits communication to the audit committee. We believe requiring that every such matter be raised at the audit committee level will potentially dilute other more meaningful communications from the engagement team to the audit committee and would necessitate that a communications hierarchy be established to assist the audit committee in distinguishing between matters that are material to the financial statements and internal control effectiveness and matters that are of lesser significance. We think the auditor should have the discretion to discuss only those matters it believes are material to the company or otherwise appropriate, in the auditor's professional judgment, to discuss with the audit committee.

Audit firms are currently required to communicate with audit committees on a wide variety of matters, including any disagreements with management about matters that could be significant to the company's financial statements or the auditor's report, any serious difficulties encountered in performing the audit, auditor independence, material errors, fraud or illegal acts, and significant deficiencies and material weaknesses in internal controls.

In the normal course, auditors also communicate to the audit committee on significant accounting matters as they deem appropriate in their professional judgment. The Proposing Release, however, would not permit the auditor to exercise discretion about whether a matter merits the attention of the audit committee, which would result in communications about items that are not high risk, controversial or otherwise material to the company. Moreover, the Proposal does not define "significant accounting matters," which could lead to additional confusion. We believe that the requirement should be limited to those matters that are qualitatively or quantitatively material to the company. This would provide the appropriate standard for the auditor and would be consistent with the audit committee's oversight role of accounting matters that may pose risk to the financial statements.

Based on the foregoing, we respectfully suggest that this proposal be modified as follows to limit it to consultations outside the audit firm and to matters that are material to the company:

13 f. "Significant accounting matters **<u>that are qualitatively or quantitatively material to the company</u>** for which the auditor has consulted ~~**outside the engagement team**~~ **<u>external parties</u>**."

<u>Question 12</u>

In response to the Board's inquiry regarding consultations with non-accountants, we do not believe that the requirement that the auditor communicate to the audit committee when the auditor is aware that management consulted with other accountants about auditing or accounting matters should be extended to conversations with non-accountants, such as consulting firms or law firms. It is our experience that management discusses accounting matters with non-accountants, such as law firms or executive compensation consultants, in the ordinary course of business. These conversations assist management in any number of ways. We fail to see, however, the value to the audit committee of having the auditor inform it of such conversations. In addition, the proposed requirement would impose a burden on both the auditor and audit committee that would have limited value to the audit committee in discharging its duty.

<u>Question 16</u>

In response to the Board's inquiry regarding the manner of communications between auditors and audit committees, the Society strongly supports that the Board proposes to continue the current practice of enabling auditors to communicate either orally or in writing. Audit committee members certainly receive a significant amount of written information in advance of their meetings. A requirement that all communications from the auditor be produced in writing may, in fact, have a negative impact on auditor communications with the audit committee during audit committee meetings, by unduly limiting the dialog at those meetings to only those items that were covered by the written materials provided in connection with the meeting. In addition, it is important to note that detailed minutes are kept of the matters discussed at Audit committee meetings. For the foregoing reasons, we support the proposal to allow the auditor the continued flexibility to communicate with the audit committee either orally or in writing.

Question 18

In response to the Board's inquiry regarding the proposed auditor evaluation requirement, we note that each public company audit committee has a different style by which it interacts with the company's auditor. We do not believe communications between the audit committee and auditor will benefit from a one-sided evaluation and request that the Board eliminate the proposed requirement that the auditor evaluate the adequacy of two way communications. We note that audit committees already carry out annual self-evaluations of the effectiveness of the committee, which generally include consideration of how well they communicate with the outside auditor.

To the extent that the Board does adopt the proposed requirement that the auditor evaluate the adequacy of two way communications, we request that the Board provide clear guidance on the parameters that should be considered by the auditor in performing the evaluation. For example, should the auditor take into consideration that all members of a specific audit committee may not have auditing expertise? What process should be followed by the auditor in order to tailor the evaluation to each audit committee?

In addition, we request that the Board provide specific guidance on issues such as:

- What are the implications of the auditor determining that the communication process is inadequate?
- Does a negative evaluation create potential liability for the audit committee?
- How and to whom should the final the evaluation be communicated?
- Does the audit committee have the ability to challenge the auditor's conclusion?

As the above questions indicate, we are concerned that the proposed evaluation process could create the potential for conflict between the audit committee and auditor, and accordingly, believe any such requirement only be made effective once these conflict concerns are more fully understood and addressed.

* * *

We appreciate this opportunity to share our views with you, and would be happy to provide you with further information to the extent you would find it useful.

Respectfully submitted,

The Society of Corporate Secretaries and
Governance Professionals

May 28, 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

Dear Sir or Madam:

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 Audit Standards* ("proposed standard"). Our responses herein are predicated on our understanding of the proposed standard, as written, without full knowledge of the basis for the Board's conclusions. To the extent further disclosure is provided as to the Board's basis for certain provisions, our responses may require reconsideration.

We fully support the Board's objective to enhance the relevance and effectiveness of the communications between the auditor and the audit committee. While we support the overall objective, we have concerns about certain provisions in the proposed standard. These concerns can be summarized into the following overall observations:

- The proposed standard could be perceived as diminishing the role of management, as the financial statement preparer, in the financial reporting process by placing certain non-audit responsibilities on the auditor. Although we fully support the objective of two-way communication between the auditor and the audit committee, the proposed standard focuses on the auditor – audit committee relationship rather than the more robust three-way communication that should exemplify financial reporting governance between management, as preparer, auditors and the audit committee. We fully endorse and respect the role of auditors in an efficient capital market; however, certain of these required communications, in our opinion, could have the unintended effect of compromising the independence of the auditor on the audit engagement.

- The proposed required communications with the audit committee are quite voluminous, and in some cases are already required to be included in other materials reviewed by the audit committee (for example, the Form 10-K). We are concerned that truly critical issues may be missed if the audit committee is overwhelmed with information.

This letter repeats each of the specific questions posed by the Board in bolded typeface followed by our responses. Unless the context otherwise requires, references to "our," "us," or "we" mean the Audit Committee of the Board of Directors of Sprint Nextel Corporation.

Objectives of the Auditor

***Question 1* - Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?**

The first three objectives of the proposed standard are appropriate and desirable. We have a fundamental concern with the fourth proposed objective, which is stated as "evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit". This objective implies that only two significant parties (the audit committee and the auditors) are required to communicate in order to support the objectives of the audit. We believe that the proposed standard should refer to "three-way" communication to include management as a critical part of the process. While we agree with the core principle of auditor independence underlying the Sarbanes-Oxley Act of 2002, and believe that direct and robust communication by the Audit Committee with the auditors is critical, we are concerned that the proposed standard does not recognize the important role of management in the audit process. Management has responsibility for the financial statements, and it is management that should play the key role in discussing accounting matters such as critical policies, estimates and judgmental areas with the audit committee. While the auditors should participate in these discussions, they should not be tasked with the responsibility of regulatory communication, and should not be a substitution for a robust dialogue between management and the audit committee. We believe that this standard should help to focus the auditors on expanding on management's dialogue with the audit committee and educating the audit committee as to the procedures the auditor performs to ensure management's assertions are accurate. We also believe that this "three way" focus will help to eliminate duplicative communications and ensure that important information is not overlooked or not given due discussion because it is included in excessive, unnecessary information. We suggest that this perspective be taken in the objectives section and throughout the standard.

***Question 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?**

With the exception of our concern outlined in response to Question 1, the objectives are adequately articulated.

Establish a Mutual Understanding of the Terms of the Audit

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

We agree that it is appropriate for the auditors to furnish a written audit engagement letter annually in order to establish a mutual understanding of the terms of the audit. We also suggest the proposed standard be enhanced by including a recommendation that auditors highlight significant changes from the prior year engagement letter to the audit committee. We also believe that auditors should fully explain all provisions limiting auditor liability in the audit process.

Question 4 - Are there other matters that would enhance investor protection that should be added to an engagement letter? If so, what other matters should be included in an engagement letter?

The current matters required for inclusion in the engagement letter are sufficient.

Obtaining Information Related to the Audit

Question 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?

Yes, it is important that the auditors engage in a robust discussion with the audit committee regarding risks of material misstatement and fraud risks, as well as inquire as to specific complaints or concerns that have been brought to the attention of the audit committee. We suggest that the proposed standard link this requirement to the required communications of audit strategy and risks which should be completed during the planning phase of the audit and updated, as appropriate, prior to final report issuance.

<u>Overview of the Audit Strategy and Timing of the Audit</u>

Question 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?

Yes, the proposed requirements are appropriate; although we believe such discussions, specifically those concerning significant risks, should be led by management with involvement from the auditor. We suggest that the proposed standard be enhanced by providing a suggested timeline for these communications, such as within the first seven months of the fiscal year, so that the discussions occur early enough in the audit process to allow time for auditors to implement adjustments to the audit process as a result of input received from the audit committee and/or management. We also suggest that auditors be required to include information about senior members of the engagement team, including their relevant qualifications and experience, to help the audit committee in assessing the qualifications of the audit engagement team.

Question 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?

Yes, this requirement is sufficiently clear.

<u>Accounting Policies, Practices, and Estimates</u>

Question 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)?

We feel that management should have the primary responsibility for communicating with the audit committee regarding accounting policies and practices, as well as critical accounting estimates. The proposed standard as written, including the Note at the end of paragraph 12 which states that management "may" communicate the above matters, appears to place the ultimate responsibility of communicating these fundamental accounting issues on the auditors. This implicitly diminishes management's role in leading the robust discussions that should occur with the audit committee. We believe a more appropriate alternative is to require auditors to be present at these discussions which would then provide the appropriate forum for discussion without unnecessary duplication. Auditors should not be a substitute for robust discussions between management and the audit committee, rather a supplement to management's discussion where they believe that further clarification is required, and auditors should offer their evaluation of the quality of the Company's financial reporting.

Notwithstanding the fundamental issue addressed above, we also have the following concerns with the proposed standard.

The proposed requirement in paragraph 12(a)(ii) for 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" is duplicative with the requirements of Staff Accounting Bulletin 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* to disclose such information in the financial statements. This disclosure requirement is the responsibility of management in their capacity as the financial statement preparer. Requiring external auditors to develop their own estimates of impact and effect could compromise their independence in the audit process. Audit committee communication requirements would become more voluminous as a result of this proposed standard, which would increase the likelihood that important issues will not be thoroughly discussed with the audit committee due to communication of too much information. We do not believe this will provide any communication of further value between the auditor and the audit committee beyond the disclosures already required for such matters.

Although we support disclosure of audit engagement team consultations with national office for significant or material matters, we do not endorse a disclosure requirement of all audit engagement team consultations with their national office. We believe this requirement ultimately will reduce, not enhance, the frequency of consultations, both formal and informal, that currently occur within audit firms. We are concerned that this required communication may reduce or impede the likelihood of further communication between the engagement team and the national office. We believe that communication between the auditor and their national office is often informal and helpful in allowing the engagement team to assess accounting matters. If this informal communication is subject to specified regulatory disclosures, it will require additional complexity in the process within each accounting firm which could diminish a healthy debate on client issues.

Although we do not support such disclosure, if required, we believe further clarification needs to be included about what consultations need to be reported, as audit firms have varying degrees of "formal" and "informal" consultations. These consultations can range from a formal issue raised with the firm's National Office, to informal phone calls or "hallway discussions" with another professional in a local office or non-national office. Currently, there would likely be subjectivity involved in deciding what consultations need to be reported. To increase clarity and consistency, we would suggest requiring that auditors only disclose significant matters on which they consulted with their National Office or with a Firm-designated subject matter expert. In addition, to ensure this communication serves its intended purpose, we believe it necessary and critical to include (a) the name of the partner(s) engaged within the national office on each topic and (b) the accounting firm's basis for a final conclusion including, but not limited to, the applicable authoritative literature upon which the Firm's conclusion is based. We believe this additional requirement will provide further accountability within each Firm's consultation processes, highlight when a Firm is taking a position based on GAAP versus their own interpretation of accounting matters, and encourage engagement partner(s) to participate in the consultation process in a role commensurate with their auditor responsibility.

Question 9 - Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

No, the proposed standard should reference the SEC standards, but should not include duplicative information.

Question 10 - Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

The definition is appropriate; however, refer to our responses to Questions 8 and 11 with regards to the requirement for communicating with the audit committee about critical accounting estimates.

Question 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?

In addition to our fundamental concern discussed in Question 8 above that the primary responsibility for communicating these matters lies with management, we are also concerned that the proposed communications with regards to critical accounting estimates could not be prepared independently. The proposed requirement seems to be asking auditors to put a range around management's estimates, which are based on management's judgments. This would put the auditors in the role of management, which would seem to be a violation of auditor independence. Further, the SEC already recommends that Management's Discussion & Analysis in the Form 10-K include the effects of the critical accounting policies applied, the judgments made in their application, and the likelihood of materially different reported results if different assumptions or conditions were to prevail (Financial Reporting Release No. 60), and therefore its presentation to the audit committee would be duplicative.

We also have a concern that the information required by paragraph 12(b) of the proposed standard would be extremely voluminous and could lead to the audit committee missing a piece of information that it might deem truly critical because it is embedded within a lengthy presentation.

For the above reasons, we propose that paragraph 12(b) of the proposed standard be removed.

Management Consultations with Other Accountants

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

Similar to our response to Question 8, such communication should be the responsibility of management not the independent auditor. Of course, if those consultations result in an accounting conclusion by management that is not consistent with GAAP, the independent audit firm should disclose such matters to the audit committee.

Going Concern

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

We believe the going concern communication requirement is sufficiently clear.

Corrected and Uncorrected Misstatements

Question 14 - Are the requirements appropriate regarding the communications for uncorrected misstatements?

Yes, we agree with the requirements regarding communications for uncorrected misstatements.

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

Our response is dependent on how the Board defines corrected misstatements in the context of this proposed requirement. We agree that the audit committee should be informed of corrected misstatements which represent out-of-period adjustments. However, we do not believe that items detected during a Company's close process, utilizing existing controls over financial reporting, constitute corrected misstatements unless those items represent out-of-period adjustments. The identification of which party, management or auditor, detects potential intra-period misstatements is often unclear and subjective due to timing of audit procedures in relation to the controls process. Further, corrected misstatements identified by the auditor are accumulated and evaluated by auditors for purposes of analyzing the implications on the company's internal controls over financial reporting, and any which rise to the level of a significant deficiency or material weakness would already be communicated to the audit committee as required by Auditing Standard No. 5 *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Therefore, we recommend that the proposed standard be revised in paragraph 18 to say "The auditor should also communicate those corrected misstatements ~~that might not have been detected except through the auditing procedures performed~~ which have been corrected outside of the period to which they apply, including the implications such corrected misstatements might have on the financial reporting process".

Form and Content of Communications

Question 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?

The standard should recommend that all required communications presented during scheduled audit committee meetings (whether in person or telephonic, regular or special meetings) be presented in a written format in order to prevent misunderstandings or, alternatively, be provided in writing subsequent to the scheduled meeting as deemed necessary by the audit committee. Communications which occur outside of scheduled meetings (i.e. a phone call with the audit committee chair to discuss an issue which arose subsequent to the scheduled closing meeting) should be followed up on a timely basis with a communication in writing when the matter is considered significant.

Timing

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

We agree with the proposed requirement that communications be performed on an annual basis prior to the issuance of the audit report. Potential changes in the macro-economic environment, the company's business or industry, and the composition of the audit committee and audit engagement team are all factors which indicate that these communications should be formally refreshed on an annual basis.

Adequacy of the Two-Way Communication Process

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

Please refer to our response to Question 1 in which we articulate our fundamental concern that the standard should speak to a "three-way" communication process which would include management. Notwithstanding that objection, we believe that a requirement for the auditor to evaluate the adequacy of the communication process would be perfunctory and not value added. This could result in a "check the box" approach in which the auditor would be highly unlikely to conclude that inadequate communication is occurring.

Other Communication Requirements

Question 19 - Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?

Yes, the other communication requirements are sufficiently clear and relevant to the audit committee's role as overseers of the audit process and the auditor relationship.

Question 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?

Yes, we believe the matters included as significant difficulties in paragraph 21 are appropriate.

Question 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 of the company under audit?

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

Appendices

Question 22 - Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Other than as addressed in our responses to Questions 1-21, we believe the information included in Appendices A-C to the proposed standard is appropriate.

*****

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 Ryan Siurek (913-315-7600) regarding our submission.

Sincerely,

Larry C. Glasscock
Chairman of the Audit Committee of the
Board of Directors

cc: Robert Brust, Chief Financial Officer
Ryan Siurek, Vice President-Controller
Mary Pat McCarthy, KPMG
Mike Power, KPMG

Texas Society of
CPA Certified Public Accountants

May 26, 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

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of Certified Public Accountants in Texas, as well as the public interest. The TSCPA has established a Professional Standards Committee (PSC) to represent those interests on accounting and auditing issues. The PSC has been authorized by the TSCPA's Board of Directors to submit comments on matters of interest to the PSC's membership. The views expressed in this letter have not been approved by the TSCPA's Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the TSCPA.

We are delighted to have the opportunity to provide input into your deliberations. Our response includes answers to the questions that were posed in the Exposure Draft.

Question 1: Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?

We believe the objectives as stated in the proposed standard are appropriate and should not include additional matters.

Question 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?

We believe the objectives are adequately articulated and need not focus on the outcome that should be achieved by performing the required procedures.

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

An engagement letter is an appropriate vehicle to use in establishing a mutual understanding of the terms of the audit engagement with the audit committee. We believe the requirement for a written engagement letter in connection with an audit engagement is long overdue. We further believe this requirement will serve to align the professional literature with the protocol currently followed by a vast majority of accounting practitioners.

14651 Dallas Parkway, Suite 700 • Dallas, Texas 75254-7408 • 972/687-8500 • 800/428-0272 • Fax 972/687-8646

Question 4: Are there other matters that would enhance investor protection that should be added to an engagement letter? If so, what other matters should be included in an engagement letter?

We are comfortable with the items currently addressed in the proposed engagement letter. However, we do have some concerns regarding the use of the term "investor protection" in question 4. In our opinion, and based on what is currently presented in our professional literature, we do not believe the auditor's role is to protect the investor. Auditors are responsible for opining on a client's financial statements by indicating whether or not the auditor believes those financial statements are presented fairly in accordance with generally accepted accounting principles. We believe use of the phrase "enhance investor protection" in an auditing standard could lead to the presumption that auditors are taking on responsibilities that extend the auditor's perceived and actual responsibilities to investors. As an illustration, note that the auditor's opinion is not addressed to investors but, rather, to the audit committee or board of directors. We see a great deal of difference between being responsible for issuing an opinion on the fair presentation of an entity's financial statements and the far reaching concept of investor protection.

Question 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?

The inquiry proposed by the Board regarding 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, is most appropriate. Such an inquiry is sufficiently broad to garner the kind of information that would be valuable to an auditor. We do wish to raise a word of caution in relation to the proposed inquiry of the audit committee. This caution concerns situations that occur in most small public entities where the audit committee is composed of internal directors rather than independent directors. In such instances, the auditor should be alerted to the fact that a management-constituted audit committee might not be prone to raise contentious issues with the auditor. In such situations, the auditor should not rely totally on the fact that no complaints or concerns were voiced by members of the audit committee. The auditor should be alerted to exercise caution in such situations and approach them with a greater degree of skepticism than would result if the audit committee was composed entirely of independent directors.

Question 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?

We believe the requirement to provide information on the auditor's audit strategy and timing is appropriate. However, this requirement introduces new and unfamiliar territory for most auditors. Thus, we suggest that the Board provide more specific guidance, as well as relevant examples, on the kind of audit strategy/timing communications that would serve to avoid compromising the effectiveness of the audit procedures.

Question 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?
To the extent that the types of arrangements mirror those identified by the SEC, this aspect of the proposed standard is clear.

Question 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)?

Yes, the proposed requirements are clear.

Question 9: Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

We believe it's completely appropriate to include the SEC requirements in a standard involving the audits of public companies since the SEC has the ultimate responsibility and oversight in this area. However, the proposed standards should be consistent with the guidance provided by the SEC and not include significant differences.

Question 10: Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

As long as this definition is consistent with the definition used by the SEC, there should be no dissention. Since the rules of the PCAOB must be functionally consistent with the rules of the SEC, the definition of critical accounting estimates should be the same.

Question 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?

We believe, in their purest form, the communication requirements regarding critical accounting estimates are appropriate. However, we believe the composition of the members of an entity's audit committee, to whom these communications are made, poses a potentially significant problem. That problem concerns the composition of the audit committees of a majority of public companies to which this proposed standard applies. According to a white paper issued by the SEC Advisory Committee on Smaller Public Companies, dated August 10, 2005, "Approximately 80% of all U.S. public companies provide 6.4% of all U.S. public market capitalization." Further, the Sarbanes-Oxley Act (Section 2) defines the term audit committee to mean, "(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting process of the issuer and audit of the financial statements of the issuer; and (B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer." We assume the 20% of public companies that provide approximately 93.6% of U.S. public market capitalization have audit committees composed entirely of independent directors. In these instances, we believe the communications regarding critical accounting estimates are appropriate and are being made to an appropriate group. However, we are concerned about the 80% of public companies whose audit committee, we assume, is often composed of directors who are also members of the entity's management team. In these instances, we have some concern about the communications regarding critical accounting estimates being made to management and the effect of those communications. Could such communications compromise the auditor's independence and objectivity? These communications could be interpreted as an auditor assisting the client in the implementation of accounting principles and the determination of accounting estimates. Such implications seem to us to represent a slippery slope when the audit committee is also a part of the entity's management team. As a minimum, we believe the Board should address the issue of the composition of an audit committee for small public companies and the implications for such communications regarding the auditor's independence and objectivity.

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

Yes, if such consultations concern matters considered important enough for the auditor to discuss with the audit committee, the company should be required to disclose these matters to the auditor. Also, the auditor should be required to inquire about whether such consultations have occurred.

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

We believe the communication regarding going concern matters is clear.

Question 14: Are the requirements appropriate regarding the communications for uncorrected misstatements?

These requirements are appropriate.

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

We believe all corrected misstatements should be communicated to the audit committee as these may also be indicative of challenges within the financial reporting process that should be addressed by the board and management.

Question 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?

We believe the choice of communication method should be left to the judgment of the auditor. The auditor is in the best position to determine which matters should be communicated orally and which should be in writing. The prudent auditor would document all oral communications in the audit working papers so a record of the communication is available.

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

The requirements in the proposed standard are appropriate. We believe the matters communicated annually should be consistent with current guidance in the professional literature.

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

We believe the requirement is **not** effective. An evaluation of two-way communications can only be adequate if both parties are involved. If only the auditor evaluates the effectiveness, and he or she understands what was communicated, it doesn't indicate anything about the other party's understanding.

Question 19: Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?

We believe the suggested language is sufficient provided it considers that the results of audit procedures performed after the initial communication with the audit committee may result in a modification to the audit report that was not previously expected. We do not believe any additional communication requirements should be added to the proposed standard.

Question 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?

We believe the matters included in paragraph 21 are appropriate and no other matters should be included as significant difficulties.

Question 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 of the company under audit?

We do not consider any of the requirements included in the proposed standard to be inappropriate. However, as we have mentioned earlier in our response we encourage the Board to give further consideration to the fact that many small public companies do not have separate audit committees, and the board and management are often interchangeable. These companies typically have limited internal accounting and financial reporting resources. Thus, it is often difficult to communicate formally with the board prior to the issuance of the audit opinion. Some consideration of the potential problems with the applicability of this proposed standard to small public companies should be given and addressed in the final standard.

Question 22: Is the information in Appendices A – C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

We find the appendices to be sufficiently clear and appropriately constructed.

We appreciate the opportunity to provide our input to the standard-setting process.

Sincerely,

Melissa A Frazier

Melissa A. Frazier, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants

HUNTER
www.hunter.cuny.edu

Department of Economics

October 21, 2010

By Email

Office of the Secretary
The Public Company Accounting Oversight Board
1666 K Street N.W.
Washington. D. C. 20006-2803
By e-mail: comments@pcaobus.org

Re: Exposure Draft - Proposed Auditing Standard Related to Communications with Audit Committee and Related Amendments to Certain PCAOB Auditing Standards

Dear Sir or Madam:

The Advanced Auditing class (Eco 775) at the Hunter College Graduate program in New York City appreciates the opportunity to comment on this exposure draft.

The class discussed the above proposed exposure draft and have attached our comments.

If you would like additional discussion with us, contact Professor Joseph A. Maffia, at 212-792-0404.

Sincerely,

Joseph A. Maffia

Professor Joseph A. Maffia, CPA

Hunter College of The City University of New York, 695 Park Avenue, New York, NY 10021
phone: 212.772.5400/5401 fax: 212.772.5398 www.econ.hunter.cuny.edu

Hunter College Graduate Program
Economics Department
Advanced Auditing Class
ECO 775

COMMENTS ON PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES AND RELATED AMENDMENDS TO CERTAIN PCAOB AUDITING STANDARDS

DOCKET No. 030

October 18, 2010

<u>Principal Drafters</u>

Borrero, Cindy
Ercetin, Secil
Kekic, Eldar
Rafickrullah, Calvin
Rezk, Monika
Tung, Henry

Hunter Advanced Auditing Class

Acosta, Jenny
Amanat, Uzma
Grueniger, Christine
Hoshino, Kozue
Johnson, Tiffany
Kenny, John
Kitahata, Akina
Lee, SunJeong
Li, Ji
Liang, Li
Liu, YingYing
Malik, Mahvash
Narinesingh, Arielle
Navarrete, Daisy
Newcombe, Jonathan
Noorani, Ashraf
Padilla, Wendy
Pande, MangalaGau
Peng, Weining
Puchala, Jolanta
Redhead, Maurice
Sanderson, Timothy
Seo, Hyunseok
Shafiq, Shahrin
Siwka, Agnieszka
Spikes, Hasea
Su, Mao
Tamimu, Ali
Tan, Kwon
Tonge, Emily
Waxman, Michael

Professor Joseph A. Maffia, CPA

As graduate students we appreciate the opportunity to comment and address particular questions in the proposed standards relating to communication with audit committees. We have reviewed the exposure draft and offer the following comments for consideration by the PCAOB.

Overview of Proposed Standard

We support the Board's direction in enhancing effective communication between auditors and the audit committees. We also compliment the Board's consideration for the existing standards issued by the IAASB and the Proposed SAS "terms of engagement" by the ASB.

We believe the proposed standard will enrich and promote further involvement of the audit committee with the engagement of the audit. With respect to the proposed objective and certain requirements, we comment on the following matters:

Evaluation of the Adequacy of Two-Way Communications

The Objective

Q2: Are the objectives adequately articulated? Should the articulation of the objectives focus on the outcome that should be achieved by performing the required procedures?

The objectives are clear, concise and well articulated. These objectives allow the audit committee to enrich their oversight responsibilities.

We propose that the last objective be more focused on the outcome of evaluating two-way communications between the auditor and the audit committee. Rather than the objective being focused on the *evaluation* itself, this improvement can be made by adding requirements to focus on *promoting the effectiveness* of the communications.

We suggest the following revision to the objective:

"~~Evaluating~~ **To promote** ~~the adequacy of the~~ **effective** two-way communications between the auditor and the audit committee to support the objectives of the audit."

The word *promote* is more appropriate as an objective and the word *effective* emphasizes the desired outcome of two-way communications between the audit committee and the auditor.

Methods of promoting effectiveness such as the performance of an evaluation will be further explained by the related standards in paragraphs 26-28 of the proposed standard.

Paragraph 26-28

Q18: Does the requirement to evaluate the adequacy of the communication process promote effective two-way communications? Is more information on this requirement needed?

While we agree that the effective two –way communication between the auditor and the audit committee benefits the audit and can strengthen the audit process, we don't believe that the one way evaluation of this communication will benefit the relationship between the auditor and the committee and therefore the success of the audit. The evaluation alone will be insignificant to the quality of the communication since it will be obligatory and has no value added.

For that reason we propose that paragraphs 26-28 be removed from the proposed standard. We believe that ISA 260[1] provides clear guidance on this matter and should be adopted in place of paragraphs 26-28 of the proposed standard.

We believe that the communication should be independent and it can definitely gain from guidance by the Board but not from regulations imposed by the Standard which can make the communication issue even more challenging. This part of the proposed standard – paragraph 26 through 28 – conditions the auditor's action when the communication is not adequate. The specifics of the relationship between auditors and audit committee need to be taken under consideration. Evaluating "your employer" will present an interesting challenge to the auditor and for that reason should be left to the auditor's professional judgment. As well as shift the responsibilities toward the auditor where the communication should actually involve the management – audit committee and the auditor (tree-way communication). Auditor cannot decide if the audit committee is in fact fully informed by the management on the issues or if the understanding of the matters communicated by the auditor is in place. Employing this responsibility solely on the auditor is taking the focus from the actual audit process and put the auditor in odd position to make a judgment without the knowledge of all the facts.

---

[1] IAS 260: Adequacy of the Communication Process

22. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.

Obtaining Information Relating to the Audit

Q5: 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?

We believe that it is appropriate. We agree that it complements the Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*.[2] One thing we suggest is an addition to the proposed statement. Since internal control is also as important as the matters provided in the proposed standards, the audit committee should be aware of the internal control system issues. It will also increase the dialogue between audit committee and the auditor. That can lead to a more effective communication.

We suggest the following revision to the proposed statement:

"The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit, including **internal control-related issues** and complaints or concerns raised regarding accounting or auditing matters."

Accounting Policies, Practices and Estimates:

Q10: Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

The definition calls to demonstrate how management derived critical accounting estimates and their reasons for those decisions. We believe if the auditor is aware of critical estimates being done by management they have a duty to investigate where this logic came from and if it is well supported. The requirement is appropriate, especially when critical accounting estimates have an impact on the financial statements.

We suggest an improvement to definition iii. As follows:

"iii. Any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the

[2] Paragraph 51 of Proposed Auditing Standard, *Identifying and Assessing Risk of Material Misstatement*.

effects on the financial statements, and the information that ~~supports or~~ challenges such changes"

We believe "*the information that supports"* is redundant of "description of the reasons for the changes". A description of the reasons for the changes would tend to include information that **supports** the change in assumptions or processes made by management to the critical accounting estimates. Leaving "challenges" as the last clause places further emphasis on the relevancy of disagreements to the changes of assumptions or processes.

Management Consultations with Other Accountants:

Paragraph 15

Q12: Should this requirement be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms?

This requirement should be expanded to include consultations on accounting or auditing matters with non-accountants, such as **consulting firms** or **law firms**. These matters can affect the company's long term stability and/or the actions the company plans to take. It may also suggest the company's future is in jeopardy or its planned activities may negatively affect their financial statements and investor's investments. The question is raised if extensive effort would be required to confirm these consultations. The length to which auditors should go about to verify the information obtained should be specified in the proposed standard.

We suggest the following revision to paragraph 15:

"When the auditor is aware that management consulted with other accountants, **consulting firms or law firms** about auditing or accounting matters, the auditor should communicate to the audit committee his or her views about significant matters that were the subject of such consultation".

Corrected and Uncorrected Misstatements:

Q14: Are the requirements appropriate regarding the communications for uncorrected misstatements?

We believe that the requirement is appropriate, especially the schedule of individual misstatements as this will give the committee the greater insight of the affect these misstatements may have.

We, however, don't believe that communication of the bases for immateriality has to be communicated to the committee. This communication would reveal more information than necessary of the auditor's methods of conducting the audit. Therefore, we propose the following part of paragraph 18 be removed from the proposed standard:

~~**"The auditor should communicate to the audit committee the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative factors considered."**~~

Furthermore, we believe that the note to paragraph 18 is a requirement; therefore should be elevated to be a part of the paragraph.

Q15: Should all corrected misstatements including those detected by management be communicated to the audit committee?

We strongly disagree that corrected misstatements detected by management should be reported to the audit committee. Even if the auditor would be able to determine which entries are corrected misstatements and which ones are end-of-year adjustments, it would still indicate the strength in internal control and as such would not need to be reported to the audit committee.

We propose following change to the paragraph 18:

"The auditor also should communicate those corrected misstatements that ~~**might not have been detected except through the auditing procedures performed**~~ **<u>were detected by the auditor</u>**, including the implications such corrected misstatements might have on the financial reporting process."

<u>Timing:</u>

Q17: Are the requirements in the proposed standard on the timing of the auditor's communications appropriate? Should only certain matters be communicated annually? If so, which ones?

We agree with the requirements regarding the timing of the auditor's communication, as we recognized the timely communication with the audit committee as a crucial part of the auditing process.

Information, especially those based on and related to Financial Reports are only useful if presented in the timely manner. Due to the changes in business, economic environment or the audit committee like change in its members, communication should be executed on an annual basis. The volume of it should depend on the auditor's professional judgment with respect to the significance of the matters and necessary follow up and correction measures.

Other Communication Requirements:

Paragraph 21

Q20: Are the matters included as significant difficulties in paragraph 21 of the proposed standard appropriate? What other matters should be included as significant difficulties?

We believe "**inadequate communications with management**" should be added to paragraph 21 as a significant difficulty. Communication between auditors and management is vital to ensure necessary information related to the audit is obtained and understood. A difficulty is presented when management is often unavailable, busy or do not provide adequate time to communicate with the auditor about certain matters. Any concerns the auditor may have will be unjustified if there is a lack of adequate communication with management.
We suggest the addition of this significant difficulty to be included as follows:

The auditor should communicate any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include:

a. Significant delays by management or unwillingness by management to provide information needed for the auditor to perform his or her procedures;
b. An unnecessarily brief time within which to complete the audit;
c. Extensive, unexpected effort required to obtain sufficient appropriate audit evidence;
d. Unreasonable restrictions imposed on the auditor by management;
e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested; and
f. Inadequate communications with management.

28 May 2010

Our ref: ICAEW Rep 50/10

Office of the Secretary
PCAOB
1666 K Street
N.W.
Washington
D. C. 20006-2803

By email:
comments@pcaobus.org

PCAOB Rulemaking Docket No. 030

Dear Sir

PCAOB RELEASE NO 2010 - 01: PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES AND RELATED AMENDMENTS TO CERTAIN PCAOB AUDITING STANDARDS

The ICAEW welcomes the opportunity to comment on the proposed auditing standard on auditor communications with audit committees published by the PCAOB on 29 March 2010.

The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

Katharine E Bagshaw FCA
Manager, Auditing Standards
ICAEW Audit and Assurance Faculty
T + 44 (0)20 7920 8708
F + 44 (0)20 7920 8754
E: kbagshaw@icaew.com

SIGNIFICANT ISSUES

1. The introduction to the PCAOB's proposals focuses on the provision of information by auditors to audit committees to enable audit committees to carry out their duty to protect investors. Current work in the UK has highlighted the significance of the work of audit committees with auditors and management in contributing to the value of audit. Audit committees perform a key role in upholding audit quality and investor protection, and it is important not to loose sight of these objectives. The audit committee, and the provision of information to it, are not ends in themselves and any guidance must necessarily be with a view to enhancing audit quality and investor protection. Audit committees make their best contributions when a balance is achieved between well defined compliance work, and an unstructured and informal element, unconstrained by the need for documentation of compliance with standards. Audit committee members need to be free to ask their own questions in order to function well. Our overall impression of these proposals is that they represent an attempt to mandate some of the unstructured element of audit committee operations in auditing standards, and to narrow the scope for the exercise of judgement by auditors, management and the audit committee alike. We are not convinced that this will improve audit quality or investor protection because auditing standards are not the best way to address deficiencies in how audit committees function. In this context we note an article in the May 2010 American Accounting Association Journal of Accountancy entitled *Audit Committee Member Investigation of Significant Accounting Decisions* which makes it clear that a key element of the effectiveness of audit committees depends on the quality and expertise of the audit committee members and not necessarily the provision of yet more information.

2. We are somewhat concerned that the PCAOB does not appear to have asked specific questions about a number of the additional requirements, such as the requirement to communicate about consultation outside the engagement team.

3. We note the fact that there might be more emphasis on communications from the audit committee to the auditor, but that it would not sit well in an auditing standard for auditors. This tension exemplifies point 1 above concerning the importance of some audit committee functions that are outside the boundaries of standards and compliance.

4. In isolation, few of the proposed changes appear unreasonable on the face of it but they all represent additional communications that are likely to require additional work. We are not convinced that they will enhance audit quality or the effectiveness of audit committees. The proposals appear to be written on the premises that audit committees are at present ill served by both auditors and management who are not communicating important information to them, and that it should fall to the auditor to remedy deficiencies in management communications with audit committees. We believe that the former premise is the exception and not the rule, and that the latter is contrary to the spirit of co-operation that is necessary in order for auditors to perform high quality audits. We urge the PCAOB to consider in all cases (a) whether auditors should be required to use their judgement in considering informing the audit committee about a particular matter, which is what happens at present, (b) what exactly the audit committee is likely to do with the additional information provided in the generality of cases, and (c) the possibility of unintended consequences should inappropriate communications be mandated, such as the relationship between management and auditors being undermined. There is also a risk that providing a detailed list communications requirements may result in boiler plate disclosures to satisfy the requirements of an auditing standard which make it harder for audit committees to discern the more significant matters.

5. The PCAOB might wish to consider whether any issue of under-communication by auditors might be better addressed through the inspection process.

6. We appreciate that the proposed standard is necessarily predicated on a US corporate governance model in which the audit committee exercises oversight over management and appoints the auditor, and in which, implicitly, helping the audit committee fulfil its functions takes precedence over the relationship between auditor and management. In jurisdictions such as the UK, the audit committee is a sub-committee of the board, and recommends the auditor to the shareholders, who appoint auditors. Many other variations exist. Nevertheless, the audit is normally for the benefit of the stockholders and/or the capital markets and not for the audit committee or the board. It would be helpful if the proposals recognised that auditors of foreign private issuers may need to consider how the requirements of the standard should be applied in the context of the corporate governance requirements of the relevant jurisdiction. We draw attention in this context to the UK's Audit Quality Forum publication, *The Impact of Audit Committees on Auditing* which analyses the differences between the impact of audit committees on auditing in the UK and the US and can be found at www.icaew.com/auditqualityforum.

7. In our 2 March 2010 response to the PCAOB on its exposure of the risk standards, we encouraged the PCAOB to effectively challenge the IAASB in areas in which it believes that ISAs should be improved. We noted that in order for that challenge to be effective, there is a need for the PCAOB to be robust and detailed in its explanations of differences between PCAOB standards and ISAs[1]. We encourage the PCAOB once again to improve the quality of these explanations and we give specific examples below. This type of challenge is an important part of the convergence process, which is not well-served by the small wording differences or relatively inconsequential additional requirements noted in our detailed responses and 'other matters' below.

8. In our response to the PCAOB on the risk standards, we also noted a need for a description of the significant differences that the PCAOB believes exists between the proposed standards and ISAs and ASB standards, and vice versa, and this remains true in this exposure draft. The PCAOB should also be clear about the significant changes it expects to audit practice as a result of its proposals.

9. *Communicating consultation outside the engagement team*: we are concerned that an unintended consequence of this proposal might be to discourage necessary consultation. Issues consulted on are likely to be significant anyway and would therefore be communicated to the audit committee as such. The requirement might undermine the necessary authority of the engagement partner. In practice, auditors may well communicate such matters to the audit committee but this, like several other requirements, should be considered as a matter of judgement because communication is not always appropriate. There is also an issue with defining what counts as a consultation given different practices within firms both small and large. Does a telephone call, a chat in the corridor or a brief email exchange mentioning the issue in passing represent an enquiry or a consultation? We also wonder whether such matters might be construed as including matters discussed with the SEC Practice Section Review undertaking the Appendix K review, which we do not believe should be the case. The proposals state that these consultations do not include discussions with the engagement quality reviewer and it would help is this could be explicitly expanded to cover the SEC Practice Section Reviewer.

10. *Communication of misstatements*: In practice, significant misstatements are reported regardless of whether management or auditors discover them or whether they are corrected; audit committees find this valuable because it reflects on the quality of financial reporting processes. However, the paragraph 17 requirement to report a detailed schedule of uncorrected misstatements seems unrealistic because in practice, summaries are reported and we would not

---

[1] '…..going forward, it will be enormously helpful to the international standard-setting process if the PCAOB can be crystal clear about which areas of PCAOB standards it believes to be technically better than ISAs, and why. The PCAOB should challenge the IAASB in areas in which it believes ISAs can and should be improved.'

expect audit committees to find additional value in being provided with the same level of detail as management.

11. *Accounting policies and critical accounting estimates:* the paragraph 12 note *can* be read as suggesting that auditors, instead of focusing on their own views on such matters and communicating them, should assess whether management has adequately described such matters to the audit committee, and to step in if not. This is problematic. There would appear to be much greater value in an auditor assessment of such issues independently of management than in auditors attempting to prove a negative by determining what has not been communicated, and filling in the gaps. If this is not the intended meaning of the note, it might be made clearer. There is value in some duplication of reporting by management and auditors in such areas in any case. In practice, matters that have been missed by management *are* communicated by auditors but to permit auditors to rely on what management has communicated as being adequate might result in poorer quality communications overall. The detailed requirements of this paragraph imply that auditors should communicate very detailed matters that are the responsibility of management. It might be helpful to note that such disclosures are expected to be rare, and that the requirement is intended to act as a spur to management to make the required disclosures. Auditors might be encouraged instead to comment to the audit committee on the information management *is* proposing to disclose under SEC requirements and/or GAAP[2].

12. *Communication of consultations between management and lawyers etc:* the rationale for this proposal is not clear. The question arises (again) as to what exactly constitutes a consultation and in any case, such issues are (again) likely to be significant and reported on that basis.

13. It would be helpful for each PCAOB pronouncement to explain clearly the status of the requirements, the notes and the appendices, particularly when they cover a variety of types of material as in this case.

ANSWERS TO SPECIFIC QUESTIONS

1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters 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?

The objectives suffer from the same flaws as the objectives in the ISA, in that they amount to little more than a summary of the requirements. This is partly a result of a lack of foundational principles for the development of objectives, a weakness in both PCAOB and IAASB standard-setting. A starting point for the development of the extant ISA was, of course, the extant US standards. We are concerned that these flaws are becoming embedded and self-perpetuating and we encourage the PCAOB to take the opportunity to break this cycle. Part of the purpose of an objective is to enable an auditor to stand back and ask whether there are any necessary additional audit procedures, beyond those required by the standard, to achieve the objective. This is not possible if the objectives only summarise the requirements. We agree that objectives should articulate the outcome; they do not do so at present. We note in particular item (d) which requires the auditor to evaluate the adequacy of the two-way communication process, and we disagree with the PCAOB's rationale for including it. A requirement to evaluate is not an objective, but a requirement, and it effectively requires the auditor to evaluate his own performance as part of the communication process; the PCAOB notes the corresponding ISA requirement which is to 'promote' the two-way communication process and dismisses it on the basis

[2] Paragraph 125 of IAS 1 (revised 2007), *Presentation of Financial Statements,* includes, *inter alia*, a requirement to disclose '..*information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year..*'.

that there are ‘no related requirements’. We do not agree that there are no related requirements – the related requirements are the requirements in the ISA to evaluate the process. The outcome, purpose and objective of evaluation are promotion of the process. To align requirements and objectives such that they are indistinguishable renders the distinction inoperative, and is to misunderstand the nature of both objectives and requirements. ‘Promotion’ is an intentionally wider and higher target than merely evaluating a process. We also note that question 18 below refers to the promotion of two-way communication.

We struggle to understand either the substance or the significance of the slight wording differences with the ISA wording in item (b) – the ISA requires auditors to communicate the planned scope and timing of the audit, the PCAOB proposes communication of the audit strategy and timing.

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

Yes. The difference with the ISAs in this case can be justified by the different population to which PCAOB standards apply. ISAs apply much wider variety of audit engagements.

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

Not that we are aware of.

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?

Assuming the inquiry referred to is in paragraph 8 of the proposed standard regarding complaints and concerns (the question is not clear), the proposed requirement is not objectionable (even though there is no corresponding requirement in the ISA), but we question whether an auditing standard is the right place to effectively impose a requirement on the audit committee to communicate such matters to the auditor. We are also concerned that the auditor might be overwhelmed by communications of frivolous or vexatious complaints and, assuming that only significant complaints and concerns are to be communicated, such matters would be communicated in any case under other requirements of the standard. Or is the auditor being asked to second guess judgements made about complaints to the audit committee?

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?

Yes, and No.

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?

Material on page 9 of the preamble in appendix 3 about affiliated and network firms and related arrangements is relevant and might be included in paragraph 10 (d) of the proposed standard.

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)?

The new requirement for auditors to communicate matters on which they have consulted outside the audit team is discussed above under ‘significant issues’. We do not believe that a good case has been made for this new requirement. There may well be practical problems in applying it and indeed the proposal may in fact be counter-productive in that it might discourage necessary consultation. Assuming that an operational definition of what constitutes a consultation can be found then issues consulted on are likely to be significant. Auditors may well communicate such matters to the audit committee under other requirements of the standard and this, like several other requirements, should be a matter of judgement to be considered by the auditor because communication is not always appropriate.

Paragraphs 12 and 13 appear complex in comparison with ISA 260 paragraph 16 (a) and appendix 2 but they are generally clear, and part of the complexity comes about through the incorporation of Regulation S-X requirements around critical accounting policies and practices, which is valuable. It would help, however, to clarify that the 'significant accounting policies and practices' in paragraph 13 (a) are the same as those referred to in paragraph 12 (a).

The new requirement to communicate, if management has not, the anticipated application of new accounting requirements that are not yet effective would require the auditor to effectively do management's job for them, which for some complex standards could involve a significant amount of work and might breach the auditor independence requirements.

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

Yes.

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

Yes.

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?

These matters are discussed above under 'significant issues'. The paragraph 12 note possibly permitting auditors to fill in gaps on what management has reported, instead of forming their own view on such matters and communicating them, might result in poorer quality communications overall.

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

This requirement should be extended, as the distinction between the roles of accounting and law firms is not always clear or significant in the US environment.

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

Yes, although we do not agree that the IAASB has similar requirements to the PCAOB's proposed requirements and we continue to urge the PCAOB to move further towards the international position in this area.

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

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

These matters are discussed above under ‘significant issues’. The PCAOB should have the same requirements for corrected and uncorrected misstatements given that in practice, significant misstatements are reported regardless of who found them or whether they are corrected.

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?

The ISA requires that matters must be in writing where oral communications are inadequate which does not seem to be an onerous requirement. In practice, anything of any significance should be documented in any case.

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

The requirements are appropriate in this context.

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

Yes, and No, although we note under ‘significant issues’ above our preference for the promotion of effective two-way communications as an objective (over evaluation).

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

We are not convinced by the rationale for holding over the paragraph 4 requirement which is likely to be covered by other requirements in any case. Significant issues discussed with management prior to appointment or retention reflect conditions existing before the audit committee hired the auditors and it may not be appropriate to retain it from AU 380.

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?

Wording differences with the ISA should be eliminated as all of them are insignificant (’Restrictions imposed on the auditor by management.’ vs. ‘Unreasonable restrictions imposed on the auditor by management,’ for example).

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 of the company under audit?

No.

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter.

This matter is discussed above under ‘significant issues’. It is important that the status of the appendices is clear.

OTHER MATTERS

Whilst not part of the standard, the comparison of ISAs, SAS and the PCAOB’s proposals is incomplete, in a number of areas. For example, the proposed standard requires the auditor to inquire of the audit committee about whether they are aware of other matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. The proposal states that the proposed auditing standard *Identifying and Assessing Risks of Material Misstatement* includes a requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks. The proposal goes on to state that ISA 260 and SAS 114 do not contain a similar requirement. This is true but there is a requirement in ISAs 315 and 240 for auditors to make inquiries of those charged with governance as part of their understanding of the nature of the entity and the system of internal control. There are also specific requirements in ISA 240 to make inquiries of those charged with governance regarding actual, suspected or alleged fraud and to consider whether the information gathered as part of understanding the entity and its environment is indicative of a risk of material misstatement due to fraud.

The Institute of Internal Auditors

Richard F. Chambers
Certified Internal Auditor
Certified Government Auditing Professional
Certification in Control Self-Assessment
President and Chief Executive Officer

May 27, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803, USA

Response e-mailed to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 030. PCAOB Release No. 2010-001, March 29, 2010

Dear Sir/Madam:

The Institute of Internal Auditors (IIA) welcomes the opportunity to comment on the *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*. Our comments are based on a thorough analysis and discussion, utilizing a core team of audit experts who serve on The IIA's Professional Issues Committee. These individuals consist of experienced Certified Public Accountants and Certified Internal Auditors who have worked in public accounting and in audit management positions in small, medium, and large multinational companies.

The proposed standard is extremely important to The IIA. As defined in The IIA's International Professional Practices Framework (IPPF): "Internal auditing helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." The IIA Standards Section 2110 addresses Internal Audit's specific responsibilities related to corporate governance processes. As internal audit professionals, we are well positioned to understand the implications and impact of these principles on audit, risk management, control, and governance practices within companies.

We strongly support the proposed PCAOB standard that addresses the need for improved communication between the auditor and the audit committee. We see the need for auditors to provide accurate, complete, and timely information to the audit committee to allow them to provide oversight of audits performed. We also believe a properly organized internal audit function compliments and supports the external audit of an organization's financial statements and internal controls.

Global Headquarters
247 Maitland Avenue
Altamonte Springs, FL
32701-4201 USA
T: +1-407-937-1100
F: +1-407-937-1101
www.theiia.org

Tel: +1-407-937-1200 • Fax: +1 407-937-1101 • E-mail: richard.f.chambers@theiia.org

The following are our principal comments and observations. More detailed responses to the exposure document are included in Attachment A.

1. Overall, the document is very well written. We agree the audit committee is the organizational body to engage and oversee the work of the external auditor. We also agree the auditor has a responsibility to clearly communicate with the audit committee on the strategy, objectives, approach, risk assessment process, and timing of work. This two-way communication should occur throughout the audit so both the auditor and the audit committee can maintain a productive and professional relationship (see the response to question 1).

2. The auditor should obtain audit committee views on the internal audit function and reliance on internal audit work performed (see the response to question 5).

3. We believe the auditor's "planned" use of internal audit staff needs to be broadened to include a cooperative and coordinated relationship (see the response to question 6).

4. The proposed standard states the auditor should communicate to the audit committee so an "experienced auditor" would understand the communication. Ideally, that communication would be at a level that reasonably competent audit committee members would understand the communication, or at the very least, financially literate audit committee members would understand the communication (see the response to question 16).

The IIA welcomes the opportunity to discuss any and all of these recommendations with you. We offer our assistance to the PCAOB in the continued development of this standard.

Best Regards,

Richard F. Chambers

Richard F. Chambers, CIA, CGAP, CCSA
President and Chief Executive Officer

About The Institute of Internal Auditors
The IIA is the global voice, acknowledged leader, principal educator, and recognized authority of the internal audit profession and maintains the *International Standards for the Professional Practice of Internal Auditing* (*Standards*). These principles-based standards are recognized globally and are available in 29 languages. The IIA represents more than 170,000 members across the globe and has 103 affiliates in 165 countries that serve members at the local level

Attachment A

The Institute of Internal Auditors
Response to the
PCAOB Proposed Auditing Standard Related To
Communications With Audit Committees And Related Amendments

A. Objectives of the Auditor

1. Are the objectives of the auditor in the proposed standard appropriate?

Except as noted below, we agree with objectives (a) - (c). For objective (d), we see the need for the auditor and the audit committee to assess the adequacy of two-way communication throughout the audit to ensure a productive and professional relationship that meets the objectives and responsibilities of both parties.

The auditor should provide sufficient information to the audit committee to allow the committee to fulfill its responsibility of overseeing the work of the auditor and evaluating the auditor's effectiveness. This objective should be added to the Standard and consideration given to identifying specific information requirements. At a minimum, the Standard should require the auditor to discuss with the audit committee the level, frequency, and timing of the information that will be provided. Please see our response to Question 18 for additional comments.

See below for additional suggestions.

If not, why? Should other matters be included in the objectives?

In addition to the above, consider revising objective (b) as follows: "(b) communicating to the audit committee an overview of the audit scope, strategy, and timing of the audit, including a description of the process and the results of the auditor's risk assessment process."

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?

Yes

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?

Yes - In addition, the Standard should address the timing of the engagement letter.

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

The engagement letter should address the responsibilities of the auditor and audit committee in support of two-way communication.

Additional engagement letter considerations should include:

- ***The use of a global audit team, including its use of other firms, affiliated firms, and relationships with and among those parties, including whether they are subject to quality control procedures performed by the auditor.***
- ***The firm's planned use of internal subject matter experts, outside of the members of the audit team, and the focus areas of these experts.***
- ***Clear description of fee arrangements. (Comment – please review this suggestion together with our response to question 6 below.)***

C. Obtaining Information Related to the Audit

5. Is the proposed requirement to inquire of the audit committee appropriate?

Yes

What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

The auditor should ask the audit committee about the independence and objectivity of the internal audit function, the adequacy of internal audit resources, the frequency and quality of the committee's communications with internal audit, and the quality and significance of the internal audit function's observations about internal controls and financial reporting.

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?

The extent of "planned use" of an organization's internal auditors should be consistent with previously accepted agreements and the audit fee. The proposed standard implies the auditor can use the organization's internal audit staff without limit and without regard to other chartered or mandated

responsibilities, the previously approved audit plan, or other organization responsibilities. This planned use of internal audit staff should have been previously discussed and agreed upon with the Chief Audit Executive. There should be more focus in the Standard on the external auditors' use of the internal auditors' work and that cooperative and coordinated relationship.

The auditor's strategy should include the approach to risk assessment and evaluation of the control environment.

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?

Communicate the process for informing the audit committee when there are changes in key personnel and the potential impact on the quality of the audit.

Explain how the quality of the extended audit firm (including any global teams) will be managed. Specifically,

- ***Paragraph 10d of the proposed standard should be expanded to require communication of the percentage of the reporting entity's assets/revenues/risk areas that is audited by other firms, affiliates, or global offices of the firm.***
- ***Paragraph 10e should include steps taken by the auditor to manage the quality of the work done by other firms, affiliates, or other offices of the firm.***

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., the difference between a critical accounting policy and a significant accounting policy or practice adequately described)?

The auditor should inform the audit committee of alternative GAAP accounting policies or practices that, if followed, could result in improved transparency and accountability in financial statement reporting. This communication may be helpful even though the accounting policy or practice currently followed complies with GAAP.

The discussion of policies, practices and estimates should be the responsibility of management. The auditor's primary role should be as summarized in the note at the bottom of paragraph 12 in the exposure draft.

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

Yes - as a reference, but not to replicate.

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

Yes

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?

Yes
Please see Question 9 - these should be responsibilities of management; the auditor's responsibility should be to comment on the adequacy of the communications between management and the audit committee.

F. Management Consultations with Other Accountants

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

Yes

G. Going Concern

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

Yes

H. Corrected and Uncorrected Misstatements

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

Yes - however consistent with item 9 above, these should be responsibilities of management; the auditor's responsibility should be to comment on the adequacy of the communications between management and the audit committee. Additionally, significant deficiencies and material weaknesses should be discussed.

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

Yes - for auditor identified mistakes. Misstatements detected by management should be reported only when they related to a failure in internal controls significant to the preparation of the financial statements.

I. Other Matters

We have 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?

Except for matters clearly considered inconsequential, important matters supporting the achievement of the overall objectives of the audit and the objectives of the auditor as previously described should be communicated to the audit committee in writing. This will provide a record and avoid later disputes, confusion, and misunderstanding about what was said.

Paragraph 23 of the proposed standard indicates auditor communication should be in sufficient detail to enable "an experienced auditor" to understand the communication. This sentence should be changed to "auditor communication should be in sufficient detail to enable reasonably competent audit committee members to understand the communication made to comply with the provisions of the standard." As an alternative to the above, "auditor communication should be in sufficient detail to enable financially literate audit committee members to understand the communication." Ideally, all audit committee members should understand auditor communication and that should be the communication objective of the auditor. The purpose of auditor communication with the audit committee is <u>not so experienced auditors</u> understand the communication.

K. Timing

17. Are the requirements in the proposed standard on the timing of the auditor's communications appropriate?

Yes - see question 4 relating to the timing of when the engagement letter should be delivered.

Should only certain matters be communicated annually? If so, which ones?

No additional comments.

L. Adequacy of the Two-way Communication Process

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

Paragraphs 26 - 28 seem to focus on the auditor "evaluating" the two-way communications at the end of the engagement and prior to issuance of the report. Suggest the paragraph be amended to: "The auditor should communicate with the audit committee throughout the audit to promote two-way communications and enable both parties to fulfill their responsibilities, including the audit committee's oversight of the auditor." (Comment - this Standard places the auditor in a difficult position as the audit committee selects the auditor, they negotiate the audit fee, and they provide oversight of the auditor's work. The independence of the auditor to make an objective and impartial assessment of the audit committee is problematic.)

M. Other Communication Requirements

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

Paragraph 20 of the proposed standard does not adequately explain what "matters" means. Examples or more descriptive discussion should be added.

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?

Paragraph 21.b. identifies "An unnecessary brief time within which to complete the audit;" as an impediment imposed by management. Should management attempt to impose such requirement, the auditor should report this communication to the audit committee for its review and direction.

An additional bullet should be added stating "Other factors indicating a severe weakening in internal control."

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 of the company under audit?

No additional comments

N. Appendices

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Yes

May 28, 2010

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 030

Thank you for the opportunity to provide comments on the new proposed standards related to audit committee communications and other amendments. This is a subject matter of importance to both audit committees and investors and I commend the PCAOB for working to address these issues.

Attached are my comments. If you have any questions, please let me know (ebloxham@thevaluealliance.com or 614-571-7020).

With best regards,
Eleanor Bloxham
CEO, The Value Alliance and Corporate Governance Alliance
614-571-7020
ebloxham@thevaluealliance.com

Re: PCAOB Rulemaking Docket Matter No. 030

I provide my comments based on my expertise in the board governance arena and the duties of audit committees, their need and that of investors for sound financial reporting -- as well as my understanding of current issues in the auditing process.

In the main, I very much agree with the direction of the PCAOB in this rulemaking. Certainly, given the important role of audit committees today, clarification on the communications process between the audit committee and the auditor is worthwhile.

My major suggestions on the proposals fall into three broad categories.

(1) **Consider ways for this rule-making to help address issues which arose in the financial crisis – as well as other broader financial reporting issues.**

Financial reporting in general -- In the April 2010 edition of the Corporate Governance Alliance Digest (http://www.thevaluealliance.com/PDF/CGADigest040810.pdf), I discussed a recent survey by CFO Magazine of directors and financial managers, which had some surprising results. "According to the survey**, 1 out of 2 senior finance executives *do not* believe the Board understands the business performance information** that finance provides to the board. And almost 1 in 6 board members surveyed serve on boards where they don't believe the Board understands the business performance information it receives." Specifically, as it relates to GAAP reporting, "according to the survey, *almost one in five - 19% of board members do not think the GAAP reporting provided by finance is "excellent" and* ***almost one in three -- 32% of financial executives*** *do not rate GAAP reporting as excellent. "*

The financial crisis - Clearly there was a systemic breakdown in the financial crisis we have just experienced. Information in the periodic reports *did not* tip off investors, analysts or even many audit committees about the financial conditions/positions of companies that went, practically overnight, from being well capitalized and highly admired to institutions with plummeted stock prices in desperate need of financial bailout.

The financial crisis is not an event that should be ignored when it comes to the issue of financial reporting or *auditor communications*. As easy as it might be to do so, this was not just an event which should be ignored as a one-time, unforeseeable occurrence. It was a systemic failure that has lessons within it that regulators should seek to solve to prevent recurrence.

Clearly, not everyone was in the dark: some firms, at the time, were able to take advantage of a dangerous market while others held assets whose valuations were questionable (loans themselves, loans packaged as securities, or synthetically created).

While auditors may have attested 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", many investors would argue, I think rightly, that for many firms, the financial statements *did not* present fairly, in all material respects, the financial position of the Company. The risks were hidden and thus the reports were misleading.

How can this rulemaking take some small steps to address these issues?

(a) One way is thru the language chosen in the rule itself. **The language chosen should reflect the aims of the Sarbanes Oxley Act of 2002**.

It is critically important to reinforce the overarching objective of financial reporting in the language that is conveyed to auditors in this PCAOB rulemaking. Of course, the importance of the Sarbanes Oxley Act ("SOX") is recognized in the very first sentence of the introduction to the invitation to comment. It is very important to re-enforce its importance in the rule itself, however, as it is far too common and too easy for auditors to focus narrowly on the objectives of issuers *meeting accounting standards* rather than the SOX objectives related to providing financial reports, which include *broader disclosures required to ensure that the financial reports present fairly the financial position/condition of the company -- and are not misleading*.

Make the broader objective clear up front. For example, it would be helpful to begin the rule with an outline of the objective of a fair presentation which includes both the statements and related disclosures.

Throughout the rule, use language that is consistently broad in proactively reinforcing the responsibilities with respect to full disclosures -- to ensure a *fair presentation, in all material respects,* of the financial position/condition of the issuer. For example, paragraph 2 of the proposed standard could be enhanced with an addition to its last sentence which reads "and communication of other matters is encouraged, by this standard, on any and all matters that would lead to better financial reporting and fair presentations of financial condition or position – and enhances the audit committee's oversight efforts". Paragraph 4 could be broadened from "any discussions regarding the application of accounting principles and auditing standards" to "any discussions regarding the application of accounting principles and auditing standards or the fair presentation of financial condition." For example, paragraph 20 could be broadened from "could be significant to the company's financial statements or the auditor's Report" to "could be significant to the company's financial statements, related disclosures, a fair presentation of financial condition, or the auditor's Report." In paragraph 22, "oversight of the financial reporting process" could be broadened to "oversight of the financial reporting process and the fair presentation of the company's financial condition". Paragraph 27 could be broadened from "material misstatement" to "material misstatement or unfair presentation". Section C1 of Appendix C, describing the auditors responsibilities, should include assessments of the quality of the financial reporting with respect to its fair presentation, in all material respects, of the financial position of the Company. Again, the language could be broadened from "material misstatement" to "material misstatement or unfair presentation." Communications about management consultations with non-accountants should include consultations not only on accounting or auditing matters, but more broadly on financial reporting and related risk matters with non-accountants also. (Question 12)

The Value Alliance. 6834 Willoughby Ct. Westerville, OH 43082 USA www.thevaluealliance.com
Eleanor Bloxham. 614-571-7020. ebloxham@thevaluealliance.com

All of this focus on providing the bigger picture could seem like a minor point but, with a history of rules based auditing, *it is essential* to provide a level of specificity with respect to *all that should be considered* in order to change mindsets and/or improve outcomes.

(b) Another way to address the lessons from the financial crisis and issues in financial reporting more generally is to **enhance the communications requirements in the proposed rule.**

Communications by the external auditor to the audit committee should include a self-assessment of its work the prior year.

This self-assessment should include an analysis of issues missed in the last audit which may have given rise to misleading or missing information related to the financial position of the firm **and how the audit process will be enhanced going forward** to better ensure issues of that type are not missed in subsequent audits. **The rule should specify this** as one of the items the auditor should communicate to the audit committee.

Using the financial crisis as an example, the auditor would communicate that the financial condition at the financial services firm, pre-crisis, was not clearly represented in the periodic reports and communicate with the audit committee how, going forward, in broad terms, the audit will address issues of market conditions and lack of reliability of credit ratings and valuation models, as examples, in its review of a fair presentation of financial position. (As we all know, issues with credit raters came to public awareness with Enron and have been discussed ever since. This wasn't a one-time event. What is key is establishing a communication environment, with the audit committee, which fosters learning.)

A formal requirement in this rule to communicate a self-assessment and changes to the audit process, going forward, will help to ensure a learning process for both the audit firm and audit committee and represent a small step, but an important one, toward preventing future failures by auditors to sound the alarm related to "going concern" and other vulnerabilities in the financial reporting.

Paragraph 22 should include language such as: "This communication includes a self assessment by the auditor of prior years' work and, prior to the audit's start, how weaknesses will be corrected in this year's audit." In communication of the audit findings, the auditor should explain how it made those corrections.

(2) **Re-consider assumptions about the timing and the nature of two-way communications.** In the April edition of The Corporate Governance Alliance Digest http://www.thevaluealliance.com/PDF/CGADigest040810.pdf, I reviewed some interesting academic literature on auditing which suggested that it is very important to be "*aware of the way in which information is presented" …* "and the issues that could impair judgment as a result"

"One recent study showed that 'when auditors are initially exposed [to] more ambiguous information, they are less likely to ultimately identify the error'. (http://ssrn.com/abstract=1113496 , The Impact of Initial Information Ambiguity on the Accuracy of Analytical Review Judgments, Luippold, Kida)"

"Another study showed that a management diversion to look at error free accounts causes auditors to miss earnings management issues elsewhere. In fact, this study showed that, with no management interference, *surprisingly,* over *2/3 of the time, auditors were* *unable* *to uncover earnings management issues – and* *over 90%* *of the time auditors were unable to uncover the error* if they were diverted by management to look at reliable accounts. (*Now You Don't See It*, Sarah Johnson, CFO Magazine, March 1, 2010; http://ssrn.com/abstract=1424004 Managing Audits to Manage Earnings: The Impact of Baiting Tactics on an Auditor's Ability to Uncover Earnings Management Errors, Luippold, Kida, Piercy, Smith)"

(a) I provide this to say that **it should not be assumed that the audit committee, sharing information about what it "knows" in advance of the audit, will be helpful** (i.e. tips or complaints). In fact, if the audit committee provides auditors with "false clues" (Not intentionally, but because these are the complaints they have received) it may worsen the already low ability (according to the academic literature) of auditors to spot issues in the periodic reports. It may cause the auditor to focus on yesterday's problems rather than forestalling future ones.

On that basis, I would recommend the following communications timeline. First, have the auditor undergo the testing. After it is complete, have the auditor solicit the audit committee for its views with respect to complaints, tips and other risks – and then have the auditor follow up to test for those, if they have not already been specifically addressed. This could be easily done by clarifying the timing on paragraph 8 of the standard.

If this suggestion is not adopted, based on the academic research, this new rule may create more harm than good – worsening, rather than improving, audit quality. It may also undermine the ability of the audit committee to assess the competence and thoroughness of the external auditor.

(b) Audit committee members will come and go and external auditors will turnover. Retention of background knowledge is as (if not more) important to the audit committee as the auditor; therefore, **it is important for the auditor to repeat communication** of recurring matters. (Question 17) I think the engagement letter should be required **annually**. (Question 3) There will be new audit committee members, new directors and new auditors. It is less assumptive and enables all parties to reach a more robust understanding. Regarding paragraph 10 of the standard, the "if applicable" language should be removed – and this information should be provided, in writing, **pre-engagement to the extent possible** and as soon as possible thereafter to promote the audit committee's ability to oversee the auditor.

(c) **Communications by the auditor should be in writing to the audit committee, on all matters, followed by engaged discussion.** (Question 16)

The option to present information orally only makes communication (i.e. a two way understanding) less likely. It will also create less assurance that all of the required communications have occurred – or occurred in a thorough manner. It will also dampen the effectiveness of the discussion.

Why? Written communications, followed by discussion, provide all types of people – those who assimilate information by themselves, in groups, in writing or orally, the best opportunity to understand and evaluate the information presented. Written communications, followed by discussion, which is what well governed boards practice and are accustomed to, as a protocol, will provide the best opportunity for real communication and information exchange.

Paragraph 23 of the standard should say "The auditor should communicate to the audit committee the matters in this standard both in writing and orally."

(3) **Recognize the responsibility of the audit committee for oversight of the external auditor and of management.**

How specifically will this impact the rule as written?

(a) **Corrected misstatements, including those detected by management, should be communicated to the audit committee.** (Question 15) This will promote the audit committee's oversight of management. In addition, related to paragraph 12 of the standard – 12.d. in communicating critical accounting policies and practices, accounting estimates **should be communicated whether or not** the auditor determines that potential bias exists. This helps in the audit committee's oversight of the external auditor. Related to the note to paragraph 12, the audit committee has oversight responsibility *for both* the external auditor and management. The auditor **should communicate all described matters,** whether or not they believe management has or has not omitted or inadequately described them. This will promote the audit committee's oversight of management and of the external auditor. Paragraph 16.e. append the words "and why" – the auditor should communicate the treatment **preferred by the auditor and why**. This will allow the audit committee to better understand the reasoning and compare it with other arguments they may have heard. Paragraph 21 significant difficulties should be communicated during the audit **in a timely manner in order to seek resolution**. Again, it is the audit committee that has oversight responsibility for both the external auditor and management. In assessing the adequacy of two-way communications (paragraph 26) the auditor should also include: e. **the extent to which the audit committee provides oversight** over the auditor's work and f. the **thoroughness of the audit committee's assessment** and oversight of the auditor's work.

(b) **Outline the circumstances under which the auditor is prohibited from communicating with management -- and must keep communications confidential.**

For example, information in the executive sessions of the audit committee should be kept between the audit committee and the auditor and not shared with management. (I am personally aware of an auditor who, apparently, regularly tipped off management about executive audit committee discussions in order to prepare them.) This thwarts the ability of the audit committee to properly oversee management and determine their skill level and motivations. It also undermines good communications with the external auditor if the audit committee believes its concerns and issues (i.e. the information shared) will not be held in confidence. Thus, I believe the auditor's own actions can impact paragraph 26.c. of the standard.

The Value Alliance. 6834 Willoughby Ct. Westerville, OH 43082 USA www.thevaluealliance.com
Eleanor Bloxham. 614-571-7020. ebloxham@thevaluealliance.com

This is just one example – the PCAOB should explore and document others in the rule.

(c) **Outline that the auditor should (and the default position, on all matters, should be to) communicate through the audit committee and communicate findings to the audit committee first**.

Management may provide information to the auditor in the course of the audit but the audit committee is the body charged under SOX to provide oversight to the external auditor. Therefore, the auditor should provide the audit committee with information first. The auditor and audit committee should then agree on a chain of communication involving management with which the audit committee feels comfortable.

This will allow the chains of communication to be somewhat flexible but still recognize that the primary information flow regarding the audit, its scope, its findings etc. are with the audit committee, not with management.

For example, paragraph 4 of the standard – advance discussion with management - should be discouraged. For example, Appendix C, Section C1 – b.2.a. ii and iii. After informing the audit committee, determine the protocol for informing management.

Since there may be issues due to lack of management information or other management related problems, Appendix C, Section C1 – b.2.a.iv. should consider communications with the independent Chair, lead director, chair of the nominating and governance committees, or the independent directors first, as appropriate. Similarly, since there could be issues with both management and the audit committee, related to paragraph 28 of standard itself, the auditor should consider taking such actions as a. communicating with the independent Chair, the lead director, the chair of the nominating and governance committee, the independent directors or the full board, as most appropriate to the circumstance.

Regarding Appendix C, Section C1. – c.5, to enhance the two-way communication and emphasize the oversight duties, at the conclusion of the engagement, *the audit committee will provide the auditor with a letter from management* that confirms certain representations made during the audit -- and c.6. Management is responsible …. for affirming *to the audit committee* and to the auditor.

Language suggestions

- Paragraph 18 of the standard – should communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial, *if they were*
- I recommend that, in the standard and the appendices, the term "material"/"materiality" be defined.
- AU sec 722 uses the term accountant rather than auditor.

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE DIRECTOR, FINANCIAL REPORTING
AND INVESTOR OPPORTUNITY

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber

May 28, 2010

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

Re: PCAOB Rulemaking Docket Matter No. 030

Dear Members and Staff of the Public Company Accounting Oversight Board:

The United States Chamber of Commerce ("Chamber") is the world's largest business federation representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC recognizes the vital role that external audits play in capital formation and supports efforts to improve audit effectiveness. Communications between auditors and audit committees is an important part of that process and we appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") *Proposed Auditing Standard Related to Communications with Audit Committees* ("Proposal").

An updating of the PCAOB's Interim Auditing Standards on auditor-audit committee communications is needed particularly with the changes that have occurred since the implementation of the Sarbanes-Oxley Act of 2002 ("SOX"). However, the proposal only concerns one side of the communication process, without a full appreciation of the entire dialogue that occurs in the management of a public company. The PCAOB has no authority over directors and management and appears to have not taken into account their roles in this process. This has harmed the proposal and hampered the ability of the PCAOB from achieving its intent.

The CCMC therefore requests that the PCAOB engage in further outreach to better understand all aspects of auditor-audit committee communications. Moreover, we encourage you to engage the Securities and Exchange Commission in this outreach due to its role in this area. A failure to conduct additional outreach may lead to the promulgation and application of a misguided standard that can impair the very communications that the PCAOB seeks to stimulate. Accordingly, the CCMC requests that either the comment period be extended, or the proposal be withdrawn for later re-exposure, in order to expand outreach to better understand the realities of the auditor-audit committee dynamic and facilitate the intent of the proposal.

The CCMC's specific concerns are listed below.

I. Enhancing the Auditor-Audit Committee Dialogue

The CCMC agrees that a healthy dialogue between auditors and the audit committee is necessary for effective internal control procedures, external audit functions, management of a company, and long-term value creation for shareholders.

The proposal represents a fundamental shift from the assumption underlying the existing PCAOB interim audit standard (AU Section 380, *Communication with Audit Committees*) which states that audit committee communications are *incidental* to the audit. In contrast, the release text of the proposal states that "[t]he Board considers communications with audit committees to be an integral part of the audit process."[1] We have concerns about the PCAOB's approach to implementing this fundamental change.

Auditor-Audit committee communications are a three sided triangle made up of auditors, management and directors. The PCAOB has jurisdiction over one side of the triangle- auditors, but not over the other two. The responsibilities and duties of management and directors are embedded in state corporate law, federal law, and regulations. Therefore, the PCAOB cannot impact all sides of the triangle and appears to not have taken into account the duties and responsibilities of directors and management.

---

[1] ***Proposed Auditing Standard Related to Communications With Audit Committees* PCAOB Rulemaking Docket Matter No. 030,** Page 16.

Our comments focus on two new requirements in the proposed standard related to (1) the two-way communication between the auditor and the audit committee and (2) the auditor's evaluation of the quality of the company's financial reporting and disclosures.

II. The Two-Way Communication Between the Auditor and the Audit Committee

One of the Board's primary objectives in proposing a new standard is to "emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit."[2] The proposal generally provides for written or oral communications, unless otherwise specified. Nonetheless, based on release text, the Board's intent is that the auditor should lead an active two-way discussion with the audit committee and further states that having a robust dialogue on key matters is the most important factor in effective communications with the audit committee.[3]

As stated earlier, the PCAOB has no authority over audit committees and other entities are legally charged with that authority. However, the Board, through the back-door of an auditing standard, is shifting the responsibility from the audit committee to the auditor.

While evaluating the *adequacy* of the two-way communication is the objective, in release text, the PCAOB states that the two-way communication should be *open, active, robust,* and *substantive.*[4] So, notwithstanding the proposed guidance in the standard itself that specifies the basis for the auditor's evaluation of adequacy (pp. A1-13 to 14), the implication is that in order to be adequate the two-way communication must also be open, active, robust, and substantive. Not only do we take issue with this threshold for adequate communications with the audit committee for the purposes of conducting the audit, we are concerned with establishing these thresholds through

[2] Ibid, Page 3.
[3] Ibid, Page 16
[4] Ibid, Pages 7 and 16

release text rather than the standard itself. We have previously expressed our concern over the use of release text in this way to alter and expand the requirements in an audit standard itself.[5]

Finally, we recognize that the International Standards on Auditing ("ISAs") promulgated by the International Auditing and Assurance Standards Board ("IAASB") similarly require that the auditor evaluate whether the two-way communication with the audit committee has been adequate for the purposes of the audit. However, the IAASB's guidance on the basis for this evaluation is in the section of the ISA on application and other explanatory material. As such, the IAASB's guidance is not intended to impose a requirement. This illustrates a significant difference between the approach to crafting standards taken by the PCAOB and the IAASB that needs to be reconciled. We continue to encourage the PCAOB to make convergence of auditing standards a priority and to take up the leadership mantle in making this goal a reality.[6]

III. The Auditor's Evaluation of the Quality of the Company's Financial Reporting and Disclosures

Currently auditing standards include a requirement for the auditor to *inform* the audit committee about such things as the initial selection of and changes in significant accounting policies or their application and the process used by management in formulating particularly sensitive accounting estimates and judgments. Current auditing standards also require the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability of the accounting principles applied by management. However, the PCAOB's proposed standard goes well beyond a discussion of these matters and requires the auditor to evaluate them.

---

[5] For example, see letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the Securities and Exchange Commission ("SEC") on **SEC File Number PCAOB-2009-02, *Auditing Standard No. 7 – Engagement Quality Review*.**

[6] For example, see letters from the United States Chamber of Commerce's Center for Capital Markets Competitiveness on **PCAOB rulemaking docket matter No. 026, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*** (February 18, 2009 and March 2, 1010), on **PCAOB rulemaking docket matter No. 025, *Proposed Auditing Standard on Engagement Quality Review***, and on **SEC File Number PCAOB-2009-02, *Auditing Standard No. 7 – Engagement Quality Review.***

In turn, it is the auditor's evaluation that would then be discussed with the audit committee.

For example, the proposal would require the auditor to discuss with the audit committee:

- The auditor's evaluation of the quality, not just the acceptability under the applicable financial reporting framework of significant accounting policies and practices;[7]

- The auditor's evaluation of management's disclosures related to critical accounting policies and practices (in MD&A), along with any significant modifications to these disclosures proposed by the auditor, but not made by management; and

- Alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures, and the treatment preferred by the auditor.

Management is responsible for the financial reporting and disclosures. Yet, The PCAOB's proposed requirements set up a dynamic that pushes auditors to use financial reporting policies and practices to impinge on matters that are not only within the purview of management, but is the legal responsibility of management. This will create confusion around financial reporting, adversely impact the management of a company, and blur lines of responsibility, ultimately harming investors.

IV. Auditor Independence and Litigation Risk

The Board's proposal raises significant issues with respect to auditor independence and litigation risk. Assigning the auditor responsibilities for making the

---

[7] Current standards recognize that objective criteria have not been developed to aid in the consistent evaluation of the quality of a company's accounting principles. The PCAOB's proposed standard deletes this statement without providing any objective criteria for such an evaluation.

financial reporting process and the oversight of that process more effective appears to violate the Securities and Exchange Commission ("SEC") guiding principles on auditor independence. The Board's proposal mandates actions by auditors that have the potential, to create mutual or conflicting interests with audit clients, or put the auditor in the position of acting as management.

These actions could significantly exacerbate litigation risks for auditors. With any adverse outcome, it would open-up auditor judgments on the nature and timing of audit committee communications to second-guessing in private actions and regulatory enforcement. Frankly, it creates what appears to be a strict liability regime for auditors through auditing standards. Furthermore, even without adverse outcomes, it would expand the scope for allegations of audit deficiencies through the Board inspection and enforcement processes over issues that are not central to audit quality or within the scope of responsibility for auditors.

V. Conclusion

The CCMC is concerned that the Board's proposal has the potential to significantly alter the long-standing and well recognized role and responsibilities of the external auditor, management, the board of directors and the audit committee. The Board has no authority over management the audit committee or the board of directors.

Nonetheless, the Board's proposed standard pushes auditors towards becoming responsible for and gatekeepers on the effectiveness of audit committees generally and the board of directors more specifically. In addition, the Board's proposal pushes auditors in the direction of stepping into the shoes of management on matters of financial reporting and disclosures.

While well intentioned, the Board's proposal lacks an understanding of the legal responsibilities and roles of management and directors. Indeed, the proposal goes beyond the bounds of the Board's jurisdictions and responsibilities. Accordingly, the CCMC respectfully requests that the proposal should be withdrawn and reconsidered after sufficient additional outreach to correct these deficiencies.

Sincerely,

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

May 28, 2010

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

Subject: PCAOB Rulemaking Docket Matter 030: PCAOB Release No. 2010-001: *Proposed Auditing Standards Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) proposed new auditing standards on auditor communications with the audit committee.

We appreciate the PCAOB's efforts to update its auditing standard on auditor communications with audit committees and agree that this communication is a critical element of an effective audit. We also agree that independent, informed, and proactive audit committees are necessary to protect the interests of public company investors, and we believe that the changes in the proposed standard to align more closely with the communication requirements of the Securities and Exchange Commission (SEC) are necessary and appropriate. Similarly, we believe that the proposed standard would provide auditors valuable guidance for enhancing the substance of those communications.

We do have concerns, however, on several important issues in the proposed standard, which we discuss below.

Going Concern

Paragraph 16 of the proposed standard requires that "*the auditor should communicate to the audit committee, when applicable, certain matters relating to his or her evaluation of a company's ability to continue as a going concern.*" A footnote in the introduction to the proposed standard recognizes that "*the requirements included in this standard may change depending on the outcome of the Financial Accounting Standards Board's project regarding going concern.*" However, due to the importance of the Financial Accounting Standards

Board (FASB) project, users of this proposed standard should be made aware of the ongoing FASB project related to the going concern issue, and that the FASB has recently decided to provide guidance that defines a going concern and clarifies the time period for the going concern assessment. If this PCAOB-proposed standard is finalized before the FASB issues its guidance, the finalized standard should alert users about the pending FASB guidance and the effect it may have on implementation of the PCAOB standard. If the PCAOB's proposed standard is finalized after the FASB issues its guidance, we trust that the finalized standard will incorporate any changes resulting from this project to help ensure that the proposed standard is consistent with any guidance or requirements established by the FASB.

Corrected and Uncorrected Misstatements

Paragraph 17 of the proposed standard requires that "*the auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that was presented to management.*" However, the comparison to the analogous standards issued by the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants (AICPA), listed in Appendix 3, states that "*The proposed standard requires the auditor to provide the audit committee with the **same*** [bolding added for emphasis] *schedule of uncorrected misstatements related to accounts and disclosures presented to management…*" Therefore, as written, it appears that the PCAOB standard would allow for a summary or other higher-level presentation for the audit committee. If the PCAOB wishes to require that the audit committee be provided with the same schedule of uncorrected misstatements presented to management, rather than a summary of uncorrected misstatements or a schedule that shows only the net effect of the uncorrected misstatements, the requirement should be expressly stated in the standard.

Further, we note that while the requirement in paragraph 17 references the Securities Exchange Act of 1934,[1] there is no mention of the guidance contained in the SEC Staff Accounting Bulletin No. 108, (SAB No. 108) "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*". The effects of prior year misstatements are integral to evaluating the effect of uncorrected misstatements for the current year. The SEC staff noted in SAB No. 108 that the evaluation of uncorrected misstatements related to prior periods can be accomplished by quantifying an error under both the rollover, or income statement, approach, and the iron curtain, or balance sheet, approach and evaluating the error measured under each approach. As both the "iron curtain" and "rollover" methods are commonly used in practice and the choice of method can significantly affect the auditors' proposed adjustment decisions, we believe that the proposed standard should alert users of the issue and refer them to the guidance in SAB No. 108.

[1] 48 Stat. 881, 15 U.S.C. § 78a – 78kk

Form and Content of Communications

Paragraph 23 of the proposed standard requires that "*The auditor should communicate to the audit committee the matters in this standard either in writing or orally, unless otherwise specified in this standard. The auditor should document the communications, whether communicated orally or in writing, in sufficient detail to enable an experienced auditor, having no previous connection with the engagement,* ***to understand the communications made to comply with the provisions of this standard****.*" [bolding added for emphasis]

We note that although the PCAOB, IAASB, and AICPA have issued similar audit documentation standards, only the PCAOB has this very specific documentation requirement in its standard on communications with audit committees. We see no compelling reason for this additional PCAOB requirement, and we are concerned that this PCAOB requirement, taken in combination with the phrase "made to comply with the provisions of this standard" implies a level of specificity of documentation not otherwise required by PCAOB standards. This level of specificity may inhibit effective two-way communication between the auditors and the audit committee. Accordingly, we encourage the PCAOB to remove this requirement from the standard on communications with audit committees.

Lack of objective criteria for determining the adequacy of two-way communications

Paragraph 28 of the proposed standard requires that "*If the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved, the auditor should consider taking such actions as: (a) Communicating with the full board of directors; (b) Modifying the auditor's opinion on the basis of a scope limitation; or (c) Withdrawing from the engagement.*"

We are concerned that the proposed standard provides no objective criteria for determining when the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved, and we believe that the proposed standard should establish objective criteria to determine when the auditor should take actions. In order to improve consistency of application, we recommend adapting and incorporating criteria from ISA 260, "*Communication with Those Charged with Governance*" paragraph A42, and the clarified SAS, "*The Auditor's Communication With Those Charged With Governance*", as follows:

ISA 260, paragraph A42

Adequacy of the Communication Process (Ref: Para. 22)

A42. The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and **the audit committee** ~~those charged with governance~~; rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include:

- The appropriateness and timeliness of actions taken by **the audit committee** ~~those charged with governance~~ in response to matters raised by the auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to inquire as to why appropriate action has not been taken, and to consider raising the point again. This avoids the risk of giving an impression that the auditor is satisfied that the matter has been adequately addressed or is no longer significant.
- The apparent openness of **the audit committee** ~~those charged with governance~~ in **its** ~~their~~ communications with the auditor.
- The willingness and capacity of **the audit committee** ~~those charged with governance~~ to meet with the auditor without management present.
- The apparent ability of **the audit committee** ~~those charged with governance~~ to fully comprehend matters raised by the auditor, for example, the extent to which **the audit committee** ~~those charged with governance~~ probe issues, and question recommendations made to them.
- Difficulty in establishing with **the audit committee** ~~those charged with governance~~ a mutual understanding of the form, timing and expected general content of communications.
- Where all or some of **the audit committee** ~~those charged with governance~~ are involved in managing the entity, **the committee's** ~~their~~ apparent awareness of how matters discussed with the auditor affect their broader governance responsibilities, as well as their management responsibilities.
- Whether the two-way communication between the auditor and **the audit committee** ~~those charged with governance~~ meets applicable legal and regulatory requirements.

We thank you for considering our comments on this important issue.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

ROBERT N. WAXMAN, CPA
866 UNITED NATIONS PLAZA, FL 4
NEW YORK, NY 10017

May 28, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

comments@pcaobus.org

Re: Rulemaking Docket Matter No. 030

PCAOB Release No. 2010-0001: Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards

Gentlemen:

I appreciate the opportunity to comment on the proposed auditing standard. By way of background, I have advised boards of directors and audit committees on accounting, audit and SEC matters, have served on the audit committee of a large not-for-profit entity and on the board of directors and the chair of the audit committee of a New York Stock Exchange company. My views on this proposal are informed by my experiences as an audit committee member and as an accountant and auditor in public practice.

My comments are organized as follows –

A. General Comments
B. Responses to Questions asked in the Overview
C. Suggestions for the improvement of the Proposal
D. Appendix A – Definitions
E. Appendix C – Matters Communicated in the Audit Engagement Letter

A. General Comments

The Auditor and the Audit. The Introduction to the proposal says, "Effective two-way communications between the auditor and the audit committee on such [accounting and disclosure] matters might ... benefit the auditor in performing the audit." I agree that the required communications "might benefit the auditor in performing the audit;" however, the proposal does not make the case for the benefit to the audit by showing how the proposals communications to the audit committee directly achieve the auditor's responsibilities. This responsibility is clearly expressed in the Engagement Letter in Appendix C as –

> Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.[1]

The proposal does not offer or reference any research or findings that show the communications in the proposal (which are principally one way to the audit committee) do in fact directly achieve the objective of the audit. I note that the AICPA's AU 380 ("The Auditor's Communication With Those Charged With Governance") does not make any such claim when saying –

> While communication with those charged with governance may assist the auditor in planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.[2]

The Audit Committee. Audit committees ordinarily welcome any and all information from their auditors; nevertheless, audit committees are overloaded with required duties including the oversight of the internal audit function, compliance with regulatory and legal requirements, the integrity of the financial statements, whistleblower procedures, etc., and the new communications included in this proposal, (which go beyond those in extant AU 380, "Communication With Audit Committees") do not fill any long pent-up needs of audit committees. In fact, if any of the communications included in this proposal are needed by the audit committee, it has been my experience that the committee members will not be shy to ask for it.

Certain of the new communications appear to best fit into what may be considered "best practices," and may very well be useful to the audit committee, but they should not be unconditionally required or presumptively mandatorily required of the auditor.

B. Responses to Questions asked in the Overview

Q. 1. Are the objectives of the auditor in the proposed appropriate? If not, why?

> See comments under paragraph 3 of the proposal in Section C below.

Should other matters be included in the objectives?

> Yes.

Q. 2. Are the objectives adequately articulated?

> Yes, the summary of the proposal encapsulated in the objectives would be sufficiently stated after the clarifications specified in the comments to paragraph 3 of the proposal.

Should the articulation of the objectives focus on the outcome that should be achieved by performing the required procedures?

> As now written, the objectives in paragraph 3 do not focus on outcomes, except for the two-way communications under paragraph 3(d). An articulation of the expected the outcomes would make the standard more "principles based" (less rules based) and encourage (and allow) auditors to receive meaningful communications and corroborating information by using professional judgment and procedures that are not called-for in the proposal.

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

---

[1] AU 110.02 and AU 316.01.

[2] AU 380.33.

A tailored engagement letter should be required annually that (among other things) provides for discrete audit services. Among many other benefits, this annual letter would reduce the possibility that the "continuous representation" doctrine will permit otherwise untimely malpractice claims to proceed against auditors.

Q. 4. Are there other matters that would enhance investor protection that should be added to an engagement letter?

Yes.

If so, what other matters should be included in an engagement letter?

I believe the following matters should aid the audit committee in fulfilling its functions and further protect shareholder interests.

1. The engagement letter should be addressed to the audit committee or its chair and those in management who will sign the letter. It should be signed and delivered to the auditor before any substantial audit procedures are undertaken.

2. In that the audit committee has oversight over the appointment and compensation of the auditor, and that the proxy rules require disclosure of the audit fees,[3] these fees (that is, all audit fees, and (if not covered by a separate engagement letter) all audit-related fees), should be included in the engagement letter.

3. Since services and fees must be pre-approved by the audit committee, engagement letters for subsidiaries, and services provided to employee benefit plans and statutory audits, should be addressed to the audit committee.

4. The auditor must commit to and is responsible for providing timely services; therefore "timing of the audit"[4] should be included in the letter. Timing of the audit is discussed in AU 311, "Planning and Supervision," and securing timely services from the auditor is another matter that is vitally important to the audit committee and shareholders.

5. Section 10A(a) of the 1934 Act[5] requires audit procedures that are designed to detect illegal acts, identify material related party transactions and evaluate whether or not the registrant is a going concern. These required Section 10A procedures should be included as part of the auditor's responsibilities in the engagement letter.

6. The engagement letter in Appendix C only sets forth the responsibilities of the auditor and management; however, since these letters are addressed to the audit committee and signed by its chair, it is important that the responsibilities of the audit committee also be included in the letter. I suggest that certain of the language in 1934 Act Rule 10A-3, "Listing

---

[3] 1934 Act, Item 9(e) of Schedule 14A.

[4] As used in paragraph 9 of the proposal.

[5] Section 10A(a) In General.- Each audit required pursuant to this title of the financial statements of an issuer by an independent public accountant shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission-

1. procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts;
2. procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein; and
3. an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.

Standards Relating to Audit Committees,"[6] and Regulation S-K, Item 306, "Audit Committee Report," be added to the letter in Appendix C.

7. Paragraph 10 of the proposal contains a number of other communications that are appropriate for inclusion in the engagement letter. For example, the use of other firms to perform audit procedures, and the confirmation of the "principal auditor" status in light of the use of those other firms.

Q. 5. Is the proposed requirement to inquire of the audit committee appropriate?

Yes and no.

Yes, the requirement regarding "complaints or concerns raised regarding accounting or auditing matters" (paragraph 8) is an appropriate line of inquiry for the auditor.[7]

No, the proposal requires the auditor to "inquire of the audit committee about whether they are aware of other matters that may be related to the audit ...." This is entirely too broad and unfocused, in essence it asks "Is there anything you can or should tell us that relates to the audit? Is there anything we should know?" The final standard should provide more specific guidance and focus this line of inquiry only on material matters.

As mentioned, while this proposal refers to two-way communications in many places, the proposal, as written, is predominately only a one way communication from the auditor to the audit committee, with the single exception found in paragraph 8 of the proposal.

What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

Among other things, the audit committee's understanding about and views on

(a) complex and/or unusual transactions,

(b) material related party transactions,

(c) nonmonetary transactions,

(d) specific industry accounting followed for new lines of business, and

(e) uncertain tax positions.

If not readily apparent, this communication should include an explanation of the business purpose and economic rationale behind the transactions, tax positions, or specific industry

---

[6] Rule 10A-3 says:

(2) Responsibilities relating to registered public accounting firms. The audit committee of each listed issuer, in its capacity as a committee of the board of directors, must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the listed issuer, and each such registered public accounting firm must report directly to the audit committee.

[7] Exchange Act Section 10A(m)(4): Complaints. Each audit committee shall establish procedures for--

A. the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

B. the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

accounting, whether the nonmonetary exchange has commercial substance, and (if not already documented) whether the audit committee (and the full Board) approved such transactions and accounting.

Q. 6. Are the requirements to provide information on the auditor's audit strategy and timing of the audit appropriate?

No. See below and comments under paragraph 9 of the proposal.

Does the auditor need more guidance related to the requirement to provide information on the auditor's audit strategy?

Yes.

If so, what type of guidance would be helpful?

Audit Strategy vs. Scope of the Audit vs. Audit Plan

First, "audit strategy" must be explained. Audit strategy is not a defined term and means different things to different auditors and audit committee members. For example, AU 312.16[8] differentiates "audit strategy" from the conduct and "scope of the audit," and AU 380.33 appears to distinguish "audit strategy" from "audit plan" and the nature, timing and extent of audit procedures. Further AU 311, "Planning and Supervision," says that in planning the audit, auditors may consider "Discussing the type, scope, and timing of the audit with management of the entity, the board of directors, or its audit committee."[9] There is no mention here about "audit strategy."

1934 Act Rule 10A-3(b)(2) says –

> The audit committee ... must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged ... for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the listed issuer, and each such registered public accounting firm must report directly to the audit committee.

It is therefore necessary for the audit committee to understand the details of the audit and review with the auditor the plan and scope of the audit, and this request for this information should be initiated by the audit committee. Many audit committees include in their charter a provision to obtain and review the annual audit plan of the auditors, including the scope of the audit activities and to monitor the plan's progress and results throughout the year.

In sum, the term "audit strategy" must be defined so that all auditors will interpret it the same way and be able to differentiate it from "plan" and "scope." Perhaps all these words are synonymous; if they are then the definition should say so, and if they are not, then the final standard should distinguish them.

---

[8] AU 312, "Audit Risk and Materiality in Conducting an Audit," states:

> .16 An assessment of the risk of material misstatement (whether caused by error or fraud) should be made during planning. The auditor's understanding of internal control may heighten or mitigate the auditor's concern about the risk of material misstatement. (Footnote omitted) In considering audit risk, the auditor should specifically assess the risk of material misstatement of the financial statements due to fraud. (Footnote omitted) The auditor should consider the effect of these assessments on the overall audit strategy and the expected conduct and scope of the audit. (Emphasis added)

[9] AU 311.04(e).

Compromise the Audit

The proposal's warning (on page 9) informs auditors that having this discussion about audit strategy is dangerous and may reduce or entirely eliminate the effectiveness of certain audit procedures. I believe that any discussion of planning materiality, tolerable error, the nominal amount for recording audit differences, the extent and detailed scope of tests and procedures are not appropriate discussion topics with the audit committee or management. The final standard should provide some guidance aimed at eliminating any risk of a compromised audit.

Q. 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?

Paragraph 10(d) of the proposal (regarding "[t]he roles, responsibilities, and locations of firms participating in the audit ...") is clear. However, while it may be interesting information to members of the audit committee and supports and justifies a portion of the audit fee, conveyance of this information to the audit committee is unnecessary for the purposes of achieving the objectives of an audit. See additional comments on paragraph 10 of the proposal.

Q. 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)?

No. Appendix A should define "accounting policies" which APB 22, "Disclosure of Accounting Policies," defines as –

> The accounting policies of a reporting entity are the specific accounting principles and the methods of applying those principles that are judged by the management of an entity to be the most appropriate in the circumstances to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles and that, accordingly, have been adopted for preparing financial statements.

The PCAOB's definition should then differentiate these APB 22 "significant accounting policies" disclosed in the financial statements footnotes from "critical accounting policies and procedures," required by the SEC[10] which must be disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

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

Yes. In that the SEC has oversight and enforcement authority over the PCAOB, and that all rules of the Board are not effective without prior approval of the SEC, the final standard should be wholly integrated with the SEC's requirements. Consequently, the standard should cite the all relevant SEC pronouncements, for example, 1934 Act Section 10A(k),[11] either in Notes, footnotes, or in an appendix to the final standard.

---

[10] SEC Release 33-8040; FR 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies."

[11] Rule 10A(k) Reports to Audit Committees. Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer--

1. all critical accounting policies and practices to be used;

In addition, there may be certain non-SEC rules that are important to auditor/audit committee communications and relationships such as Sarbanes-Oxley Rule 303, "Improper Influence on Audits," that should either be included in the final standard, or a reference made to that Rule.

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

While the definition used in Appendix A of "critical accounting estimates" is used in the SEC literature,[12] the terms used "financial condition" and "operating performance" need to be updated and modernized to "financial position" (or "balance sheet") and "statement of operations" (or "statement of income").

Further, the proposal does not address why the term "assumptions" used by the SEC (Release 33-8350; FR 72) has been left out of the PCAOB's definition.

To follow the SEC's lead, the definition should differentiate between critical accounting estimates (disclosed in MD&A) and accounting policies (disclosed in financial statement footnotes) under FR 72.[13]

Q. 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?

See comments under paragraph 12(b) of the proposal.

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

No. Management's discussions with a "reporting accountant"[14] should be discussed with the audit committee (paragraph 15 of the proposal). All other consultations by management

---

2. all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
3. other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

[12] The definition in SEC Release 33-8350; FR 72, "Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations," is –

> When preparing disclosure under the current requirements, companies should consider whether they have made accounting estimates or assumptions where: the nature of the estimates <u>or assumptions</u> is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and the impact of the estimates and on financial condition or operating performance is material. If so, companies should provide disclosure about those critical accounting estimates <u>or assumptions</u> in their MD&A (emphasis added).

[13] Such [critical accounting estimates] disclosure should supplement, not duplicate, the description of accounting policies that are already disclosed in the notes to the financial statements. The disclosure should provide greater insight into the quality and variability of reported financial information. The discussion in MD&A should present a company's analysis of the uncertainties involved in applying a principle at a given time, or the variability that is reasonably likely to result from its application over time.

on accounting or auditing matters with non-accountants should not be a required communication by the auditors to the audit committee. The auditor's judgment should dictate whether or not to communicate this category of information to the audit committee.

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

No. The Note to paragraph 16 of the proposal is not clear as to what must be communicated (a) "when the auditor has concluded that implementation of management's plan mitigate the effects" of a going concern, and (b) when management's plan do not mitigate the effects of a going concern discussed on page 14 (the sentence before question 13).

If there is any distinction in disclosure (other than whether or not management's plans do or do not mitigate the going concern), those disclosures should be differentiated. Further, the Note should be integrated into the final standard.

Along with this communication, any contemplated modification to the standard report should be timely (interpreted by me to mean immediately) communicated to the audit committee.

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

No. While the communication of uncorrected misstatements is appropriate, I do not agree with the requirement to "communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative factors considered," when that communication may compromise the audit by revealing, for example, the auditor's planning materiality, tolerable error and the amount used for recording audit differences, among other auditor considerations.

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

Yes, all material corrected misstatements detected by the auditor should be communicated to the audit committee.

However, I see no benefit to the audit committee, or to the audit process, of having all corrected misstatements detected by management communicated to the audit committee. This should be furnished only if the audit committee asks for it, or those corrected misstatements were not detected on a timely basis and are therefore considered by the auditor a significant deficiency, material weakness[15] or the subject of a management letter.

Q. 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?

---

[14] Reporting accountant is defined as follows (AU 625, "Reports on the Application of Accounting Principles," paragraph 2):

> For purposes of this section, reporting accountant refers to an accountant in public practice who prepares a written report or provides oral advice on the application of accounting principles to specified transactions involving facts and circumstances of a specific entity, or the type of opinion that may be rendered on a specific entity's financial statements (footnotes omitted).

[15] See AU 325, "Communications About Control Deficiencies in an Audit of Financial Statements."

In my experience, audit committees usually want all important communications to be written; whereas auditors would likely prefer using their professional judgment to determine those orally communicated and those that should be written. The final proposal should encourage the written documentation of all significant communications.

If at a meeting with the audit committee there are oral communications concerning non-trivial matters, then that meeting with the audit committee should be documented for the working papers (e.g., the subject matter, who attended, the date and time, the location and what was concluded).

The Note to paragraph 23 requires the auditor to include in the audit documentation a copy or summary of management's communications that are specified in paragraph 12 of the proposal that had been given to the audit committee. As commented on under paragraph 12 of the proposal this accumulation of documents or summarization of communications throughout the year is unfeasible.

Q. 17. Are the requirements in the proposed standard on the timing of the auditor's communications appropriate?

Yes, however the proposal does not consider the auditor's review of interim financial information and all the communications with the audit committee that stem from those reviews throughout the year. It is difficult to envision just how the auditor is to evaluate the audit committee communications without consideration of all these "during the year" communications.

Should only certain matters be communicated annually?

No. Matters that should only be communicated annually should be left to the professional judgment of the auditor. No matter should be fixed as to when it should be communicated.

If so, which ones?

Not applicable.

Q. 18. Does the requirement to evaluate the adequacy of the communication process promote effective two-way communications?

If you grade a process, that act of evaluation does not make the two-way process better.

Grading your "employer" will be an interesting challenge to auditors, especially if auditors must document their views about the quantity and quality of the discussions throughout the year, and document their views regarding the members of the audit committee. Does the auditor evaluate the audit committee as knowledgeable and well informed, or the opposite? How does the auditor do this? Do they give the audit committee a grade, for example, A to F? Pass or Fail? How will auditors evaluate their own role in the communication process?

Is more information on this requirement needed?

Yes. Questions that need to be answered –

1. What does the auditor need to know and do to perform this subjective evaluation of the adequacy of effective two-way communications?

2. What (if any) training or ability should the auditor have in order to uniformly evaluate the adequacy of all the communications made during the year?

3. How do the communications meet the objective of the audit?

4. See other comments on paragraph 26 of the proposal.

Q. 19. Are these other communication requirements appropriate and sufficiently clear?

Yes.

What other communication requirements should the proposed standard include, if any?

Not applicable.

Q. 20. Are the matters included as significant difficulties in paragraph 21 of the proposed standard appropriate?

Yes.

What other matters should be included as significant difficulties?

Not applicable.

Q. 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 of the company under audit?

The final standard should apply to all SEC registrants without regard to size or industry.

Q. 22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? The appendices include other matters, e.g., should other items be included in an audit engagement letter?

See my specific comments on these appendices and the engagement letter.

C. Suggestions for the improvement of the Proposal

Paragraph 3. The objectives of the auditor.

The Auditor and the Audit. I recommend the final standard provide some exposition of the direct link between the communications to the audit committee and the ultimate objective of an audit, i.e., "the financial statements are free of material misstatement."

The primary objective of this proposal should be to meet and satisfy that ultimate objective.

The Audit Committee. Since the passage of Sarbanes-Oxley, and the release of updated SEC and exchange rules, I believe that many audit committees have enhanced their performance to the point where the committee's agendas are crammed with required activities and many committees are overburdened.

I have not found any research or studies that show audit committee members have a direct interest in many of the communications by the auditor set forth in this proposal.

The communications in this proposal should not be mandatory unless it can be empirically shown that (1) these communications achieve the objective of the audit, (2) audit committees are not effective in fulfilling their oversight responsibilities, and (3) that the communications cataloged in the proposal are shown to be necessary to meet the audit committees oversight obligations.

Paragraph 3(a). Communicating to the audit committee the responsibilities of the auditor ....

The objective should more closely follow the requirements of Appendix C and I suggest the paragraph be worded as follows –

> Communicating to the audit committee the objectives of the audit, the auditor's, management's and the audit committee's responsibilities in relation to the audit, and establishing a mutual understanding of the terms of the audit engagement by means of an audit engagement letter;

Paragraph 3(b). Communicating to the audit committee an overview of the audit strategy ....

See the response to Question 6 regarding "audit strategy."

Paragraph 3(d). Evaluating the adequacy of the two-way communications between the auditor ....

The standard should state (1) the reasons for the evaluation and (2) what particular audit objective is achieved through the adequacy of the communications.

As mentioned in response to question 5, while this proposal refers to two-way communications in many places, the proposal is predominately only a one way communication from the auditor to the audit committee, with the single exception found in paragraph 8 of the proposal. There is a discernible disconnect between all the one-way communications and this objective to evaluate the two-way communications.

The standard does not plainly link the evaluation to the objectives of the audit, that is, if the evaluation, for example, is sub-par, are the audited financial statements materially misstated? How would the opinion be qualified? Is there a scope limitation? Is there an explanatory paragraph needed (and what would it say)?

Paragraph 5. The auditor should establish a mutual understanding of the terms ....

This sentence should include the term "engagement letter," and suggest it read as "The auditor should establish a mutual understanding of the terms of the audit engagement with the audit committee ~~in connection with the audit~~ <u>by means of an audit engagement letter</u>."

As mentioned above, since the letter is ordinarily addressed to the audit committee (and others) and signed by the audit committee chair (and others), the engagement letter should have a section that sets out the responsibilities of the audit committee.

Paragraph 6. The auditor should record the understanding of the terms of the audit engagement ....

As mentioned in response to question 4, the engagement letter should be signed by all the appropriate parties and delivered to the auditor before any substantive audit procedures are undertaken. This recommendation should be reconciled with the Regulation S-X definition of when a professional engagement period begins.[16]

The Note to paragraph 6 should be deleted and a footnote added to paragraph 5, after the mention of the engagement letter, referencing Appendix C.

Paragraph 7. If the auditor cannot establish a mutual understanding of the terms ....

Notwithstanding its use in AU 310, "Appointment of the Independent Auditor," the difference between "accept" and "perform" needs to be explained. Consider the following suggested change, "If the auditor cannot establish a mutual understanding of the terms of the audit engagement with the audit committee, <u>or the engagement letter is not appropriately signed</u>, the auditor should decline to ~~accept or~~ perform the engagement."

Paragraph 8. The auditor should inquire of the audit committee whether ....

See the comments under question 5. A more focused discussion should begin with those outlined in paragraph 53(b) of proposed Auditing Standard "Identifying and Assessing

[16] Under Regulation S-X, Rule 2-01(f)(5)(ii)(A) – The professional engagement period begins when the accountant either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is earlier; ....

Risks of Material Misstatement."[17] Assuming that this proposed Auditing Standard is adopted as exposed, then paragraph 8 would be redundant and should be deleted.

Paragraph 9. The auditor should communicate to the audit committee an overview ....

See response to question 6 regarding the communication to the audit committee of an overview of the audit strategy.

Page 8 of the Overview of the proposal says –

> Early communication of these matters may enable the audit committee to understand the auditor's views regarding risk and to provide insights regarding additional risks not identified by the auditor in order for the auditor to incorporate them into the audit strategy.

This communication would only provide additional insight if the auditor asks the audit committee for their understanding of the audit risks; however, the proposal does not require (or mention the need for) the auditor to inquire of the audit committee about significant risks.

It is not clear whether the term "audit strategy" subsumes "significant risks identified during risk assessment procedures," or if significant risks are another subject to be communicated. If just another subject, then the word "including" should be deleted.

As to "timing of the audit," include with paragraph 9 the discussion from paragraph K (page 16) –

> For example, some communications, such as information regarding the audit strategy and the significant risks, should be made as early as possible and other matters, such as changes to the auditor's significant risks initially identified should be communicated in a timely manner.

Regarding the discussion of significant risk, in order not to compromise the audit, I believe the auditor should just outline the risks, and not discuss what additional procedures will be undertaken to meet those risks.

Note: The overview is intended to provide information about the audit, but not specific details ....

Here the question is when does the auditor "cross the line" from the general to the specific? From a benign communication to having compromised the audit? There is no simple solution and as mentioned above I believe that is would be helpful to define "audit strategy" in such a way that it would be interpreted the same way by all auditors and audit committees.

---

[17] This paragraph discusses –

> Inquiries of the audit committee, or equivalent, or its chair regarding:
>
> (1) The audit committee's views about the risks of fraud;
>
> (2) Whether the audit committee has knowledge of fraud, alleged fraud, or suspected fraud affecting the company;
>
> (3) Whether the audit committee is aware of tips or complaints regarding the company's financial reporting (including those received through the audit committee's internal whistleblower program) and, if so, the audit committee's responses to such tips and complaints; and
>
> (4) How the audit committee exercises oversight of the company's assessment of the risks of fraud and the establishment of mitigating controls.

Paragraph 10. The auditor also should communicate the following matters ....

Delete the word "also."

Paragraph 10(a). The auditor's determination of whether persons with specialized skill ....

This may be worthy questions for the audit committee to ask the auditor, but it not a necessary procedure needed to perform the audit.

Paragraph 10(b). The auditor's consideration of, and planned use of, the company's ....

It is unclear why this communication of the "consideration of and planned use of internal auditors during audit" is needed by the auditor to achieve the objective of the audit (i.e., whether the financial statements are free of material misstatement).

Paragraph 10c. The auditor's consideration of the extent to which the auditor plans to use ....

The difference (if any) between paragraph 10(b) and 10(c) regarding the consideration and use of internal auditors should be explained.

Paragraph 10d. The roles, responsibilities, and locations of firms participating in the audit ....

Use of other firms is assumed to mean auditing firms, if so, I suggest adding "audit" (or "registered public accounting") before the word firms.

Paragraph 10e. The basis for the auditor's determination that he or she can serve as principal auditor.

In drafting the engagement letter, the auditor should determine that (based on the then facts) it will be the principal auditor. That assessment should be included in the engagement letter. It is not clear why the basis for this conclusion is a necessary separate communication to the audit committee assuming the auditor follows the guidance in AU 311 and AU 543 in his or her audit.

Paragraph 11. The auditor should communicate to the audit committee significant changes ....

This paragraph should be combined with, or added to paragraph 9 and should plainly say that this means any <u>significant</u> decrease or increase in the risks initially identified.

This undertaking by the auditor, to timely communicate significant changes to the planned audit strategy or the significant risks initially identified (due to the results of audit procedures or in response to external factors or changes in the economic environment), should be incorporated into the engagement letter.

Paragraph 12(a)(ii). The anticipated application by management of accounting or regulatory ....

The SEC requires disclosure of newly issued pronouncements which will have a material impact on financial statements; consequently, there is no need for this requirement since there is already sufficient disclosure in MD&A and the financial statement footnotes, all of which audit committees are obliged to review.

This paragraph should reference SAB Topic 11-M, SAB 74, as it was referenced on page 10.

Paragraph 12(a)(iii). The methods used by management to account for significant ....

The final standard should clarify why it believes that the audit committee, the board of directors, management including the CFO do not already communicate this and other information in this proposal, and that the auditor then has the responsibility to remedy these internal communication breakdowns.

There is no evidence that the audit committee in its oversight of financial reporting does not have ample access to management, the CFO, the internal auditors, and others, and needs this information about (1) "methods" to be communicated to it by the auditors, and (2) that the auditor must tell the audit committee about accounting for significant and unusual transactions.

If there is empirical evidence that a significant number of audit committees are ignorant of all this information, then there is a bigger problem and this proposal will not and cannot cure it.

Paragraph 12(a)(iv). The effect of significant accounting policies in controversial ....

In the caption before paragraph 12 (Accounting Policies ...) and paragraphs 12 and 12(a) the word "significant" should be inserted (thus "Significant Accounting Policies ...."). This will then agree the requirements in this paragraph with those in paragraph 13(a).

Paragraph 12(b)(i). A description of the process used by management to develop ....

Why is this reporting by the auditor to the audit committee needed? Assembling this information is not within the purview of the auditors and if the audit committee needs this information it can be obtained directly from management, and if necessary, that information can be supplemented by questions posed to the auditor. The internal controls over critical accounting estimates should be communicated by management, not the auditor.

Paragraph 12(b)(ii). Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;

This information is required in MD&A by FR 72 for interim and annual reporting. There is no need for auditors to communicate this to the audit committee since the audit committee is obliged to review all the financial statements and other information included in filings with the SEC

Paragraph 12(b)(iii). Any significant changes to assumptions or processes made by management ....

Again, this is required by FR 72, and there is no need for auditors to communicate this to the audit committee.

What is the significance of "... in the year under audit ....? Are not all of these communications in this proposal for the year under audit?

Paragraph 12(b)(iv). When critical accounting estimates involve a range of possible outcomes ....

If the audit committee (or management) deems it necessary to build such pro forma financial statements with various plus and minus outcome ranges across perhaps a dozen critical accounting estimates they certainly are already free to do so. This is not an audit procedure required of auditors[18] and auditors should not be asked to prepare these extraordinarily elaborate pro forma financial statements.

Note: As part of its communications to the audit committee, management may communicate ....

Note 12 of the Proposal asks for exception reporting and requires that the auditor gain knowledge of every communication by management to the audit committee throughout the year, evaluate those communications, and then report to the audit committee whether or not the matters were adequately described or not communicated. Such communications are not necessary to achieve the objectives of the audit. Auditors should not be in the business

---

[18] See AU 342, "Auditing Accounting Estimates."

of fixing the communications between management and the auditor committee; this requirement is unworkable and should be removed.

Paragraph 13. The auditor should communicate to the audit committee the following matters:

I could not determine from this release why <u>all</u> the guidance in extant AU 380.11[19] was not included in this proposal. It should be.

Paragraph 13(b)(i). An evaluation of management's disclosures related to the critical accounting ....

The footnote (referring to Reg. S-X, Rule 2-07(a)(1)) should also include a reference to 1934 Act Section 10A(k) dealing with critical accounting policies.

Paragraph 13(b)(ii). The reasons certain policies and practices are considered critical ....

This requirement goes beyond the disclosures made by management in MD&A and required by auditors under Section 10A(k).

As written this communication is too terse. Management is primarily responsible for determining whether accounting policies are critical. If the auditor does not agree with management's determination, or believes there are critical accounting policies which management overlooked and management disagrees, then the auditor should communicate this disagreement with the audit committee.

Paragraph 13(b)(iii). How current and anticipated future events generally may affect ....

This requires that anticipated future events must be foreseen by the auditor, then the auditor must understand how such future events would impact the particular registrant and a specific critical accounting policy. This goes beyond the objective of a financial statement audit and is likely well beyond the skill set of many auditors. Again, management determines whether accounting policies are critical, the auditor may or may not agree.

Paragraph 13(c). Critical accounting estimates. Both the auditor's evaluation of the reasonableness ....

Paragraph 13(d). Accounting Estimates. If the auditor determines that potential bias ....

---

[19] AU 308.11. In connection with each SEC engagement (reference omitted), the auditor should discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting. Since the primary responsibility for establishing an entity's accounting principles rests with management, the discussion generally would include management as an active participant. The discussion should be open and frank and generally should include such matters as the consistency of the entity's accounting policies and their application, and the clarity and completeness of the entity's financial statements, which include related disclosures. The discussion should also include items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information included in the financial statements. (Footnote omitted) Examples of items that may have such an impact are the following:

- Selection of new or changes to accounting policies
- Estimates, judgments, and uncertainties
- Unusual transactions
- Accounting policies relating to significant financial statement items, including the timing of transactions and the period in which they are recorded

Objective criteria have not been developed to aid in the consistent evaluation of the quality of an entity's accounting principles as applied in its financial statements. The discussion should be tailored to the entity's specific circumstances, including accounting applications and practices not explicitly addressed in the accounting literature, for example, those that may be unique to an industry.

Reference should be made to AU 342, "Auditing Accounting Estimates." Here, in evaluating the reasonableness of an estimate the auditor is instructed to consider bias among many other things.

At issue is whether there is any estimate management makes that is free of bias and determining and reporting on management's "potential bias" assumes the auditor knows every fact, assumes the auditor is her (or him) self entirely free of any bias, and is therefore a very subjective determination. Notwithstanding these caveats, the auditor should report what appears to be a possible management bias to the audit committee.

The final standard should address the question: After reporting on management's potential bias, what action or communication should the auditor expect from the audit committee?

Paragraph 13(f). Significant accounting matters for which the auditor has consulted outside ....

The release does not explain why communication with others outside the engagement team should be communicated to the audit committee. What will this communication convey to the audit committee? Does it suggest the auditor's believe there is some uncertainty or risk associated with the subject of the consultation? There is a matter about which the auditors have little or no knowledge? Something else? Should the audit committee now evaluate the experience, competence and sophistication of the audit team or audit firm if there is such consultation?

In sum, unless the auditor's are consulting on an accounting position that is contrary to management's position, such communication to the audit committee is unnecessary.

Paragraph 14. When other information is presented in documents containing audited financial ....

This responsibility should be incorporated into the engagement letter. Under AU 550 this is an auditor – management issue and therefore I suggest that the PCAOB amend AU 550 if communication should also include the board of directors and the audit committee.

Paragraph 15. When the auditor is aware that management consulted with other accountants ....

The PCAOB standards do not include the AICPA's interpretation of AU 625, "Reports on the Application of Accounting Principles," thus there is no exception for "advisory accountants."[20] Consideration should be given to amending AU 625 or revising that standard to more closely align with the AICPA's recent proposed auditing standard.

Paragraph 16. The auditor should communicate to the audit committee ....

In addition to this going concern issue, auditor's should consider other communications required under 1934 Act Section 10A, "Audit Requirements," e.g., the procedures designed to provide reasonable assurance of detecting illegal acts and procedures designed to identify related party transactions.

Paragraph 17. The auditor should provide the audit committee with the schedule of uncorrected ....

This should be clarified and say –

> The auditor should provide the audit committee with the schedule of <u>all</u> uncorrected misstatements related to accounts and <u>uncorrected</u> disclosures that ~~was~~ <u>were</u> presented to management.

---

[20] AICPA AU 9625.

The final standard should differentiate this requirement from the SEC's requirement regarding "material correcting adjustments",[21] and the SEC's requirement regarding "unadjusted differences."[22] The final standard should also consider defining "uncorrected disclosures." I assume this to mean either financial statement disclosures that are materially misleading, or disclosures that were not made, but should be.

Paragraph 18. The auditor should communicate to the audit committee the basis for the auditor's ....

This appears to require the sharing with the audit committee and management (a) the level(s) of materiality used by the auditor, both individually and in the aggregate, (b) the amount of tolerable misstatement that the auditor is willing to accept, (c) analysis of uncorrected misstatements on trends, (d) the rollover and iron curtain considerations, and (e) various subjective qualitative measures.

I believe this sharing will compromise audits.

Some comments on the second sentence.

1. I cannot determine why this is a necessary communication, unless it is meant to show the value of the audit, or how error prone management is. Clearly, the auditor cannot issue an unqualified opinion on the financial statements if the financial statements are materially misstated.

2. Should auditors communicate <u>undetected</u> misstatements to the audit committee? AU 312.65 says –

> If the auditor concludes that the effects of uncorrected misstatements, individually or in the aggregate, do not cause the financial statements to be materially misstated, they could still be materially misstated because of further misstatements remaining undetected. As the aggregate misstatements approach materiality, the risk that the financial statements may be materially misstated also increases; consequently, the auditor should also consider the effect of undetected misstatements in concluding whether the financial statements are fairly stated.

Consideration should be given to including some mention of undetected misstatements in the engagement letter.

3. Also this proposal does not deal with if and how the auditor should communicate rollover and iron curtain effects of uncorrected misstatements assuming the basis for immateriality is shared with the audit committee.

AU 312.53 says –

> In aggregating misstatements, the auditor should include the effect on the current period's financial statements of those prior period misstatements. When evaluating the aggregate uncorrected misstatements, the auditor should consider the effects of these

---

[21] Section 401(a) of the Act requires that each financial report of an issuer that is required to be prepared in accordance with generally accepted accounting principles (GAAP) shall "reflect all material correcting adjustments ... that have been identified by a registered accounting firm...."

In sum, there is a confusion of terms, e.g., uncorrected misstatements, uncorrected disclosures, material correcting adjustments, and unadjusted differences.

[22] Regulation S-X, Rule 2-07(a)(3) and Section 13(i) of the 1934 Act. In sum, there is a confusion of terms, e.g., uncorrected misstatements, uncorrected disclosures, material correcting adjustments, and unadjusted differences.

uncorrected misstatements in determining whether the financial statements are free of material misstatement.

Note: The auditor should communicate that uncorrected misstatements or matters underlying ....

A reference to AU 312.60(n) should be included in the standard.[23]

Paragraph 20. The auditor should communicate to the audit committee disagreements ....

This paragraph should discuss how, or if, this disagreement with management and reported to the audit committee would be reported in Item 9, "Changes in and Disagreements With Accountants on Accounting and Financial Disclosure," in the circumstances detailed in Regulation S-K, Item 304.

Paragraph 21(d). Unreasonable restrictions imposed on the auditor by management ....

It is assumed that "restriction" means restrictions on the scope of the audit; however, if it is meant to convey another meaning the paragraph should be expanded.

Paragraph 22. The auditor should communicate to the audit committee other matters arising ....

This objective of this paragraph is that the "auditor ... communicate to the audit committee other matters arising from the audit that are significant to the oversight of the financial reporting process ...." Because responsibilities of a board and the audit committee are governed by state law and are limited by a litigated series of principles, auditors should not be asked to interpret or fulfill this "oversight" responsibility.

This paragraph might be better stated as "... that ~~are~~ may be ~~significant~~ relevant to the oversight of the financial reporting process." As it now reads, the sentence assumes that auditor's are knowledgeable regarding the rules, regulations, laws and duties governing the audit committee's oversight of the financial reporting process.

Paragraph 23. The auditor should communicate to the audit committee the matters in this standard ....

Note: If management communicated matters identified in paragraph 12, the auditor should ....

For the reasons stated in paragraph 12 of the proposal, this inclusion of this documentation may be unworkable, and therefore summaries and copies should not necessarily be collected and included in the working papers.

Footnote 25: See AU sec. 532, Restricting the Use of an Auditor's Report, which applies to ....

The final standard should explain why AU 532 is referenced. The AICPA's recent revision of AU 380 states, in paragraph 17 –

> Restricted Use: When the auditor communicates matters in accordance with this SAS in writing, the communication is considered a by-product report (footnote to AU 532.07). Accordingly, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management, and is not intended to be, and should not be, used by anyone other than these specified parties.

Paragraph 24. Audit committee communications should occur in a timely manner ....

---

[23] Under AU 312.60(n), uncorrected misstatements impact on future periods means: "The likelihood that a misstatement that is currently immaterial may have a material effect in future periods because of a cumulative effect, for example, that builds over several periods."

Saying that communications should be "timely" is entirely too general and is therefore meaningless; however, without the final standard containing a lengthy and detailed exposition regarding timing I cannot think of or suggest a "fix."

Note: Communications with the audit committee chair may be appropriate if done in order to ....

This assumes that the chair does not or would not communicate with the balance of the audit committee. This follow up with the entire committee places an unwarranted and unnecessary burden on the auditor.

Paragraph 25. All communications required by this standard should be made annually to the audit ....

It is not clear how this annual requirement fits into the one in paragraph 24 "occur in a timely manner." Regulation S-X, Rule 2-07 talks to the filing of the audit report, while AS 3, "Audit Documentation," references the report release date, and AU 530 mentions the auditor's report date. Notwithstanding all these different dates, all the communications should be made at least annually before the date of the auditor's report.

Paragraph 26. Prior to the issuance of the auditor's report, the auditor should evaluate ....

Guidance regarding this evaluation should be included in the final standard. For example, this evaluation can only be performed at the most senior level of the engagement team, and only by those with direct "hands on" involvement with the audit and who were in direct communication with the audit committee for a substantial number of meetings during the course of the year.

The key here is who on the audit team makes this determination? If more than one person interacts with the committee during the year, should this evaluation be the subject of a "brainstorming" session?

If the auditor is going to assess the audit committee, then the evaluation must take into consideration its impact on the risk of material misstatement and the ability to obtain sufficient audit evidence, and be made no later than the date of the auditor's report. In order to fulfill the proposed requirement in paragraph 27 the evaluation cannot be made during the period between the date of the auditor's report and the date of the issuance of the report

Paragraph 26(a). The appropriateness and timeliness of actions taken by the audit committee ....

This requirement should be expanded to discuss the nature and type of matters raised by the auditor that would require a reaction by the audit committee.

Paragraph 26(b). The openness of the audit committee in its communications with the auditor;

Similar to the evaluation required in paragraph 26(a), this determination of "openness" may be entirely too subjective. How does the auditor determine if every card is face up?

Paragraph 26(c). The willingness and capacity of the audit committee to meet with the auditor ....

Willingness and capacity are two separate determinations. Executive sessions are ordinarily scheduled by the audit committee for every committee meeting, and, for example, the NYSE Rules require such meetings.[24]

---

[24] The New York Stock Exchange Rules (303A.07) already require audit committees to meet with the auditors:

(E) "... meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors ...."

Paragraph 26(d). The extent to which the audit committee probes issues raised by the auditor.

This evaluation is similar to that in paragraph 26(a), and this paragraph should be combined with 26(a). If there is a meaningful difference, the final standard should differentiate the two paragraphs.

Note: The auditor should read the minutes, if any, relating to audit committee ....

The final proposal should require that the auditor also read and be familiar with the audit committee's charter.

Paragraph 27. If the auditor determines that the two-way communications have not been adequate ....

Under paragraph 26, the evaluation must be made before the report is issued, but if this is after the report is dated, is it not too late?

This paragraph should be expanded to say just what the "appropriate action" should be. Does it mean those actions outlined in paragraph 28?

D. Appendix A – Definitions

A2. Audit committee

This definition should be referenced to Section 3(a)(58) of the 1934 Act.

A3. Critical accounting estimate

This definition should be referenced to SEC Financial Reporting Release No. 72, "Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations."

A4. Critical accounting policies and practices

This definition should be referenced to SEC Financial Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies."

To avoid confusion between "critical accounting policies" and "accounting policies." this Appendix should define the latter term as found in APB 22 quoted in response to question 8 above.

In addition to the above comments, the term "audit strategy" should be defined, see response to question 6 above.

The term "uncorrected disclosures" should be defined, see comments on paragraph 18 of the proposal.

E. Appendix C – Matters Communicated in the Audit Engagement Letter

Paragraph C(1)(b)(1)

b. Audit of financial statements:

1. The reliance on other auditor's (and the extent of such reliance) should be included in the engagement letter, along with the declaration that the auditor signing the letter is the "principal auditor."

2. Paragraph 14 of the proposal requires the auditor communicate to the audit committee the auditor's responsibilities when other information is presented in documents containing

audited financial statements. This audit responsibility regarding the accuracy of other information should be integrated into the engagement letter.

3. Under the SEC's rules on auditor independence, the audit committee is required to pre-approve audit and non-audit services for the issuer and all of its consolidated subsidiaries, whether those subsidiaries are separate issuers or not. This requirement should be integrated into the engagement letter.

Paragraph C(1)(b)(2).

b. Audit of financial statements:

The requirements contained in the 1934 Act Section 10A belongs in the engagement letter, see response to question 4.

Paragraph C(1)(c).

5. At the conclusion of the engagement, management will provide the auditor with a letter ....

The proposal does not contain a requirement that the representation letter be communicated to the audit committee. The engagement letter should specifically require that the signed management representation letter will be provided to the audit committee on the report date. A best practice would have the auditors give the audit committee a draft of the letter before it is signed by management.

6. Management is responsible for adjusting the financial statements to correct material ....

I suggest adding the underlined to this paragraph "... are immaterial, both individually and in the aggregate (qualitatively and quantitatively), to the financial statements taken as a whole ...."

For other matters that should be included in the engagement letter, see the response to question 4 and comments under paragraphs 11 and 18 of the proposal.

xerox

Gary R. Kabureck
Vice President; Chief Accounting Officer

Xerox Corporation
45 Glover Avenue
Norwalk, CT 06856

Gary.Kabureck@xerox.com
tel 203.849.2630

June 24, 2010

Mr. J. Gordon Seymour
Secretary, Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC. 20006-2803

PCAOB Rule Making Docket Matter No. 030 – Exposure Draft - Communications with Audit Committees

Dear Sirs:

In my capacity as a member of the Standing Advisory Group (SAG) I am pleased to have the opportunity to provide my comments and suggestions on the PCAOB's recent Exposure Draft (ED) "Communications with Audit Committees" (Release No. 2010-001). Xerox Corporation is a multinational organization with operations in over 130 countries and annual revenues of approximately $22 billion. Our audit fees, exclusive of non-recurring items and non audit services, have approximated $20 million in recent years. Xerox's Audit Committee meets approximately 12 times each year. We view these meetings as a very important governance process and extensive time and preparation, by all participants, is required for these meetings to be effective. Accordingly any proposals that potentially affect these meetings are of interest to the Company. These comments represent my views as a member of the SAG and as Chief Accounting Officer of the Company and do not necessarily represent the views of our independent auditors or the members of our Audit Committee.

Before providing specific comments, let me begin by stating my support for the Board's efforts to comprehensively update the current auditing standards with respect to audit committee communications. The ED and the covering Release are well written – the stated objectives are clear and appropriately emphasize the critical importance of effective two way communication. In my opinion the ED appears to codify the best practices in place today and for active, well run audit committees the ED should not generally represent a significant change from current practice.

While I endorse the majority of the ED's proposals, I do have concerns with certain of the detailed recommendations which arguably include placing the auditors in the role of management and certain prescriptive requirements which will not generally add meaningful content to audit committee meetings.

My detailed comments and recommendations follow:

Accounting Policies, Practices and Estimates and the Auditor's Evaluation of the Company's Financial Reporting

A significant portion of the ED (three full pages; paragraphs 12-13) is devoted to the aforementioned topics and appears to be the most central requirement of the ED. For a variety of reasons I do not believe many of the requirements of paragraphs 12 or 13 are necessary or practical and in a number of respects they appear to transfer to a company's auditors the usual role of management in communicating this information to a company's audit committee.

It is the responsibility of management for the preparation of a company's financial statements including the selection of accounting policies and procedures, the determination of the significant assumptions and estimates necessary for the preparation of those statements and the assessment of the range of possible outcomes for a given transaction, business activity or contingency. Many of the proposed auditor communications in paragraphs 12 and 13 are current requirements for management and in general I do not see the need for significant incremental auditor requirements in this area. I recommend the Board and the staff review management's current responsibilities (from other standards and standard setters) and incorporate such in the final Standard. I do observe the "Note" to paragraph 12 permits the auditor to allow management to make these communications however it appears to me there is not sufficient emphasis of this potentiality reflected into the details of paragraphs 12 and 13. It is also important to note that there is nothing to prohibit an audit committee from requesting the auditor's views on any of these subjects if they consider it important. I will use a few examples to illustrate the need for an overall reconsideration of the paragraph 12 and 13 requirements.

- Paragraph 12.a. ii requires communication as to how a company may adopt an issued but not yet effective new accounting standard. The need for these disclosures already exists and I recommend the final Standard parallel the related management requirements in SEC Staff Accounting Bulletin No. 74. Should management's disclosures be inadequate in a material way then it would be appropriate for an auditor to comment about such inadequacy in the context of the financial statements taken as a whole.
- Paragraph 12.b – with respect to critical accounting estimates, in general this section will be very difficult for an auditor to operationalize. While an accounting estimate may be important, it does not automatically follow that the estimate is problematic or without a reasonable basis. A more relevant communication would be a requirement for audit committee discussion of material changes in how critical estimates are determined and the underlying basis for such changes.
- Paragraph 12.b .iv – with respect to communicating the range of possible outcomes I believe this is properly the responsibility of management. Frequently it will be extremely difficult, if not impossible, for an auditor to adequately establish a range of possible outcomes independent from management involvement. To try to do otherwise places an auditor in the difficult position of assuming the auditor knows

more about a company's operations than does management. Assuming however that this requirement remains in the final Standard I recommend the definition of 'range' be clarified to mean the 'relevant range' so as to avoid the time and cost of preparing analyses of highly remote outcomes.

- Paragraph 13.a requires the auditor to communicate his or her evaluation of the quality and not just the acceptability of a company's selection of accounting policies, practices and disclosures. The draft requirement is too broad without a practical definition of 'quality'. For example, is 'quality' in the eyes of the auditor's personal or firm preferences or measured against existing practice? Alternatively is 'quality' measured against the stated financial reporting objectives included in FASB releases, etc?
- Paragraph 13.d requires the auditor to communicate potential bias in management's accounting estimates. As a practical matter 'potential' bias always exists and I suggest this requirement be narrowed to instances where there is reasonable evidence of actual bias in management's estimates.

As an overall comment on paragraphs 12 and 13 I find their collective construction and flow somewhat confusing and redundant and at a minimum the Board needs to re-consider the overall drafting of these paragraphs.

Corrected and Uncorrected Misstatements:

I concur with the ED's requirement for auditors to provide to audit committees a schedule of the quantitative, uncorrected errors found during the course of an audit and the basis for the auditor's conclusion that the uncorrected errors are immaterial (assuming that is the case). With respect to corrected errors found by the auditor, I recommend this requirement be limited to events that resulted in significant deficiencies or material weaknesses. Adjustments below these thresholds are, by definition, relatively minor and would not be a good use of audit committee time.

In response to Question 15 regarding communication of corrected misstatements found by management, I strongly disagree with this potential requirement. It will be difficult, if not often impossible, to differentiate between an "error" versus an adjustment that was identified by a sound system of internal accounting controls or even a routine closing adjustment in the normal course of business. Any required audit committee communications in this area should be limited to those management identified adjustments that also result in a significant deficiency or material weakness.

With respect to communicating to audit committees uncorrected misstatements for disclosure-only matters, I recommend that the final Standard permit the auditor to use professional judgment and limit required audit committee communications to unresolved disclosure matters which are significant, in the auditor's opinion, to an understanding of the financial statements. As you are aware, disclosure requirements are extensive and frequently management will make judgments as to which technically required disclosures do not add meaningful incremental content to financial statements. Further, often the passage of time will result in previously important disclosures becoming irrelevant in the current period. Lastly, for readability purposes management may decide to include some technically required financial statement disclosures in other portions of filed documents such as the Management's Discussion and Analysis (MD&A) thereby effectively mooting any practical audit concerns. Financial statement disclosures and disclosures in other filed financial information are extensive and complex; I can envision situations where a large amount of technically required but otherwise low value disclosures will be made in order to avoid this proposed requirement. This will detract from the more important disclosures which is where users need to concentrate their time.

Form and Content of Communications:

The ED provides the auditor with the option of making required communications either orally or in writing. While there is an appeal to having this flexibility, I nonetheless believe that any mandatory communications should almost always be in writing. This has several advantages including documenting the work, the avoidance of any misunderstandings and a reference point for the future. There is nothing that precludes the auditor from orally providing details at an audit committee meeting. I believe that advance meeting materials are routinely prepared and distributed for board and board committee meetings at many companies. To be clear, I am not suggesting for the final Standard to require written materials to be distributed in advance; however in my experience having audit committee communications distributed in advance of the actual meeting is a significant enabler to an efficient meeting thereby providing time for a focused discussion of the substantive issues.

Consultations Outside of the Engagement Team by Management and by the Engagement Team

The ED requires the audit committee to be informed when management consults with other accountants on accounting or auditing matters. Paragraph 13.f of the ED requires an audit committee to be informed of significant accounting matters which the auditor has consulted outside of the engagement team.

It is appropriate for the audit committee to be informed of instances where management consulted with other accounting firms when the substance of the communication was a form of opinion shopping. This is the standard today and it should be retained in the final requirements. The ED refers to 'other accountants' and I recommend the Board clarify what is meant by such. I recommend 'other accountants' in this context needs to be limited to consultations with other auditing firms. For example, there are boutique accounting firms that specialize in only accounting research on a retainer or per diem basis and a company might find it cost effective to outsource technical research rather than retain in-house expertise. In response to Question 12, the proposed Standard should not be expanded to include consultations with non accountants such as consulting or law firms. In my experience non accountants are often fully versed in the accounting related aspects of their professional practice – e.g. actuaries very well understand the FASB's requirements for pension and retiree health plans and major law firms very well understand the FASB's requirements for litigation contingencies. Other than with other auditing firms, management should be able to consult with any professional firms or other technical advisors deemed necessary without triggering a specific communication requirement with the audit committee.

With respect to the requirement for the engagement team to advise an audit committee of consultations outside of the engagement team, I recommend this requirement be limited to consultations of matters which are material and consequential to the audit and leave it to the judgment of the engagement team to determine which matters are of such significance that the client's audit committee needs to be advised. Each firm has its own standards for when national office consultations are required – what might be an empowerment to the engagement team in one firm may be a required national office consultation at another firm. Many of these consultations may not even be for a particular problem on the engagement but the firm may have a desire to ensure consistent advice is being communicated to all of its clients on a particular subject and a required national office consultation was the chosen form of control. Further there will undoubtedly be instances where the 'consultation' was little more than a routine education of an engagement team on a technical matter that was not otherwise problematic. Accordingly I recommend the final standard afford the engagement team a degree of flexibility in determining which consultations it needs to bring to the attention of a client's audit committee.

* * * * *

Thank you for the opportunity to provide these comments for your consideration on this important project. Please do not hesitate to contact me if you have any questions or comments about the contents of this letter.

Yours very truly,

Gary R. Kabureck

Gary R. Kabureck

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD:

ROUNDTABLE ON AUDITOR COMMUNICATIONS

WITH AUDIT COMMITTEES

September 21, 2010

8:30 a.m.

Washington, D.C.

MR. MARTIN BAUMAN: Good morning. I'd like to welcome everybody here to the PCAOB Roundtable on Auditor Communications with Audit Committees. I'm Marty Bowman, the PCAOB Chief Auditor and Director of Professional Standards. I'd also like to welcome those who are listening in our webcast. Like our SAG meetings, this meeting is webcast. And so I thank all of those folks for joining us as well.

On March 29th, the board proposed a new auditing standard regarding auditor communications with audit committees. And the comment period closed on May 28th. As part of those comments, we received many good comment letters and valuable input, but an important theme that recurred through many of the letters was the fact that the board should consider conducting additional outreach, especially to members of audit committees to gain insights in terms of how they saw the audit committee and auditor communication process working, and getting more views from audit committee members regarding the communications process.

Today’s roundtable represents the board’s response to those commenters, and also, the ability to get further input on some additional questions in comments that were raised during the comment letter process.

So as part of this roundtable process, we’ve prepared a briefing paper, which you’ve all seen. And additionally, the comment period has been reopened and extended through October 21st, 2010.

Today, we’ll discuss a number of topics relating to communications with audit committees, auditor communications with audit committees, including which communications are useful to audit committees in their oversight of the audit, communications relating to accounting policies, practices and estimates, two-way communications between the auditor and audit committees. One of the new features of the proposed standard was a requirement for the auditor to evaluate the effectiveness of the two-way communications. And we received quite a few comments in that area as well.

Another important topic would be whether auditor communications should with written or oral. There are a lot of differing views on that aspect also. And then several other topics will be discussed along the way.

I want to extend my personal appreciation for the willingness of all of you to be here today. I know you all have very busy schedules. Summer's just shortly over. And here you are in Washington discussing an important topic with us. It is very valuable to us in this standard setting process. So I want to express how much we appreciate the fact that you all took the time to come today.

Please everybody, please be engaged today. We really are looking for all of your inputs. So and I know I don't have to say that in most cases for most folks, but I thought I'd say that any way.

This is a very, very important topic communications, auditor communications with the audit committee. It's our view that or my view at least that it's one of the very, very important features in terms of ensuring that the audit process is working effectively. And I think Sarbanes Oxley legislation saw it that way and changed the relationship between the auditor and management, and auditor to the audit committee. The level and quality of those communications are key to an effective audit process.

Finally, I have some -- a couple of administrative items. You should have a folder in front of you today that has all of the materials you'll need. It has a copy of the proposed standard, the briefing paper, seating chart, I think copies of the slides we'll be putting up, as well as the agenda. We'll be break -- taking a break around 10:15. Lunch will be at noon right outside the doors here. And we should finish the day around 3:00 p.m. unless the conversations get really exciting, in which case it could go on very late.

Before I turn the floor over to our acting chairman Dan Goelzer, I'd like to go around the room and ask everybody to briefly introduce themselves and as well as your organizational affiliation including if you are on audit -- representative of audit committees, to tell us about that as well. So again, I'm Marty Bauman and I'll turn to my left.

MS. JENNIFER RAND: I'm Jennifer Rand. I'm Deputy Director of Professional Standards and also Deputy Chief Auditor, the PCAOB.

MS. JESSICA WATTS: I'm Jessica Watts. And I'm an Associate Chief Auditor with the PCAOB.

MR. JEB BURNS: I'm Jeb Burns. I'm the Chief Investment Officer with the Municipal Employees Retirement System in Michigan.

MS. LISA GAYNOR: I'm Lisa Gaynor. I'm an Assistant Professor at University of South Florida. And I served as member of a research team on audit committee communications.

MR. ROBERT KUEPPERS: Hi, I'm Bob Kueppers with Deloitte. I'm Deputy CEO. My responsibilities are principally regulatory and public policy.

MR. ALEX MANDL: I'm Alex Mandl. I'm on five boards. I'm involved with three audit committees. And I chair one of those. So this topic is very -- great interest to me. Thanks.

MR. STEVE HARRIS: Steve Harris, PCAOB board member.

MR. HAL SCHROEDER: Hal Schroeder, Carlson Capital, a portfolio manager, and until recently, an audit committee member and of a Lloyd syndicate.

MS. KIKO HARVEY: Kiko Harvey, I'm the Vice President of Corporate Audit and Enterprise Risk Management at Delta Airlines. And I report to the audit committee.

MR. MIKE COOK: I'm Mike Cook. I've been a member of a variety of audit committees and chaired a few over the years. Currently the chairman of the audit committee of Comcast.

MR. DAN GOELZER: PCAOB board member.

MR. LINDA GRIGGS: I'm Linda Griggs. I'm a lawyer with Morgan, Lewis, and Bockius here in Washington. And my practice consists of advising on securities regulatory matters, including financial reporting matters and corporate governance. I have served on the audit committee of a public company.

MR. ROBERT DOHRER: Bob Dohrer, National Director of Insurance Services for McGladry and Pullen.

MR. GARY KUBURECK: Gary Kubureck, Chief

Accounting Officer of Xerox Corporation. I've never been on an audit committee, but I'm a process owner for our audit committee's meeting process.

MS. JOAN WAGGONER: Joan Waggoner, I'm the Quality Assurance Partner for Blackman Kallick, a Chicago based public accounting firm.

MR. BRIAN CROTEAU: Brian Croteau, Deputy Chief Accountant at the Securities and Exchange Commission. And if I could just briefly say that while anything that I would -- any views I would express today would be my own, I certainly speak on behalf of many at the SEC in commending the PCAOB for holding this roundtable today and for all of the participants in taking the time to attend. We really appreciate it as well.

MR. ARNOLD HANISH: Arnie Hanish, Vice President, Chief Accounting Officer at Eli Lilly and Company. I've been involved in interfacing with the audit committee for well over 20 years.

MS. KAREN HASTIE WILLIAMS: Karen Hastie Williams, for my day job, I am a partner at the law firm of Crowell & Moring here in Washington. But I serve on five corporate boards and chair three audit committees. So I felt this was an important meeting for me to attend. Thank you.

MR. JIM COMR. BAUMAN: Jim Cox, and my day job is a professor at Duke Law School. And I serve and have served on audit committees.

MR. LYNN TURNER: Lynn Turner, I currently serve on the board of trustees at the Colorado Public Retirement System, a 3$8 billion investment fund. I also serve as a Senior Adviser to a forensic and economic consultant firm, LECG. I’ve served on a number of audit committees and chaired three of them. And in a prior life, also as a signing audit partner.

MR. CHARLEY NIEMEIER: Charley Niemeier, PCAOB board member.

MR. DENNY BERESFORD: I’m Denny Beresford. I’m a professor at the University of Georgia. I am now the chairman of the audit committee of three large corporations. And I served 26 years in public accounting with 10 years in between as a standard setter at the FASB.

MR. SAMUEL RANZILLA: Sam Ranzilla, I'm the National Managing Partner for Audit Quality and Professional Practice at KPMG.

MS. MARY HARTMAN MORRIS: I'm Mary Hartman Morris. I'm an investment officer at CALPERS, California Public Employees Retirement System.

MR. BILL GRADISON: I'm Bill Gradison, a member of this -- of the PCAOB board. I formally served on the audit committee of a public company in the health care field.

MR. ROGER COFFIN: Good morning, my name is Roger Coffin. I'm the Associate Director of the Weinberg Center for Corporate Governance and an Associate Professor of the Practice at the University of Delaware.

MR. LARRY SALVA: Larry Salva, Senior Vice President, Chief Accounting Officer of Comcast. Been at Comcast the last 10 years. Prior to that, spent 23 years with Coopers and Lybrand and Price Waterhouse Coopers, including as a signing partner, and also as a national accounting consulting and risk management partner.

MR. GEORGE MUNOZ: Good morning, George Munoz. I'm an attorney and CPA. I'm the audit chair of Altria and the audit chair of the National Geographic.

MR. HASNAT AHMED: Hasnat Ahmed, Assistant Chief Auditor, PCAOB.

MS. BARBARA VANICH: Barbara Vanich, Associate Chief Auditor, PCAOB.

MR. BAUMAN: Well thank you, everybody, for taking the time to do that. And clearly, we're fortunate to get a group of very qualified people to talk about on the very important subject with us today. So with that, I'd like to ask Dan Goelzer to introduce the program. Dan?

MR. GOELZER: Thank you very much, Marty. And good morning to everyone. I'd also like to welcome everyone to the Public Company Accounting Oversight Board's Roundtable on Auditor Communications with Audit Committees.

Like Marty, I want to begin by thanking all of the panelists for joining us today and providing us with the benefit of your insights and experience. The board appreciates your willingness to devote time, effort, and thought to helping us address this important topic.

This roundtable is a key component of the board's ongoing standards setting process. I've spoken in the past about the importance of openness and transparency in board standard setting. Over the last two years, we've experimented with the use of concept releases with multiple public comment periods on proposed standards, and with more focused discussion with our standing advisory group of standards setting projects.

I view roundtables like this one as another tool that we can use to make sure that the board receives the most thoughtful and relevant input available when it writes standards, and that investors, preparers, and auditors all have the chance to contribute to our decision making.

The board's proposal to enhance auditor audit committee communication was published last March. The objective of that proposal was to bring the standards related to auditor communication with audit committees into line with the role of the Sarbanes Oxley Act assigns to the committee in overseeing the relationship between a public company and it’s auditor.

The provisions of the act that deal with audit committees are predicated on the idea that independent, informed, and proactive auditor committees are central to protecting the interests of investors in reliable and informative financial disclosure. That vision can only be fully realized if there’s a robust dialogue between the auditor and the committee. The proposed standard aimed to accomplish that by expanding and clarifying the rules of the road that govern auditor audit committee communications.

The board received 34 comments on the proposal, including letters from several of the participants that around the table here with us this morning.

The primary purpose of the roundtable is to explore in more depth some of the issues that were raised in those comments. One theme that ran through many of the submissions was that before proceeding further with a new standard, the board needed to engage in additional outreach, particularly to directors and others with firsthand experience in the work of audit committees.

Along those lines, some commenters suggested that the March proposal approached the subject too much from the perspective of what auditors thought directors should receive, and without enough sensitivity to what information is actually beneficial to audit committees. Others warned against creating requirements that would turn the communications process into a sterile check the box exercise.

One goal of this roundtable is to address those concerns, and to make sure that the board understands the dynamics of successful auditor audit committee communication.

The comments also reminded us that the auditor and the audit committee have a common interest in the reliability of the company’s financial reporting. That’s why the proposal emphasized two-way communication between the auditor and the committee. If the auditor views meeting the requirements that govern its relationship with the audit committee as just another regulatory hoop that it must jump through, it may deprive itself of an important source of information and insight. The result could be to undermine the effectiveness of the auditor’s work.

Conversely, if the audit committee treats the audit as just another compliance cost, and one that needs to be minimized as much as possible, the committee may deprive itself of a valuable tool to assist in assuring the integrity of the company’s financial reporting.

Accordingly, it’s vital that any standards the board adopts in this area promote a dialogue between the auditor and the audit committee that benefits both parties.

I’m certainly looking forward to hearing your thoughts on how we can best accomplish that. Thanks again to the panelists for taking the time to be here with us today. And I’ll turn the proceedings back to you, Marty, to introduce the first topic. Thank you.

MR. BAUMAN: Thank you, Dan. The first topic, and we are going to pretty much -- we will follow the order of the briefing paper that you all have -- our first topic is communications that are useful to the committee's oversight of the audit. And let me ask board member Charley Niemeier to say a few words to introduce this topic.

MR. NIEMEIER: Thank you, Marty. The role of audit committees in corporate governance came into prominence in the 1970s under the directions of Rod Hills as Chairman of the SEC. At that time, as a part of a comprehensive strategy to address revelations of bribery of foreign officials and other corrupt practices by American public companies, the SEC directed the New York Stock Exchange to require all public companies to create -- all listed companies to create independent audit committees to oversee the preparation of accurate corporate financial reports.

In 2002, the Sarbanes Oxley Act added to the audit committee’s responsibilities to address perceived problems with management’s hold on and control over auditors. Thus, the Act required stock exchanges to require audit committees to be responsible for the appointment, compensation, and oversight of auditors, including a resolution of disagreements between management and the auditor regarding financial reporting.

We are here today to talk about the PCAOB’s proposal to update the existing audit standard, requiring the auditor to communicate certain information to the audit committee. That standard pre-dated the Sarbanes Oxley Act. So it’s not difficult to envision why an update would be appropriate. The purpose of this meeting is to solicit views, based on the practical experience of our participants about what sort of updates we should undertake.

The purpose is also to get a reaction to the draft standard the PCAOB proposed in March, which in addition to updating the existing standard uses new language, new communications from auditors, both on audit issues and on significant accounting matters beyond those required in AU Section 380, which was written long before the Sarbanes Oxley Act.

Underlying the Sarbanes Oxley Reforms in this area is the idea that audit committees are expected to be independent of management and would need to step in and champion the auditor. That said, based on PCAOB inspections and other oversight, I'm concerned that there's still a lot of situations where the auditor does not stand up to the client.

Therefore, from my perspective, the point of the proposal, whether it takes the form of what the PCAOB proposed in March, or takes some other direction, is to give the audit committee adequate information about what's going on in the audit, to allow the audit committee to know when to step in, and what is needed to do to defend the audit.

Several commenters on the proposal expressed concern that it would burden audit committees with too much information, which would increase review time and possibly obscure important issues in the audit. We're seeing feedback from the roundtable to understand what communication should be made to audit committees to aid an effective oversight at the audit. Thanks, Marty.

MR. BAUMAN: Thank you, Charley. The discussion questions we'd like to ask you to consider as part of this first topic are up on the screen and in your slides. And the first one is what matters related to the audit are most important to audit committee members in their oversight of the audit? Which of these matters should be required to be communicated by the auditor to the audit committee?

Second question is what matters do investors believe audit committees need to know for effective oversight of the audit? Which of these matters should be required to be communicated by the auditor to the audit committee?

We've asked a couple of members of the roundtable to kick off this discussion with a couple of brief comments. Please, during the session, anybody else who wants to make comments, please just turn your tent card on its side, on its edge, and we'll call on you during the discussion topic.

The first one we've asked to provide some comments on this subject is Denny Beresford.

MR. BERESFORD: I'd like to add my thanks to the PCAOB for allowing this opportunity for more input on this project. Among other things, I'd like to observe that there are more audit committee members participating in this roundtable than submitted comments on the proposal. So we've doubled the input simply by showing up here today. I think that's terrific.

As Marty said, I was asked to introduce this topic from an audit committee member's perspective. And I'd like to put things in perspective. Audit committee members consider independent auditors to be a very important resource obviously, a critically important resource, but not necessarily the most important one in terms of sort of the total package.

We spend most of our time both at

committee meetings and otherwise with financial management of our companies, what I would call kind of the first line of defense. And of course, we have several here today, corporate controllers and CFO's and so forth.

These are the individuals that we must rely completely on to maintain the accurate accounting records and controls of the corporations. They must also be candid and complete in all of their communications with us. In short, they must be absolutely qualified and trustworthy, or we should act quickly to see that they are replaced. That would be one of our principal responsibilities as audit committee members.

Of course for most companies, we have a second line of defense in the internal audit function like Kiko. This group reports to the audit committee and can help serve as our eyes and ears with respect to many of the specifics of the company's accounting. The external auditors are all extremely important, but from my perspective, they are what I would call our third line of defense.

As I like to put it when speaking to an auditing group, if there were an Oscar for auditors, it would be for best supporting actor, rather than lead actor.

Now none of that is intend to denigrate the external audit function in any way at all. We need company management audit committees, internal auditors, and external auditors that work together in a very cooperative way to best protect shareholders in the public. But these comments do influence the perspectives in my earlier letter on the proposal that I'll refer briefly to now.

As noted in the summary document for today's meeting, I'm concerned that the expanded requirements for auditor communications could easily lead to a checklist approach, whereby routine matters tend to drive out more substantive issues. We actually have a fair amount of that today as present, as auditors already have to present a list of their requirements each quarter or other periods. Part of the duties of an audit committee chair would be to caution the engagement partner to omit reading them at an audit committee meeting when nothing truly important has happened. Otherwise, there may be a tendency for them to drone on with useless words when audit committee members have many other things that they want to learn. We actually have to tell them to tell us what is actually new or different or unusual from period to period otherwise we just get a bunch of boilerplate.

So what do we really want to know? There are several others with equal or more experience than mine at today's meeting. We have five or six members of audit committees here today. Currently, there are others that have had them in the past.

So let me start with just a few. And frankly, that's my emphasis is that we should end up in this document with just a few basic requirements. As noted in my letter, I want to hear an assessment of the tone at the top of the organization, both the financial management and the overall company. And I'm not necessarily suggesting that that should be a requirement in the final standard, but that's one of most important things that the audit committee wants to know.

And also, an assessment of the quality of financial management from time to time including internal audit. Again, not necessarily a stated requirement, but something that's critically important to the audit committee members.

Other things that I'd like to hear about, and these are things that I think are subjects of -- should be the subject of specific requirements. I'd like to hear a summary of the audit plan and particularly any unusual procedures, things that are going to be the particular topics of emphasis during the year of things that have changed from year to year.

Any sensitive matters that the audit engagement partner is aware of that financial management is not bringing to the audit committees attention that should be. And that's obviously a matter of significant judgment. An important accounting or auditing issues that have been discussed with the accounting firm's national office because they're close calls.

I could probably provide a few more topics, but I'd like to let other audit committee members add their ideas during this discussion. Also, as I said, my preference would be to not have a lengthy checklist, but rather leave it to the judgment of the audit partner. And of course, I also leave it to the judgment of the audit committee members to ask the questions that they think are most important, both the judgment of the audit committee chairman, who should have a very good working relationship with the audit engagement partner, but also the other members of the committee who ask questions at the meetings.

I feel that they are more likely to do that if they are not put off what -- by what might become an overly long and boilerplate type report by the external auditors pursuant to the current draft. Again, Marty, thanks very much for the opportunity to lead off this issue. And I look forward to participating throughout the day.

MR. BAUMAN: Thanks, Denny very much for those comments with respect to the first two questions that we've posed. Lynn Turner, we'd like to hear from you on these questions.

MR. TURNER: Thank you, Marty. And I do commend the staff for their efforts to date. This is obviously an important project from an investor perspective. High quality audits is what really do -- does give us confidence in the numbers. Understand that management puts them together, but it is that independent set of eyes and the process that goes with it that establishes the credibility and reliability of those numbers to us as investors. And that information is extremely important as we decide where to allocate our capital both here in the U.S. and abroad in the various markets.

The audit committee plays an extremely important part in that overall role. They have an important role as overseers and monitors of the process. And if the audit committees are going to get their jobs done in a fashion -- in a diligent fashion, that means that the audit committees have got to get the type of information that they need to make sure that in fact the audit's getting done in a high quality fashion.

As I read through your proposal, Marty, I find that for the most part, I think the staff have done an excellent job. I think the topics that they tee up are relevant. They're certainly, as I went through them, I couldn't find one of those topics that an audit committee in my opinion wouldn't want to know if they were actually overseeing and monitoring the project. In fact, I have to ask myself how could it be that someone wouldn't want to know that information regardless of whether you got it in a list or not.

So I find it a very good starting point. I think the two-way communication, the assessment of that two way communication is an important factor. Where I've sat on the audit committees, I've asked auditors to give us that type of feedback. So I do think it's good. And in fact, as I look through the various topics, again, my experience had been we've gone through all those in the various audit committees I've sat on. And it's never really been a problem. It's never -- if we do our job right, it’s never turned into a checklist. There is that dialogue back and forth. And if you got a good audit partner, you got good audit committee people, you just don’t see it turn into a boiler plate checklist, which I agree with Denny on. That’s the last thing we want to have happen here, but my experience had been those type of items don’t turn into that.

I think Denny mentioned a couple things that are very good as far as things that you as an audit committee would want to know the assessment of the tone at the top and the quality of the financial reporting team. That’s always helpful. But there were two things that were really in my mind missing and once not so much missing, but how it’s prioritized.

But the first thing is I definitely as an audit committee member want to know what the staffing is on the audit engagement. You can put down any firm’s name on that audit report, but the audit’s only as good as the partner manager in charge.

And ultimately, as an audit committee member, I want to know who’s on the job, their experience. And then I also want to know who’s doing the heavy lifting on the difficult risky areas? It’s one thing if it’s being done by a partner with many years of experience. It’s another thing if it’s being done by someone that just doesn’t have that experience. So I’m always interested. And I’ve always got a schedule quite frankly from our auditors about who’s doing what on the audit.

The second issue is the issue of risk. And in the proposal, you mentioned back in one of the appendix, I forget which one it might be C or whatever, that when the auditors have a conversation with the audit committee about the scope of the audit, one of the components that discussion should be something about risk. But you really don’t see that in the proposal or in the standard till you get all the way back to the appendix. And it seems to me, especially in light of what we’ve been going through the last few years in this country, and the focus on risk, that the priority given to a discussion between the audit committee and the audit with respect to the risk is very important.

Auditors are already required to identify the risks. And typically, where I've sat on the audit committee, we've asked for the auditor to tee up to us, as well as the CFO independently, the top five risks in the business and then how they're going to go about auditing those top five risks and whether it's consistent with what financial management is telling us.

And so I think the fact that we don't find much until we get to an appendix about the discussion of risk and the role it plays in the scoping of the audit, I'd elevate that up to more in the body of the document.

I would note that, you know, it's been a long time since we've had the blue ribbon report on audit committees. It started a lot of this off. As we did that report, we heard many of the same concerns at the time about oh, it become boilerplate, it become a list, it would cool, not broaden the discussion between the auditors and audit committees. And quite frankly, it just hasn't, despite all those concerns, it hasn't occurred.

In fact, we probably, I think most people around the table would say the audit committees today versus where they were in 1998 is the difference between black and white. They've come much further and are doing a much better job today.

So again, I commend you for where you go. I think the proposal's very good. I'd make some refinements to it, but I think it's about right.

MR. BAUMAN: Next is Mary Hartman Morris.

MS. MORRIS: Thank you, Marty. I mentioned I'm an investment officer for the California Public Employees Retirement System, but in prior life, I was an accountant and an auditor. And I'm here to -- as a representative of CALPERS. I want to spend a little bit of time. CALPERS, of course, as you know, is the nation's largest public pension fund. What we're seeing in $210 billion in assets. This capital is allocated over 9,000 companies worldwide. I think it’s important for us -- me to mention that because as an investor, I think we try to bring a perspective that’s important to our beneficiaries.

We appreciate the opportunity to attend this roundtable and offer our perspective as -- on these important issues. Of course, we look forward to hearing a perspective of members of the audit committee -- audit community, and engaging in mutually beneficial dialogue.

Given CALPERS substantial global equity holdings, we have a vested interest in maintaining the integrity and efficiency of the capital markets. As Lynn mentioned, the financial interests of CALPERS beneficiaries are most effectively served in an environment where investors can confidently utilize financial statements to evaluate investments.

We believe robust communication between the auditor and the audit committee helps promote this confidence by ensuring the audit committee has the information it needs to serve as effective monitor.

We view the audit committee as a direct link or as a fiduciary to represent all of us as shareowners and capital providers. In our comment letter to the PCAOB, we offered support. And we thought that the communications, a requirement was a good thing and very beneficial to us. And we commend the PCAOB for proposing this regulation. And we believe that a rule of proposal will help set the baseline, although, you know, this communication is ongoing, but we believe -- to support and establish a standard.

To begin, it may be beneficial to outline the view of what we believe as the role of both the auditor and the audit committee as an investor. I spent part of my engaging companies in our portfolios, and talking to some audit committee members. A few of I've met -- during those engagement participations.

We believe that the auditors' role as decreasing the risk, material misstatements and financial reports, you know, along with a lot of other things, but we do believe that audit committees' role as protecting investors' interest and overseeing the integrity of the company's financial reporting.

From an investor's perspective, not only is it important that audit committees play the important oversight role to ensure the integrity of financial reporting, but we are very interested in ensuring the auditor provides -- audit committees what information deemed material to the market valuation of the company securities.

So bottom line for us as an investor, what is the value of our investment and the value it provides to our beneficiaries?

With this in mind, we approach the issues of communications beneficial to audit committees by first looking at information investors find important. And I think many of you have already mentioned that. We then derive what we believe the audit committee's information requirements should be.

We use -- I mean, there's lots of

different examples, lots of different studies. And I think many of you here will be speaking to that.

But I think that we used one thing in our discussion was the Institute of Chartered Accountants of England, Wales Financial Services, ICAW, they entitled a report “Audit Banks: Lessons from the Crisis.”

This report addresses the role of auditors in providing information to investors. And this report specifically addresses banks, but we believe, of course, this is beneficial for all institutions.

Key to this, I think in the crisis, is one of the things we want to ask is, you know, where were the auditors? And where was the audit committee? Was it during the crisis? And I think there is some issues outlined there that says there might be some evidence that there needs to be better communication.

First, the auditors’ opinion of key business and audit risk, we think we’d like to see that.

Second, the auditors’ opinion of key

assumptions used materially important judgments that affect the financial statements. The auditors should state whether these assumptions are aggressive, conservative, or reasonable.

Third, the key audit issues and their resolutions.

Four, significant changes to accounting policies.

Fifth, unusual transactions.

And sixth, accounting applications and practices are unique to the industry. And you know, this is already key things, but I think it’s important to summarize this, because from an investor’s perspective, we want to understand that, and be able to -- the auditor and the audit committee be able to articulate that well to investors.

As representatives of investors, audit committee members must have access to of this information. Furthermore, the information must be detailed enough that committee can effectively evaluate the merits of the company’s financial reporting process.

While we believe that explicit role, reporting requirement benefit of auditor and audit committee communication, we also acknowledge the individualized nature of each audit. So we do agree that should not be a check the box. And I think even Lynn and Denny mentioned the importance of making sure that that dialogue is consistent with not a check it box process.

That’s why we believe it’s critical that auditors use sound judgment and avoid the check the box communication. Rather, it’s our hope that these regulations serve as a foundation for building even stronger dialogue between these two parties.

We believe an audit standard will ensure a baseline to foster and facilitate robust, meaningful discussion between the auditors and the audit committees. We reiterate the importance of organic discussions between the auditor and the audit committee. And we’re not -- recommend this dialogue be scripted.

And today, of course, we look forward to hearing from audit committee members, auditors, and institutional investors, other institutional investors and others on those topics. Thank you, Marty.

MR. BAUMAN: Thank you, Mary.

Well, others in the room are putting their tent cards up. And please, do that and we'll call on you. So please get your cards up. I would just like to let one of our members of the roundtable introduce himself. We went around the table earlier. Don and everybody said who they were and their affiliations and audit committee experience and we'd love to hear from you.

MR. DONALD NICHOLAISEN: Well, good morning. Thank you very much. Don Nicholaisen, former Chief Accountant at the SEC. I'm Chair of the Audit Committee at three companies, Verizon, Morgan Stanley, and Zurich Financial Services.

So delighted to be here. Appreciate the opportunity. And I look forward to a very interesting discussion.

MR. BAUMAN: Thank you. And we look

forward to having your tent card up throughout the meeting. I think the first card up was Mike Cook.

MR. COOK: Thank you, Marty. Brief comments on this topic, agreeing largely with what Denny said, what Lynn said about the audit committee role.

I would like to make an overall observation, though, about this. I -- as I was reading into the materials, I got encouraged at one point because we started talking about financial reporting. And then, my encouragement disappeared because we drifted back into talking only about the audit. And I understand the role and authority of the PCAOB. And maybe that's why that has to be, but as you look at what's useful to the audit, what's relevant to the audit, what relates to the audit and so on and so on, it is only a part of the financial reporting process that the audit committee has a great deal of responsibility for, more so on the audit side perhaps. Another financial communications, but I think there's some evidence, at least in my opinion, that the audit as part of the total financial reporting package is declining in usefulness or certainly not gaining in usefulness compared to other forms of communication, including earnings releases and quarterly information and business performance information, non GAAP financial information, all of which I think audit committees need to be substantially engaged with and are auditors of our audited financial statements also need to be engaged with, and a dialogue about those topics is often very important.

MR. BAUMAN: I, for the that reason, would be inclined to not favor much in the way of expansion of what we have today about communications related to the audit, because I think they are quite sufficient. In some cases maybe a little more than they need to be. In some cases, they could be enhanced.

But for the most part, they're adequate. And I, for one, thinking about audit committees responsibilities and not having unlimited amount of time for these matters would not like to take a lot more time away from other areas of financial reporting, which are in my opinion, of emerging importance and perhaps greater importance to spend on the details of the audit, which already sufficiently covered, I think, in the existing requirements.

The only other point I'd make perhaps at this stage is I think the whole issue of quality of auditing and quality of financial reporting is driven by people. And I would be very much inclined to be sure that the audit committee spends its time with people meaning the audit team, and I endorse what Lynn Turner said about who are the people? How experienced are they? What particular skills do they bring that enables them to fulfill those responsibilities effectively and endorse what Denny was suggesting, which I think is critical.

I think some of the most important communications that I receive as an audit committee member from the auditing firm are people related, and are not covered by the types of things that are easy to put in a pronouncement, such as this, but tone at the top is number one on the list.

If you said you can only talk to the auditors about one subject in the course of a year, what would it be? For me, it would be tone at the top. And that is not covered here, because it's very hard to turn it into a requirement.

But if we had a focus here on best practices, and a focus on effective communication, not requirements, I think we'd get a better end product. And tone at the top would be there. The quality of the financial staff, the depth of the financial staff, particularly important as we've been through downsizing, cutting back, resources in a lot of areas. The quality of the internal audit function, substantive quality of the internal audit function. How good is it? And how reliable is it for the audit committee and for the financial reporting process?

So I would like to shift the -- some of the discussion to maybe best practices, maybe people oriented, harder to capture in requirements, but it concerns me greatly that we're going to stack up more and more and more required communications, which are of less and less value to me as a member of an audit committee, and less where I want to spend my time, talking with management and the auditors. And I won't give the three legged stool speech in great depth, but I don't view anything as two-way. I view this as a three-way process between the audit committee, the management and the auditors internal and external. And each having a equal, roughly equal place at the table, one being too long or two short, the stool likely to tumble over.

Anyone left out of the process, and it's not an effectively process. The great emphasis here on two-way communication is not the way I would go.

MR. BAUMAN: Thanks, Mike. If I could interject with a question, because both you and Denny brought it up, but I think Denny also said that he wouldn't make it as a requirement. I think I heard both of you say the most important thing you could hear, it's one thing, to hear from the auditors was about the tone at the top and the quality of management.

But yet, I think you both said that isn't something I put into the standard as a requirement for communication.

So if that’s the most important thing you’d want to hear, you’re saying we don’t need to put in there, because you’re going to ask it anyway as audit committee members? Is that the point? Maybe Denny or Mike?

MR. COOK: I’ll take a shot. And Denny can correct me. My concern about it is like anything else, if you make it a required communication, you have to define it in great depth. You have to lawyer-ize it before it takes place. You have to document it. And all of those things will stifle the communication.

And if we could have this in an environment, where not everything had to be defined in great precision, and written down, and so on and so on, I think we would enhance the effectiveness of the communication process. That is my reservation, Marty, is I’d rather list it as a best practice, and have a good dialogue, that make it a requirement and kill it.

And I think we have ample opportunity to kill it, just by trying to argue about what tone at the top really means. But I know what it means. And we, the audit partner, when I ask about it, knows what it means. And we have a very effective dialogue.

If I thought that that same dialogue was taking place after having been cleared by six people and prepared for an advance and so on and so on, it would be far less effective for me. That’s why I’m concerned about the requirement.

But I think it’s absolutely essential. I mean, this notion that audit committees can, not withstanding their very efforts and time that they put in, you breeze through, you know, six, 12, 15 days a year. You know everybody is on their best behavior. All the desks are clean. All the things are what you expect them to be.

What I want to know is what they’re like when really tough decisions need to be get made? And people need to show what their real standards and principals are. And more often than not, the auditors like you to be part of those discussions. And that's what I want to hear about. I'm afraid of institutionalizing that and killing it.

MR. BAUMAN: Thanks for expanding on that. Denny?

MR. BEREFORD: My comments would be similar. I just don't want to take the time to build an infrastructure to determine what tone at the top or quality of financial management means. I'd prefer to work that out on a one to one basis, based on my judgment and my discussions with management.

I'd also, while I'm generally, I shouldn't say generally, I'm strongly in favor of written communications as a requirement for all the other things in the document, I can't see this as something that would be subject to written communications at all.

And I just think it's far more effective to let this be a best practice without any particular framework. Just let it be something that you elect people, you appoint people to be audit committee chairman based in large part on their experience, their judgment. And I think it's something that you should allow them to use that judgment.

MR. BAUMAN: Thanks. Hal, did you want to comment on that point?

MR. SCHROEDER: I just want to ask a question of both of them. Do you think that the quality of the audit committees is up to what you're suggesting? And I ask that because both of you all are extremely experienced. You've been around a long time. You understand the issues, but not every audit committee member comes with the same background that you two gentlemen have.

MR. BERESFORD: Well, there are, I don't know what the exact number, 13,000 or 14,000 or 12,828 or something public companies. And I'm sure that the -- that there is a variance among them, but and that again is a reason for not specify exact rule. I'm sure that you're going to have some variety and how this -- something like this would be applied, Hal. That's the best I can answer it.

MR. BAUMAN: Thanks. Linda Griggs?

MS. GRIGGS: I just want to commend the PCAOB for this document. I think it’s very thought provoking. I think it tees up a lot of the issues that audit committees and auditors need to be thinking about in this two-way communication.

I do think that I come from sort of the bias that a principles based standard might be more effective in requiring the auditors to exercise judgment in developing this communication tool. And I wonder whether rather than a list of required items to discuss, a standard that sets forth recommended areas to consider and perhaps there, you could put tone at the top in this list of recommended areas, because I agree with Denny and Mike, but I also acknowledge that there -- the quality of auditors and the quality of audit committees differs across the nation. And so, providing this list of items for the auditors to think about would be very helpful.

It might not be something that an auditor would think about that he should be talking about, the tone at the top. And you might have an audit committee that hadn't really thought of that.

And so, I think teeing it up as an issue, but without making it a requirement might address some of Mike and Denny's concerns about the need for an infrastructure to identify.

Because as a lawyer, I understand, you want some precision. You want to know what the requirement is, if it in fact is a requirement. But if it's simply a list of areas that should be considered by the auditors in talking to the audit committee, perhaps you get away from that.

The other thing is you really want to empower and make the auditors realize their responsibility to exercise judgment. They've got to figure out what the audit committee needs to know. The audit committee doesn't need to know what's in the financial statements. The audit committee doesn't need to know things that are very -- have been already communicated by management.

But the audit committee does need to know what areas of risk were important enough to the auditors to develop their plan, their audit plan. They need to know what the auditors found when they completed their audit. And you know, sometimes I don't find anything bad. So there's no reason to have a presentation on that.

The other thing I feel strongly about is having been on an audit committee, I did find the written materials enormously helpful. And I don't think the auditors should be going through all the written materials. I think the auditors should then be required to talk about the important areas.

But having a list, I mean, for a non accountant on an audit committee, it was useful to me to have some of the information that, you know, they had, through their eyes, they had -- they teed up for me.

So I think there's a balancing as to what is presented orally and what is presented in writing that helps the audit committee in doing their job. Thanks.

MR. BAUMAN: Thank you. Jim Cox?

MR. COMR. BAUMAN: As I was reading the

proposed statement, I was struck by a sort of a historical observation that it was drafted roughly about two months before Don Frank was enacted, which as we know one of the many provisions in that act, carves out the non accelerated filers from the attest function of 404.

And it does raise in my mind whether this document would have somewhat different content on drift had it been written, you know, with that knowledge that that was going to happen.

Now we know that the non accelerant filers were not already subject to 404. They were only threatened to be. And they keep getting prolonged and prolonged. And so, a question that would come to my mind, and has to come my mind on the audit committees I served is, and I look rather foolishly when I asked this because for the following reasons, because the answer was that we do comply, even though we're not required to.

And that is to say what have you done, auditors, to evaluate the internal controls of this organization that are different from what you do if you were performing in a test function? And what are the risks associated with the distance there about what you would have done if you were testing and otherwise?

When I asked this question, two of the three audit committee as a serve on are related to Duke University, which complies fully, even though it’s not required to, with all the requirements. And both listing requirements for the New York Stock Exchange and all the requirements for Sarbanes Oxley. And so, they do have the attest function of our management on internal controls.

So you know, I think something has to be looked at here in terms that evaluating internal controls, because that is the sine quo non for the auditors, a test function for the financial statements themselves.

So I just commend that for the -- to think about going forward.

MR. BAUMAN: Thank you. Roger Coffin?

MR. COFFIN: Thank you, Marty. Good morning. I just wanted to go back a little bit to the concept that we spoke about regarding check the box and the nature of the communications between the audit committee and the auditors becoming too process oriented.

I think it's helpful to remember that the audit committee as part of the board historically has an oversight role. And in fact, you know, the board of directors is really designed to act as the fiduciary on behalf of shareholder interests and to oversee management, and then through Sarbanes Oxley, the direct link between the board through the audit committee and the auditor was established.

And that really, when you think about it, forms kind of the fundamental basis, I think, of modern contemporary corporate governance theory, which is to say an independent board properly incented subject to open and fair elections is a -- one of the best methods to protect shareholder interests.

And I think the PCAOB in this standard is really driving towards the independence and the informed part of the board aspect. And I commend you for that. And I largely endorse most of the communications and agree with everything has been said around the table.

I would like, though, to just amplify a little bit about the board's fiduciary role here, and how that fits into this mix. And I've described this in more detail in a comment letter that I submitted to the public file.

Remember, that boards as fiduciaries have state law requirements to act in that way. The law that applies to most of the public companies in this country is the law of Delaware. Its enabling statute has a section that -- section 141, that said the business and affairs of the corporation shall be managed by or at the direction of a board of directors.

And what that means, and what the court's have done with that statute over the past 80 years, is to amplify that, and require boards and audit committees to have broad discretion to exercise fiduciary decisions in a flexible manner.

As a matter of fact, there was a very

significant case in 2008, the case of Computer Associates versus AFNE (phonetic) in which the Delaware court actually struck down a shareholder initiated bylaw that would have purported to have infringed on the jurisdiction of a board to make its own determination.

And so, from this takeaway, what we see is that under state laws, that boards of directors must be free during their term to be flexible, and not even the shareholder owners can do things to influence or change that.

So I guess I would like to caution. That was not what I would like to caution against, although that was a wake-up call. And certainly my comments here are not intended to be that, but to go forward to this, to place this in the context of state fiduciary requirements of boards, and to allow the boards of directors to be able to do what they're doing, remember, if you -- sometimes check the boxes, as I was said, I think by Lynn Turner, most good boards are going to ask for a lot of these things. What I think we've seen, and I think what we've seen in Enron, was check the boxes actually protect bad boards. In other words, they give back boards of directors something to hide behind and to allow them to look like they're discharging their fiduciary duties.

So while I broadly endorse what's the nature of here, I think as you -- and I think all of the communications that we describe are valid. And I think you'd want to know, particularly relating to risk, I think the longer the document gets in terms of listing out the number of required communications, the more danger you run towards going down the scale of making it too much of a process.

And I think the PCAOB really just needs to be cognizant of where along that scale you'd like to fall.

MR. BAUMAN: Roger, thanks for those comments and for the loud burst in between as well that got our attention. In case anybody wasn't listening carefully, we suddenly did.

Bob Kueppers?

MR. KUEPPERS: Thanks, Marty. I wanted to pick up on -- starting with Mike Cook's comments. I think Linda took it a step further. It suggests then that maybe what we do need to do, or the board should think about is something that is more principle based, perhaps with no more than a handful of absolute musts that should be communicated, things like significant disagreements with management, material written communications with management, uncorrected misstatements. And the one that's actually no in the proposed standard, which I think would be important, is related to party matters, related to party matters have a particular risk to them that I think should require discussion.

Beyond that, I think the circumstances will dictate what else needs to happen. On the one hand, the board is trying to prescribe things auditors must do. Yet in this area, you get quickly into the effectiveness of how the audit committee functions, the relationship with the audit committee in management, the audit committee and the auditor, and the auditors and management.

But the board only has really authority to deal with one corner of that triangle. And I respect that. And I don't know what the solution is, but it seems to me that, and I have the pleasure of working directly with the audit committees of companies like General Motors, Dow Chemical, and Best Buy. All of them work quite well with all parties.

But you know, trying to look at it through this single lens, I think, puts you in a very difficult place to come up with a comprehensive effective standard and perhaps something principles based with a handful of requirements, plus what the auditors responsibilities are if something, you know, doesn't get done, or doesn't work would serve the same purpose as the standard as -- that, you know, that you've already proposed.

MR. BAUMAN: Thanks, Bob. Karen Hastie Williams?

MS. WILLIAMS: Thank you. I wanted to just focus for a minute on the relationship between the audit committee of the board and the auditors.

My practice as an audit committee chair has been to meet with the outside auditor, the inside auditor, and the CFO before every board meeting, and go over the agenda, and raise issues that I think would be relevant for the board.

I found that to be very effective in terms of bringing out any kinds of problems or disagreement between the internal auditor and the external auditor. And they have occurred. And it’s from my perspective it’s something that should be taken care of or should be addressed when we have our pre-meeting, so that when we go into the full meeting with the board, we’re prepared to state what the issue is and what the proposed resolution is.

So I think communication is really key, as I think a number of our colleagues have suggested in terms of addressing the relationships between the outside, the inside auditors as well as the CFO.

MR. BAUMAN: Would you see any changes to the proposal that we’re making as a result of that view that you’re expressing?

MS. WILLIAMS: No, I don’t think you need to make changes to the proposal. I think the proposal is fine the way it is. But I think there should be an understanding as this goes forward that there is an important dialogue. It's not just simply that the outside auditor is coming in, and here's what we see, but there is a dialogue between the key folks on the financial side in the company, as well as with the outside auditors.

MR. BAUMAN: Thank you very much. Larry Salva?

MR. SALVA: Thanks, Marty. I agree with a lot of the comments that have been made around the table. Probably most, though, with Bob Kueppers in terms of not tying too much the hands of the auditors in terms of being prescriptive on what needs to be communicated.

Because I start with the premise that Mike and Denny started with earlier. Because I view it the same way is that the -- I'm the asserter of the information. As management, there are financial statements. I take responsibility for the fair presentation that they are free of material misstatement. And I'm making that assertion in my management report.

I then rely on my internal audit function as part of my system of internal control to give me that assurance that I can make that assertion.

I also rely on the external auditors to give me assurance, as well as to provide that independent and objective so-called stamp of approval. And we've talked about this at prior SAG meetings. You know, about could the auditor report be improved in terms of communication, because right now, it's a pass/fail test.

And it seems like there is a desire on the part of some to get more knowledge about what goes into that decision about the pass/fail test. And right now, a lot of that resides with communications to the audit committee, and not directly to the shareholders or to the readers of the financial statements about the tough decisions that might have been made along the way as to whether they -- the auditors decide to give a pass.

I think that in addition to the -- that

assurance or that stamp of approval that comes from the auditors, that investors get a source of information in terms of where to deploy their capital by observing and determining in their minds the openness and the transparency with which management communicates to investors. And that's not just through the financial statements. It's through their earnings press releases, through their dealings with analysts on the analyst call, and in analyst meetings.

So I believe companies get reputations about how transparent and useful their information is. So that's another source.

So it's, as I tend to agree most with Denny that the primary line of defense for the audit committee or the shareholders is the quality of management and the managing reporting. It's then the internal audit function and then the auditors.

So placing it into that context, the, you know, then what's most important, it's tone at the top. It's absolutely tone at the top and throughout the organization as to whether the organization gets it, that they're responsibility, you know, is -- they are fiduciaries of shareholder money.

And that it's not their money to be used as they see fit. It's they have a responsibility to the owners of the business.

That tone at the top just to get back to that point of it's so important as a communication, but it's a difficult one, and certainly, I think would hamper the communication if it were required to be put in writing.

I'm not present in the audit committee meeting when that is discussed. That is in an executive session. And I would expect it should be there. And to require it in writing basically defeats that purpose. I don't see minutes of what is discussed in the executive session. It's occasionally -- when appropriate, I am informed of what has occurred in the executive session.

But one way to address that factor might be to consider a required communication from the auditor as to how tone at the top affected their risk assessment in performing their audit. Whether it was considered to be a positive factor, a negative factor, or a neutral factor, because at least from my experience in public accounting, auditors will attempt to complete a quality audit, even when the tone at the top is not the greatest. And it enhances risk assessment when it's there, but you know, and when it's really bad, typically, the decision is that you release that client from your client portfolio. Or you know, if the board doesn't deal with it appropriately in terms of changing the tone at the top.

So it's a factor. It's probably one of the most important factors, I think, in giving the audit committee their sense of whether they're dealing with good people, at least in terms of having an oversight role from external auditors and the audit committee itself.

MR. BAUMAN: Thanks, Larry. Just a couple of comments and maybe one question. For the benefit, Larry made a point about the importance of communications by the auditor to investors as well. And some comments that the current audit report, which is binary pass/fail may not be doing that. Larry has the benefit of being on our SAG as well, that -- where we've discussed this. And we've indicated that we are taking on a project in the Office of the Chief Auditor to explore changes to the auditor's report in that regard. So I wanted to share that with others here because of the importance of the point you made .

But one other thing I'd like to follow up in the context that you're agreeing with Bob Kueppers, which is an interesting point of itself that I'd to follow up, but --

(laughter)

I thought Hal Schroeder made an interesting point before. And a number of comments have been made about the requirements could just be principles based. And you don't need to a checklist, but Hal had made the point that gee, we have a very talented group of auditors around this table, and a very experienced group of audit committee members. And do we feel comfortable that we could go with a principles based standard, and that all of the other auditors who are not sitting at this table, who may not be part of the larger organizations and audit committee members who may sit on just one audit committee and not have as much experience, wouldn’t they benefit from the more detailed requirements in here? And I think that was kind of your point, Hal, wasn’t it earlier?

MR. SCHROEDER: Yes, it was the beginning of a comment that I can fill in a couple more points around that. Yeah.

MR. BAUMAN: Okay. Well, I don’t know if you wanted to comment on that now or we’re let that thought go, but I know there is that point that was brought out that I think is an interesting one for us to continue to explore here.

MR. SCHROEDER: Yeah, I had more of a question along that front. And I was reminded of a senior partner at the firm I worked for years ago. He said, you know, we talked about our internal audit approach. And he said, well, you know, we don’t write these audit approaches for the 10 percent of us who really know how to do an audit. We don't even need all this written stuff. It's for the 90 percent of the people that we're trying to bring along.

And that comment came back to mind as I listened to everyone's comments around here. We're trying to write a set of rules for the person who has the least amount of knowledge. And I'm wondering if another solution here is not to go back to the earlier comments about the five key principles, but in the process, leave it to the individual firms to develop training courses and internal programs around that.

If you're going to be a presenter at a board, or going to be talking to audit committees, you have to go through this program. And we're going to teach you and train you to what needs to be covered, and what are the key elements.

The flip side is how could you do the same thing for audit committee members to bring them up to a higher level of standard? I mean, there are all sorts of licensing requirements. If you're in the stock market, why aren't there licensing requirements if you’re on an audit committee? And I know some of that’s within your purview and some of it is not.

MR. BAUMAN: Right. Some is within and some isn’t. Thanks, thanks, Hal. George -- sorry, Larry, did you want to respond back to my point?

MR. SALVA: Yeah, just to that point, because I think I agree -- I think Linda said this that, you know, kind of combining Bob’s comment with Linda’s. Five key principles and maybe some short list of required, absolutely required communications. And the balance of it is other items to consider as they’re appropriate in terms of -- or you know, and that will give the -- kind of the best practices or memory joggers for auditors that may not be in that top 10 percent.

MR. BAUMAN: Thanks for that clarification. That was helpful. George?

MR. MUNOZ: Thanks, Marty. Speaking from audit committee perspective, I agree with the comments that Denny and Mike made and then Linda. I liked very much the principles approach to this, because as an audit committee chair, I am most concerned to make sure is the big question for my fiduciary duty is sort of who audits the auditor? Well, to me, PCAOB should be auditing the auditor. So the most important thing that we can hear at the committee is that in fact the auditors are well qualified, well, prepared to handle all of what they are supposed to be handling, so that from that perspective, to me, that’s the biggest area of interest.

Once the PCAOB starts getting onto the agenda of the audit committee, that raises a concern because of our fiduciary duty to make sure that in fact we do protect shareholder interest, and that we talk at the -- on the agenda items represent the most important things for the company at that time.

And the most important things may not be whether the auditors did what they’re supposed to do, but rather if they say they did, and financial management represents that, then we want to go to the more important issue, such as risks and other kinds of things that the audit committee has to handle.

And so, my biggest concern is that what happens, and we saw this in 404, is that the agenda started getting crowded over -- and everybody has a limited time. There's only 24 hours in a day no matter what -- however you look at it. And so, what happens is that an audit committee that goes beyond two, three hours, four hours, it gets to the point of not having a good performance in what it does.

So my concern is with the check the box, it's going to happen because I already saw this in one committee meeting that we have a very effective committee, extremely top notch. And here comes the auditor. And he says, well, I have to communicate. I have to do this.

And we're all sort of like you -- to the point of getting frustrated and says, look, we all read the material. You don't have to tell us the accounting policy changes. And we want to move on to more important subject matters. So my concern is that you're putting the auditor in a very difficult situation because "they have to, they should, they required to do these things." You're putting the audit committee in difficult situation because they have more important subject matters to discuss. So I would say I like the principles based.

And then, there's the unintended consequences. To me, with these rules, especially when you -- when we get to the other subjects and you're seeing that somehow, the auditor is going to rate the dual communication, somehow you're giving a little bit more power, if you will, to the -- in the three legged stool, you're giving a little bit more say, more power to the outside auditor that maybe is not required because somehow that outside auditor's not speaking to certain kinds of things without being requested to, that next thing you know, management is playing up to them, because if you did put tone of the talk, which I do think is extremely important, but if you put it as a requirement, for example, now you really are distracting everybody to talk about that point.

So I worry about the balance. And I think the most important thing that the PCAOB can do to tell the audit committee is to say what I think Harold just said, is the training of the auditors to make sure the auditors are looking for the right things that they are disclosing, are prepared to disclose.

There's nothing to keep them from volunteering, even if not asked, to say oh, by the way, I think it's important that we mention that in executive session or the like.

So in all the committee, and I sit on three audit committees, in all of them, the subjects that were discussed in this -- in these requirements actually do come out without being required because we get asked at one point or another, but it's up to the committee at the right time to bring them up.

Having said that, I think the PCAOB did an excellent job of probing these things. As an audit committee member, I really liked reading these things. I just don't want them to be requirements because these have their place.

MR. BAUMAN: Thanks, George. Gary Kubureck?

MR. KUBURECK: Thank you, Marty. It -- let's give a few thoughts, having listened for the last hour or so here to other people. And share some of the experiences I have with our board. I think one place perhaps, you know, as you move this process forward is to actually go to the end of the process. And by the end of the process, I mean, what two companies audit committee members need to walk out of the room with? Sort of knowing or so on?

And so in preparation for this meeting, I spoke to some members of our senior management or on another companies' boards of directors, and as particularly in their audit committee roles.

And I would probably paraphrase the feedback I got, some along these lines, is that the most important thing they want to walk away from an audit committee meeting with is confidence that there's mutual trust between management and the auditing firm and the audit committee, that they're confident that there's a very open dialogue in that there's a very good effective working relationship or issues or teed up timely. Everyone has a say at the table. And you work in a collaborative manner to resolve the issue, or if the case may be, to bring it to the audit committee for their decision as the case may be.

But that's sort of what I would probably say is the consensus of what they expect to leave an audit committee with is that level of confidence that there's a very, very good working process in front of this meeting.

So you ask yourself the question, well, how do you get there? And I think a lot of the people who have said that today, it really comes down to the people that were involved and the process that tone at the top, if there's one thing I'd probably pick tone at the top. But the -- and again, other people here have mentioned it that the audit committee has to have a feeling that there's a high quality financial staff, both financial management and internal audit management in their company, that they're very comfortable with the expertise of the audit -- the members of the auditing firm assigned to the engagement, that you got the right mixture of skills and experience, and industry knowledge, and that you understand the risks associated with the account, whatever they may be, and that the audit effort is aligned around the risks.

So going on, I would probably just say right now that there is a lot of meeting content out there already in audit committee communications. And I think you need to be cognizant that it might not be the best thing in the world to add a lot more to it, and to allow some flexibility for some judgments as to what needs to be brought forward or not.

Just one thing, our meeting protocol, and this is true for all of our board committees is but every meeting has pre-read. And from time to time, all the meeting participants are reminded by the direct -- the chairs, the committees, is that you approach a meeting content assuming all pre-read has been read. And it’s been understood by the members of the committee and do no spend time just turning the pages, going through it, but focus on the issues that this case the audit committee truly needs to understand as opposed to just being informed. You can be informed in writing, but spend a limited face to face time on understanding the issues.

And I'll give an example is -- I mean, our audit committee has to approve from time to time changes in the annual internal audit plan. And things changes or understands that. But what they do expect to understand is well, why is it changing? Was it a delay just to due to scheduling? Or is it a more permanent problem? Or do higher priority projects emerge? You know, so why are they higher priority and so on?

So I think the ED itself is a well written document and a really good effort about trying to pull a lot of stuff together that needs to be updated, but I would just sort of close on sort of advising on being careful about bulking up on required communications at the expense of deflecting and deflating audit committee focus on the critical issues they need to either understand or to make a decision with.

MR. BAUMAN: Thanks very much, Gary. Joan Waggoner?

MS. WAGGONER: Thank you, Marty. I just wanted to suggest that perhaps there is a place in principle based standards for the smaller companies in firms also. And if there is indeed a list of recommendations that can certainly be used as a sort of a catch all list for them in there.

One of the things that varies widely amongst the smaller companies are all the relationships between these various what do you call it, legs to the stool.

And for instance, in many companies, management and the board are very tight themselves. And so, therefore, the management and the audit committee can have a closer relationship than the audit committee. And as they should in some respects anyway, as do the audit committees and the external auditors.

And so, this creates some odd behaviors, which is sometimes management and the audit committee have this open communication. And they talk fairly well. And other times, management will only respond to questions.

You also get that same sort of mindset in the audit committee in the way they talk to the external auditors, where there is not an openness there and so forth and so on.

The other part to this, of course, is the wide range of financial expertise of those participants on the audit committees that you see throughout varies widely. So I don't want to over generalize here, because there are some audit committees for smaller companies that are truly excellent. And then there's others that are more margin in terms of their participation in the process.

As a result, the agenda for the meetings and the communications between the auditors and the audit committees needs to be very flexible to reflect those very different skill sets. There are -- there's oftentimes the discussion of the financial statements and the estimates and the policies are perhaps the one or three or four times a year that the audit committee actually does a deeper dive into those particular topics. And they find it helpful. And so, I would encourage to allow some flexibility to sort of decide what that agenda should be in the interest of getting those good communications moving forward. Thank you very much.

MR. BAUMAN: Alex Mandl?

MR. MANDL: Thank you, Marty. Well, a lot of really important and good things have been said here. In a way, it's almost difficult to add a lot to that, except maybe to underscore a couple that are at least particularly important from my perspective.

The first one in the topic of, you know, how I guess we call it the first line of defense. I forget now who said it. You know, the role of management in this triangular situation to me is a little bit too much on the side.

I mean, at the end of the day, it is at least from my point of view, it is management, the financial management that the audit committee depends on to really be assured and understand what the issues are, get all the perspectives of new accounting rules, of judgments, of all the things that are being addressed and being concerned.

And to me, the responsibility of the audit committee is to really make sure that management is up to what it should be -- is covering the right issues, has the right qualifications, is doing a more than adequate job in those areas.

And if that is not working right, the audit committee has to address it and do something about it.

So I guess if I sort of have a not a slight, but some additional thoughts on how this three legged stool should work, I think it’s just important to really understand the audit committee’s responsibility, making sure -- ensuring that financial management can really cover all those points, has the experience, the skill set, the capacity to present and address all those things that need to be addressed.

That does not take away in any way from

the required communications between the audit committee and the auditor for sure. But the first starting point, the first element of this dialogue, and the flow of information for the audit committee I think comes from management.

And if that doesn't work, that needs to be addressed. That was one point.

I know it's been partially said, I think, by Larry and some others, but I think that is, at least from my point of view, really, really important.

The second point has also been made, now this sort of underscored, I mean, if you sort of step back and say what should be brought to the audit committee? I mean, the bottom line is things that are really significant, or potentially significant make a difference. And there's lots of things proposed that probably are not that significant. And might be of interest, might be important, but somebody said it, I guess it was George, that you know, there is a very limited time that the audit committee has available to address issues, to address topics, to address new things, to address ongoing concerns, to address risks and on and on and on.

And therefore, the need and the critical need for prioritizing and really only focusing on those things that really will or could have a significant impact on the financial reports or all the things that goes with that, I think would be important. And I think the chairman of a committee has a particular task to make sure that indeed is what happens. Thanks.

MR. BAUMAN: Thanks for those comments. I do want to point out, because it’s come up a couple of times, and we’ll have a further discussion on this in our next topic, the proposed standard clearly does recognize the fact that very important communications are made by management and in the areas of critical accounting estimates and accounting policies and so on and so forth.

And in those areas, the auditor just needs to evaluate whether the management’s made the appropriate communications to the audit committee, and then only communicate further if the auditor believes the communications were not sufficient.

But I’ve heard that the point was made a number of times and we all agree with that, about the importance of management making those communications. And maybe we need to spell that out a little clearer in the standard, because we recognize that point. Thank you.

MR. BAUMAN: Lynn Turner?

MR. TURNER: Thanks, Marty. To start off with, I just want to come back to a comment that Mike made about the usefulness of the audit. And make it very clear from investors perspective, we don’t think that the usefulness of the audit has been denigrated in the last decade any whatsoever, that in fact, the audit’s probably more important today than ever, especially given the corporate scandals and the financial crisis. If we can’t rely on those financials, and if they aren’t credible, then we absolutely are making wrong investment allocations and can’t get the returns we need for our investors. And that’s critical.

So without a doubt, there is no question that the role of auditors and the usefulness of those audited financial statements are probably more important today than ever before. So I don't want to leave a misnomer out there that from an investor's perspective, that those had declined at all, Mike. Just a thought.

On audit committees, though, I think Hal raised a superb question. There are about 12,000 public companies out there. You get beyond the Wilshire 5000, and that leaves you with 7,000. It means the vast majority of those probably aren't able to attract the type of talent that you see in a Mike Cook or a Denny Beresford or a Don Nicholaisen. And in fact, the surveys have consistently shown that that type of expertise, someone who has actually done an audit and understands and knows an audit are not on those boards.

And in fact, that extends not only to those 7000, but that extends well up into the other 5,000.

So not all audit committees are created

equal. Not all of them have the knowledge base to ask the right questions. That's not that they're bad people or aren't going to get the job done or whatever, it's just a matter of fact. We just don't have that talent pool out there on the audit committees at this point in time.

And in recognition of that, even the blue ribbon committee report suggested -- I know it's heresy to some of you, but they actually suggest a checklist of questions for the audit committees right in the report itself with a list of questions that go beyond what's in the proposal.

And in fact, unfortunately, maybe should have been in use because it gets into a lot of risk assessment questions, and high risk areas, which would have been helpful if some audit committees had been asking those before we ever got into the financial crisis.

So the use of a checklist at times is not a -- necessarily a bad idea. And I think you got to recognize that there is a great diversity amongst the quality and expertise of the people out there trying to do the job. And if we give them some help, that's not necessarily a bad thing, because ultimately, what we as investors want to know is it that they've done their job. They've asked the right questions.

When I go back and look through the proposal, I have to come back and ask everyone around the table, tell me which of those questions that you think the audit committee shouldn't be asking? Tell me which ones you wouldn't ask. I don't think this is a comprehensive blown out list. I think it's a very reasonable starting point. It is a base list. And we've had a principle based approach to audit committees since 1978 when the New York Stock Exchange came out. And that principle based approach quite often has not worked very well.

So creating at least some base floor that will give us as investors some idea that the audit committees are really getting the job done, I think, is good. I would love to in a way, get away from this and just have audit committees tell us in their audit committee report exactly what it is that they have done, and bring transparency and accountability that way, which I think would actually even be a much better approach.

Unfortunately, audit committees who can do that today have decided not to do it. And instead, give us a very boilerplate report that quite frankly doesn't really tell us anything about all these areas that I've just heard need to be discussed. You will almost never, in fact, I might say amongst the 12,000, you won't find an audit committee report that tells us about any of those things that are so critical to us, that people just said, we need to have them asking.

So the information isn't there to hold the audit committee accountable. And I think a lot of the concern around the table is let's not create something that creates that accountability, I actually think it's an excellent thing. And I think what the PCAOB is doing here is good. There was a question about the federal laws and the role of directors. I think some of the state laws we've seen the shortcomings. And so, I know it bothers attorneys tremendously, but we are seeing the federalization of corporate governance here as the state laws, especially in Delaware, have failed miserably. And as a result, we're now seeing say on pay and proxy access, etcetera.

But the courts have ruled that as far as the fiduciary goes in this role, that having a full heart, wanting to do the right thing, but to use the courts were full heart, but empty mind doesn't work.

And in the context of the empty mind, if you haven't asked those questions, the very basic questions that the PCAOB is putting out here, I don't know how you could respond to the court that you didn't ask those questions. And if you are asking those questions, how can this stifle the conversation? I don't understand it.

Back to the issue of the tone at the top. I think there's been some good points raised about it. Certainly, no one likes to grade another person and put it down in writing. It's just human behavior. There's something about that, she just don't like the feeling of, especially if you're rating the person that's going to be writing your check. There's just something that makes you nervous about that.

But I will also add another point that I think raised the question about how far you want to get into that, even though it's a good question. And that is if we look at the track record of the auditors, in actually assessing the tone at the top. They don't have a really good track record.

Going back to the mid 1980s, about '85 when we reset the auditing standards, we actually required that auditors assess in essence that it's tone at the top. Yet you can look at one situation after another that have popped up where there's been problems. And the auditors thought they were okay with the management team, and rode with them. And certainly didn't tell the audit committee that this is a disaster. And we had a blow out.

So I think it could almost be misleading, given their historical performance and track record to be sitting there saying let's have the auditor tell us about the tone at the top, and place too much reliance on that. The track record just doesn't support that approach at all. Thank you.

MR. BAUMAN: Thank you, Lynn. Mary Morris? Is there -- yeah.

MS. MORRIS: Thank you, Marty. I guess there's a couple points I just wanted to make. I appreciate all the comments this morning. I think they're very thoughtful. And I think that as an investor, we feel that audit committees have an opportunity to actually embrace some of these ideas, sort of to articulate their perspectives. And what Lynn was explaining, I think they can distinguish themselves in well throughout the standard in providing that information to investors.

There's a couple of key terms that I think that people have brought out today, that I just wrote down and I thought was really important, you know, good governance, of course, you know, that's really important. The articulation, the transparency, the fiduciary responsibility. So as investors, you know, we look to the audit committee. That's their role to us. That is so important to us to be able to provide that insight to us.

The articulation, I think the SEC has, you know, proxy plumbing, the enhanced disclosure, I think all of that has helped investors.

I think one point that, you know, it doesn’t relate directly to the standard, but I think audit committees can understand this is and audit committee members and chairs, the effectiveness of audit committees. I think that question’s asked a lot throughout your evaluations, through your perspectives. And I think there is also the point brought up that not all audit committees are equal and not -- the experience is not there. And as an investor, I see that when I go out and I speak to audit committees.

So I think that the standard would help bring these individuals up or at least be able to bring that thought process to them.

I think that -- I was looking at -- not to throw out names, but Tapestry Networks and E and Y, I think they were talking about the evaluation and the effectiveness of audit committees. And I think that audit committees said to themselves it's important to not have any surprises, to you know, of course, have their evaluation, to have that full communication with their auditors, the relationship building.

And I think that this one point I really wanted to stress was that the standard provides sort of teeth. It really does provide the audit committee the opportunity to sort of distinguish themselves and to say, you know, for investors, you know, this is how you are looking and you're searching for alpha. And you want to invest in our company as a capital provider.

So I think it does provide confidence to investors and from the audit committee's perspective. And I think that for our search of alpha, there are value. We only have -- all of us have limited capital. It's our responsibility to our beneficiaries. But I think this is a way that audit committees can sort of embrace this new standard and distinguish themselves. So thank you.

MR. BAUMAN: Thanks. I just wanted to --

so many comments had been made regarding tone at the top as being -- and the importance of that feature.

Some discussion has been made regarding that -- how that should be discussed with the audit committee. And I think it's important point that we'll give some further thought to.

But I wanted to bring out the fact that the existing PCAOB auditing standards do require the auditor as part of the audit of an organization and their evaluation of the internal controls to assess the tone at the top as part of the control environment in the organization. So auditors are doing that, at least they should be doing that as part of PCAOB standards. And the issue here is now it maybe come up one -- a couple of times, but some of the members here at the table feel like that's one of the most important things that I'd like to hear about is that assessment.

Don Nicolaisen?

MR. NICOLAISEN: Thank you. Awful lot of comments, so I'm not -- I'm going to try not to repeat anything, but I do commend the board. I think it's appropriate to -- with the importance of the auditor's relationship with the audit committee, that there be a clear description of what the expectations are of the auditor in those communications.

And having building blocks, those things that are essential requirements that we all would concede should be communicated is an appropriate approach. And I think the listing of items is not that long or that complicated that it would cause me a particular concern.

I suspect that a lot of that, because it's there ends up being check the box and also from my perspective, that's not all that bad if the box is checked properly, and the work has been done, and there's an element of professionalism that the auditor brought to the work and says to the audit committee we've looked at these areas. These are the ones you don't need to work on. Now let's talk about those things that are really, we think, you need to put your focus on those things that are critical to you.

At the tone of the top, you've talked about I tend to get at that another way with auditors. I also ask them do your staff like to be on this job? Is this a job within the office that people are competitively trying to be the auditor of? Or is it one where you're reluctantly dragging people to the table? And that usually prompts either the issues that are really there and underlying what needs to be dealt with in relationships with management. Or it's a confirmation that we actually do have the best team.

The element of no surprises is certainly what I look for in an audit relationship. Mary Hartman Morris just mentioned that. I think it's fully appropriate from both sides. I don't want to surprise the auditor. I don't think the auditor ought to be surprising us.

And the auditor ought to expect that if there's an article in the newspaper about an industry similar to the one that I'm the audit committee chair of, that identifies a problem, somewhere within that industry, or components of that industry, that I'd want to talk about do we have that concern here? Is it something that we ought to be looking at? Are those issues that should be raised.

And also, where there restatements in the audit firm is involved in those restatements? Are there any indications that there are problems that could also migrate to our account. And in a sense, what I like to do in that way is to test the professionalism and the communication skills of the auditor.

The concept that is in here of two-way communication I agree with. I think it's sound. I'm not sure it fits all that neatly within a document that's for the auditors.

And so, there's probably other ways that you could describe it. For instance, you could describe to the auditor in a standard what to do if the audit committee is not communicating with them. And I think that the same three or different things that you've described here, and I think there our -- they would be signals, red flags that you have a problem, but I think it may be difficult to try and put in an audit committee responsibility chart or checklist in the form of a standard written for the auditors themselves.

I think you can imply certain things. Out of that, I think you can cause action to occur. I also think not withstanding what some do think is a lack of guidance on best practices for audit committees. I think there's a ton of material out there almost every account firm, every consulting and operation, endless numbers of conferences that address this issue of what audit committees ought to be paying attention to.

And I think there are some very good practices and that if there's a perceived need from the audit community that the audit committees are not living up to their expectations, that's maybe another problem, but it may be that it should be dealt with in a way apart from the communication to the auditor.

So again, I think this is good work. I think you've really drawn out a lot of the thing that do need to be address that are that we all think about. Having guidance is absolutely essential. That’s your role. And I think you’ve done a good job on what you’ve produced at this point.

MR. BAUMAN: Don, thanks for those comments. And some of the other topics that, Don, you touched on two-way communications and others, we will have further sessions today to explore some of those concepts more in-depth.

We have I think about four cards up right now on this particular topic still on what are the right communications that audit committees want and what are the communications that investors want committee members to have? So I think I have Denny Beresford, Bob Dohrer, Kiko Harvey, and Hall Schroeder and--

FEMALE SPEAKER: Arnie Hanish.

MR. BAUMAN: And Arnie Hanish. Five cards. And then we’ll take a break, if that’s all right. So Denny?

MR. BERESFORD: Thanks, Marty. Just a

suggestion. If the PCAOB staff has not already done this, I'd suggest that you actually ask some accounting firms to show you the communications that they actually have with some audit committees, both for some larger corporations and some smaller corporation -- well, some smaller accounting firms. The -- as indicated in my earlier comments, my concern is that we just get overwhelmed as audit committee members. And particularly with written communications, I'm all for written communications, but the problem is if you think about it, we get four letters of representations each year, most of which frankly could take almost the entire amount of time that we devote to audit committees. I'm exaggerating just a little bit, but those things get very long. Very little has changed. The question is, is that a very effective use of our time as audit committee members to read all of those things?

We get the annual engagement letter, where audit committee -- where audit firms sometimes try to sneak in CYA type paragraphs from time to time, Bob.

(laughter)

Not looking at you. You just happened to be the auditor for three of my four boards.

MR. KUEPPERS: That’s silly. That’s just -- I can’t imagine that.

MALE SPEAKER: That’s simply baloney. I can’t --

MR. BERESFORD: But again, a whole lot of boilerplate, very little changes from year to year. We get typically a quarterly listing of all of the, I think it’s SAS 61 and 114 I believe it is, if I’m not mistaken type requirements, much of which has not changed from quarter to quarter. We’re -- it’s usually exception type reporting.

Again, we read it all. We’re not sure exactly what it is that we’re supposed to be focusing on. Very little is being called to our attention. So the totality is that we have a lot of information to “read” or at least we think we’re supposed to read it all, but in the final analysis, there probably are maybe two or three little things buried and maybe, I mean, not exaggerating, maybe 50 or 60 pieces of paper that might be of importance to us.

Now hopefully, if we've done a good -- have done a good job with -- as audit committee members, and the engagement partner, the audit committee chairs and engagement partners, we've had them focus, at least we've had them yellow in them or something like that. And that they've only talked to us at the meetings about the things that are important.

But this is part of the problem. And this is part of the checklist mentality that there are so many of these required things that just kind of bury the time for effective communication.

So I really urge you to have the staff, if you haven't already done it, just look to see how this stuff plays out in practice now, and consider the fact that you're going to add to it another half dozen or 8 or 10 -- I don't know what it is exactly, but how these things would just be more of the same, and just add to the fact that we just have this amount of paperwork that doesn't really communicate

-- doesn’t really add to communicate -- effective communications. It just is paper that’s not necessarily working.

And as I said -- as several people have said already, all audit committees are not created effectively are the same, I should say. And I’m convinced there a lot of people -- committees out there where the engagement partner just gets up and reads to the audit committee all of those detailed things from SAS 114 each quarter. And the poor audit committee members just sit there and take it. And that’s it.

MR. BAUMAN: Thanks.

MR. BERESFORD: End of sermon.

(laughter)

MR. BAUMAN: Thanks, Denny. A couple things. One, your point is certainly a good one about getting out there and looking at things. And we have looked at audit committee reports. And in some cases, many of us or some of us here have been involved in them in very large companies. And to some extent, some of the additional requirements that were in here in our view were a reflection of what we saw some of the better audit committee reports, quite frankly, looking like, but just weren’t in today’s requirements. So in any event, but your point of making sure we’re looking to see what’s happening is a very important one.

Bob, you’ll have the first couple of minutes after the break to rebut that, all right?

(laughter)

Arnie Hanish?

MR. HANISH: Thank you, Marty. I’ll try not to be too redundant. But again, thank you. I think that over the blast -- having been in a financial management role for -- and interfacing with an audit committees for over almost 25 years, I think communications are clearly much improved from what they were 20, 25 years ago.

I think that the check the box mentality that I think many of us have talked about, I think Denny I think articulated it pretty well there right there at the end a few minutes ago. I think that what you don’t want is to have all of that litany of activity in there, and then just going throwing it page by page or line by line.

I think that many of the suggestions that are in here are probably very positive. I think that I agree with Mike Cook in the sense that there needs to be a broader perspective on financial reporting. And specifically, maybe something around press releases and other business communications.

I think that -- I actually value the input that an auditor provides me as a member of financial management with regard to the -- their assessment of our communication in press releases in particular. And I over the years have found a variety of approaches taken by auditors, some better and some worse as to the amount of input they provide.

And I think that in an audit committee, remember, it would be helpful to get the auditors' assessment as to the -- not necessarily the effectiveness, but you know, whether or not those communications, particularly the press releases, are in their view any way, shape, or form misleading, because I think in the end, some of those press releases can come back to haunt you as a company. And I think it’s good to have an independent view.

Now they’re not going to audit those press releases. I want to be careful, because I don’t want to necessarily create situation where there’s more opportunity for fees, but I think that the opportunity here for insight as part of the normal process that they go through, not just to tick and tie numbers, but to give me insights as to their -- and give the audit committee insight into the way things are being communicated and articulated are very important. Woops, are very important.

I also agree that I know we’ll be discussing two-way communications later, but it’s very important. I don’t necessarily agree that they should provide an assessment of effectiveness, but I think the important point is to have that dialogue, and also make sure that the audit committee members are versed -- sufficiently versed to answer an ask the right questions as part of a two way dialogue.

The world of accounting and financial reporting over the last 25 years has become so much more complex than it was when I started in a financial reporting role, and had been an auditor for a number of years.

But many audit committee members, many, many, many audit committee members do not have the depth of background to even know what questions to ask in an effective way from a communications standpoint.

And it's a rare situation in my view, where you get an audit committee chair that has the depth, the background, to even raise those appropriate questions with the auditor to the extent that they need to.

I've seen variety of audit committee chairs over the years. And most don't have the effective background even, many do, but most do not to even ask and engage in effective communication on the topics that are so critical today and from an investor perspective, I would want my audit committee chairs, as well as those individuals designated as financial experts to be truly financial experts and understand the complexities that we at management are having to deal with today in order to perform their fiduciary role responsibly.

And I just don’t see that consistently across the board. And I’m not sure that that is part of what we’re trying to do here. And I don’t know how we get that into the spirit, but it’s certainly not part of the standard.

I think that the idea that the auditors would comment on the quality of financial management, and I think that’s been discussed by several individuals, is really critical.

I would welcome as a member of financial management an in-depth review of--by the auditors with my audit committee of the quality not only of myself, but also of the staff and the depth of my staff.

And I don’t see that happened well and sufficiently. I don’t see it happen often enough. And it’s not just a matter of a discussion around well, how many people do you have certified? Or how many internal auditors are CIA’s? It’s really a question of having an appropriate dialogue around their experience level and the depth of knowledge, because as, again, in the fiduciary responsibility as part of this three legged stool, triangle, they clearly do have responsibility to provide an independent assessment. And as an audit committee member, I would hope that I would be getting that for my auditors as to the true depth of knowledge and capabilities and experiences, because you could have an internal audit group that has a whole host of individuals that are CPA's or CIA's that very few of whom ever spent a day of their life in public accounting and understand truly what it is to perform an audit.

Many large companies use internal audit as a rotational, educational activity to enhance the skills. But how many of those people have really been educated by CPA firms in the precepts of performing an audit and what to do look for?

And, again, going back to even my own staff, or staffs of people that are working under controllers, how many of those individuals have really deep knowledge, 8, 10, 12 years of public accounting experience? There's a whole host -- world of difference between somebody who passed the CPA exam, only had a couple years of public accounting experience versus someone who truly does have the depth.

And I just don't see those questions being asked of the auditors. And I don't see the auditors really becoming -- coming forward with those types of those comments.

The other aspect is really more around, and I think it's a responsibility of management, but if management doesn't do it, I think the auditor has to step in. And that's the aspect of education of the audit committee members. If management doesn't do it adequately, then the auditors have a responsibility to step in and educate the audit committee.

Again, it gets back to the earlier comment that I was making around in order to have an effective two way dialogue, you really do need to truly have audit committee members that understand what questions that need to be asked. So thanks for the opportunity, Marty.

MR. BAUMAN: Thanks, Arnie. Bob Dohrer?

MR. DOHRER: Well, thank you, Marty. And I'll -- recognizing the time, I'll keep my comments brief, but just to pick up perhaps from the perspective and an auditor a little bit of what Denny and Lynn and others have referred to, and that is the over communication, if you will, and just caution the board. I've heard some discussion around in lieu of requirements, perhaps a more principles based approach would be appropriate as to what information should be communicated in the proposed standard.

The caution I guess I have there is knowing the animal that we auditors are, when there's a principle that's indicated, normally, there's a hue and a cry for some sort of guidance to go along with how you implement that principle. Often, that results in a rather lengthy list of items that you would consider communicating. And oftentimes, the way the auditor may react to that is that becomes the checklist, because particularly with this subject matter, the auditor would certainly be very concerned with not communicating something that perhaps in hindsight, you know, could have been communicated. And they simply made an evaluation and a consideration that they didn't need to communicate it.

So I think that list of considers potentially turns into the checklist, which results in the expansive written type of stuff and bearing the real important matters that need to be surfaced.

So I guess in summary like -- we've heard tone at the top, quality of financial management if the consensus is that that's important information that should be communicated in substantially all cases, then let's call it that, and make it a requirement but be very careful about how we use principles, unless the principle is that the auditor should be prepared to communicate anything else that the audit committee may ask.

But when we start down the list of what that might be, in essence, we've turned it into a checklist and a requirement that will lead to boilerplate and over communication.

MR. BAUMAN: Thanks, Bob. Kiko Harvey?

MS. HARVEY: Thank you for the opportunity to join in this roundtable. I think that clearly, this has been a daunting task for the PCAOB to write this, because in a lot of ways, you're trying to regulate a relationship. And I think that's a very difficult thing to do to get the right information in the documents. And so, I commend you for your efforts.

I have heard a lot about tone at the top. I want to remind people, I think of course that's an important discussion for audit committee members to be concerned about. From an internal auditor's perspective, we probably are in a -- in one of the best roles, along with the external auditors, to provide our views on tone at the top being that we're in most of the management meetings on a day to day basis. We see the communications that go out at the company level. And so basically, we see it all.

And so, you know, if you're not reaching out to your internal audit teams to ask those questions, and you’re relying solely on the external audit group, you’re probably just getting part of the picture. So you know, an important thing to mention.

Regarding the quality of financial management, I agree that that’s something that the audit committees should be very concerned about. I think that all in all, for most of -- large public accounting or most large public companies, the quality management is very good. I also want to, you know, open the dialogue for the quality of the internal audit team. I think it’s very important that that is also considered. And I think that the external auditors are probably in a unique position to be able to provide even more insight into whether the internal audit team is really doing their job correctly, whether they have sufficiency of resources, whether they’re actually focused in the right areas.

And so, I think I would welcome that kind of feedback from the external audit teams as well.

And I know that we do receive it in the company's that I've worked for.

So I'll save my comments for later on. I know we're up against a break, but thought I'd share that with you.

MR. BAUMAN: Appreciate your comments. Hal Schroeder?

MR. SCHROEDER: Just one quick follow on. Marty, you had mentioned that in your current standards, you require an assessment of tone at the top. And I have to tell you, I'm in the investment world. And we go both long and short stocks. And some of our best short ideas have been our own assessment of tone at the top. So in a perverse way, I'm glad things aren't working so well in terms of assessment.

(laughter)

I say that half jokingly, but truly, some of our best ideas are looking at the interaction between the CEO and the CFO. And I have to question if I can see this, and I only have maybe -- meet with a CEO or a CFO four or five times a year, see him at a couple conferences, if I can see it, how do the auditors and how do the audit committee not see it? So something really needs to be addressed here. And we've said it over and over again, but that was part of a -- the quickest way to get to the point that I'm making money off of people not doing their jobs in terms of assessing tone at the top. So maybe I'll retire after this but --

MR. BAUMAN: Well, I have to break the rules here. There was -- those were the cards that were up. And I saw one card came up late, but to show you the flexibility of the organization, Sam?

MR. RANZILLA: Well, I appreciate that, Marty. And I will be very brief and not discuss any topic we're going to discuss later. As I sat through this, and as I prepared for this, I thought this first section was a place as an auditor it'd be really important for me to hear what others want.

And so, as an auditor, I think that -- I can stress that the relationship between the auditor and the audit committee is a significant relationship and plays into our ability as auditors to appropriately dispense of our professional responsibilities.

And as a result of the importance of that relationship, I think as an auditor, I have my own views about, you know, maybe someday I'll be an audit committee, and what I think is important. But I think at the end of the day, auditors want to provide information to audit committees that will help them dispense their responsibilities.

And I don't know where that is, other than my own views, but I do think there is a pretty good rhythm today between audit committees and auditors with respect to communication. Could that be enhanced? Probably. I think your standards got to leave some flexibility with respect to the various requirements.

With respect to comments around writing standards to the lowest common denominator, I mean I don't think I can emphasize enough how you cannot write standards to the lowest common denominator and expect a high functioning financial reporting regime. It just -- it simply does not work to write standards--it does quite frankly, it doesn't in most things in life, make sense to go to the lowest common denominator.

Ask a teacher if you're teaching to the lowest common denominator, what that does to the overall class? And I'm not a teacher nor an audit committee member, but that hasn't stopped me yet.

The last thing that I will say is, and something to consider is considering the varied comments around too much, too little. Once you adopt a final standard, whatever way you go, maybe this would be an interesting topic for some field testing post implementation to see whether or not you've hit it right.

I mean, obviously, you got to give it a couple of years to see, but maybe this would be a place where a post implementation would make a lot of sense.

MR. BAUMAN: Thanks. Thanks, Sam. And I want to thank everybody for the value of these comments during this very first session. Very, very thoughtful input and very valuable input for us as we go back and consider the standard.

We'll take a 15 minute break till about, according to my watch, five minutes to 11:00. And let's try to back around then. Thank you very much.

[break]

MS. RAND: All right, welcome back. Marty asked that I start this session, which I planned to moderate this session anyway. So that works out perfectly.

The next topic is accounting policies, practices, and estimates. And this is an area where we had also received significant comments from commenters.

And your briefing paper includes an appendix, appendix A, listing paragraphs 12 and 13 from the proposed standard. And those two paragraphs have several requirements regarding accounting policies, practices, and estimates.

So that's our focus of the discussion right now. Steve Harris, PCAOB board member will provide some introductory remarks. And then, I'll walk through the questions.

MR. HARRIS: Well, thank you, Jennifer. And I'll be very brief. As you point out, for the next 30 minutes, we'd like to hear the group's views on what you think should be the specific responsibility of the auditors to provide timely observations to the audit committee about accounting policies, practices, and estimates. And we're particularly pleased that leading the discussion will be Mike Cook and Hal Schroeder. While the proposed standard retains and clarifies many of the existing requirements in the current standard, it also updates the standard by incorporating existing SEC communication requirements.

Several commentators have stated that the proposed required communications, and we've heard it this morning, strike the right balance and include important critical issues on which audit committees need to focus. Others, however, and we've heard that this morning as well, feel that the proposed standard may be too onerous for audit committees with the volume of required communications, potentially taking time away from more important issues.

There were also concerns expressed that the requirements overlap with management's communication responsibilities.

During the discussion today, we are seeking your input and as specifically as possible on whether the board should modify the proposed requirements. And in that regard, we are interested in understanding which additional matters the standards should require, the auditor to communicate if any, or perhaps which proposed or currently required communications should be eliminated.

So Jennifer, thank you very much. And I understand you'll start the session off with a couple of specific questions.

MS. RAND: Thank you, Steve. We have -- we had three questions in the briefing papers. So I'll put those up on this slide. The first one was how could the communication requirements be modified so that the auditor and the audit committee focus on the most significant accounting issues and estimates? The next one, how could the proposed standard clarify the types of consultations that should be communicated to the audit committee? And then finally, are there matters in addition to those in appendix A, which are paragraphs 12 and 13 of the standard that the proposed standard should require auditors to communicate. And if so, what are those matters? And why should they be required?

If there are any requirements that should be omitted, why -- what are those and why should be omitted?

So we're not flipping back in between these two slides as we're going through the discussion, we have a discussion summary slide, highlighting those three points on here.

We have asked a couple of people, Mike Cook and Hal Schroeder to provide some of their thoughts on these questions to help open up the discussion. Before I turn it over to Mike, I would like as Marty had pointed out in the earlier session, many had commented on that perhaps some of their requirements in the proposed standard were too onerous. Most of those comments like that were directed at these specific requirements. And also, commenters indicated that management often has communicating these -- many of these points regarding accounting policies, practices, and estimates. So why -- it doesn't make sense for the auditor to duplicate all of that and waste the audit committee's time.

When we had drafted this standard, we had -- we recognized, as the board's current standard does, that management often does communicate these type of matters to the audit committee. And we had a -- we think it's a fix we can make through a drafting point, but many commenters seem to not pick up what we had intended, which was for the auditor to evaluate what management has communicated. And if the auditor believes management is appropriately communicated many of these items, they wouldn't need to repeat it. It's only in those instances if the auditor believes management hasn't done an adequate job of communicating some of these items.

So just wanted to point that out. Many commenters expressed that concern. And we are aware of that. So with that said, I'd like to open the discussion and first turn to Mike Cook and then Hal Schroeder to provide some -- your thoughts on these questions.

MR. COOK: Jennifer, I'll try not to repeat some of the things I said earlier, because some of the trains of thought are -- consist -- and I always remember one of my partners said, if you can't be right, be consistent. So and probably not right on some of these topics, but I still have the same point of view.

A couple of the key questions about, you know, the issues of what could we add, are present requirements sufficient, and so on, I have a view that the present requirements are in fact sufficient. It troubles me a bit that we are adding as we describe on page 3, these newer requirements for the auditor if management hasn't done its communication job correctly. That doesn't sit right with me. And somebody said, we've got the emphasis on the wrong syllable here.

I mean, we are telling management what

management needs to be communicating, even though we have no authority to dictate communication practices to management, but we’re doing that because we’re saying if you don’t do it, the auditors are going to be required to do it. And we write rules for auditors, therefore, we can write the rules that say if these things haven’t been done, the auditor will do them.

I don’t think that’s the right thrust. And I appreciate what Marty said earlier. And I would just say, please, do give careful attention to this question about management’s communication responsibilities and not indirectly by writing rules for auditors. If management fails, write the communication rules for management through this type of communication.

If you think that needs to be done, there ought to be a forum to do it, but not back dooring it through the audit communication process in my judgment is not the right way to go about it.

Likewise, I think there are some things that could be done with the focus on the audit. And

I continue to believe we need a broader focus on financial reporting. And Lynn and I will debate some parts of that later.

But I do think we need that broader view. And but focusing on the audit, there is one thing I would like to recommend be given consideration because Linda and I and to some extent Denny and others who were on the committee for the improvement and financial reporting labored long and hard and agonized over the issue of a framework for auditors to use and management to use. Management to use in the first instance to make judgments to make estimates. And auditors to evaluate the estimates and judgments that have been made by management in preparing the financial statements I think that would be a superb addition to this document, which would be inquiry or a dialogue between the audit committee and the audit firm about how the audit firm.

It could be the firm as a whole. It could be specific to the engagement or to a particular accounting or auditing matter. How does the firm make the judgments? What is the framework for the judgments that are made on the critical issues in the financial statements?

Seems to me that fits here, and would be a nice addition to this dialogue that is not -- it's probably suggested in a number of places, but it's not addressed directly.

Present requirements in most areas, I think, are quite sufficient. I -- this doesn't pertain to estimates and judgments, but I would hope maybe I realize some of the things we have are here because of the requirements of Sarbanes Oxley. They're part of the law. Therefore, the audit committee gets them whether the audit committee wants them or not. But it would be refreshing if we could find a way to in consultation and discussion with audit committees, to take away some of the things we don't want, don't need, and don't know what to do with when we get it. And Denny's reference to the representation letters, if we could get a one paragraph summary of the things that are new and different in some of these documents, rather than receiving full text documents. And maybe we have that flexibility and we’re not using it, but we sure get a lot of things that I asked, and I think I have a reasonable basis for knowing what to expect, I asked why am I getting this? And the answer is because I’m required to give it to you. And you’re required to take it if I’m required to give it to you, even if you don’t want it and don’t know what to do with it.

To the point that Hal made earlier about the notion about audit committees, there are audit committee chairmen who know in addition to what to emphasize to what to ignore. But there are a lot of people who don’t have that same training and background, who when they get a 40 page representation letter four times a year, presume that there must be something there that they really need to know something about and then are encumbered with the burden of reading it, and trying to understand it.

And it would be so much better if those communications could be streamlined, focused on things that are new and different, which goes to the point of how do you focus on the things that are most important? Don’t burden people with things that are not most important. Or do it in such a way that it is highly efficient. And best practices can hopefully convey some of that information.

So I’d like to see us get rid of some of the existing practices. I would very much like to see us focus on the judgment framework being a part of the communication process between the audit committee and the audit firm, because it is related to the audit and the process that has followed in doing the audit.

With respect to this question about consultation, I think it’s a very good thing. I think the idea of if there are important issues that the firm has engaged others, whether they’re industry specialists, senior partners in the firm, or the engagement team has brought others to bear on reaching important judgments and important conclusions, I think that’s a very valid thing for an audit committee to have an interest in the dialogue. Trying to define it, and defining it in some ways with references to things like informal conversations, I really don’t think, particularly if the notion might evolve, that it would have to be a written communication subject to 14 review process, I really don’t think I want to be on the receiving end of a communication when the lead partner decides to call somebody that they happen to know in another office to get an insight on a industry issue or something of that kind.

I would again urge that we write the principle of what we’re trying to achieve. We’re trying to achieve a high level, better level of knowledge, transparency at the audit committee on important issues that the firm has wrestled with.

And presumably, management has wrestled with as well. Right the principle and let the firm decide what it is that should be communicated to the audit committee that meets that requirement, and not try to write if it takes more than 15 minutes, or if there are more than three people involved, if it is somebody who’s more than 100 miles away, however else we might define this consultation, leave that out and let the firm decide what is important to communicate to the audit committee.

And then in the interest of trying to think of something that I would like to suggest we don’t need, there is something, I think it’s in -- back on page 13, which struck my fancy in this new things that we’re going to communicate under accounting estimates. If the auditor determines that potential bias exists in management’s accounting estimates, to begin with, I probably don’t think the auditor needs to be making that determination, but I have never seen an accounting estimate for which there is not potential for bias. I mean, that is the inherent nature of accounting estimates that that potential exists. And it’s that kind of a rule or that kind of an auditor determination requirement that leads to a great deal of consternation effort, cost and little of value.

If management is consistently making judgments with a bias, which produces an overall bias in the financial statements, and you feel that needs to be communicated to the audit committee, I could understand that and support it.

Every estimate that is made, that has a potential for bias is every estimate that is made. And I wouldn't suggest that that would be a step forward.

Overall, I mean, I think most of what we have today is good, works well. I'm concerned as an audit committee member of the back dooring management communication requirements and the specificity that this gives to what an audit committee is going to receive that an audit committee may not have decided it needs in a particular situation, and transferring that responsibility to the standard setting process, I think is going a little further than we should.

MR. SCHROEDER: Thanks, Mike. And I had the same observation. I thought all biases are -- there's a bias in every single estimate. So.

Unlike a lot of you around this table, I don't spend 100 percent of my time thinking about accounting and auditing issues. I spend maybe two percent of my time. And so, I apologize in advance, but I'm going to give you kind of my perspective on this.

As I read appendix A, there are three things that really struck me. The first was the volume of information. It was just overwhelming. And it seemed to be extremely technical.

The ability of the average audit committee member, I think it's going to be beyond the average audit committee member to understand the implications of what's being said.

I know how much I struggle today with accounting issues in trying to understand the intricacies, and how they affect accounting estimates and other things.

But the thing that really struck me most about this three page excerpt was that the use of the word significant and critical in a three page document, it was used, those two words were used to combine 24 times. If you're counting, it was 10 significant and 14 critical.

So I started to think about what do those words really, really mean? And I had trouble answering it, because I couldn't get over the first part of the question.

The first part is significant and critical to who? Is it to the auditor? Is it to the audit committee? Is it the board? Is it the management of the firm? Or is it the investor?

And I stumbled on the word investor because is it a fixed income investor? Is it an equity investor? If it's an equity investor, is there a long only equity investor? Or is there a long short equity investor? And you can go on and on and on.

There are multiple layers. What it reminded me of is a speech I gave to my old firm Ernst and Young. I had spent 13 years there in both practice and national office. And then a few years later, I was a sell side analyst on Wall Street. And they asked me to come back, and basically give a speech somewhere along the lines of what have you learned that you wish you knew when were an auditor? And I thought about it for a second. And I actually drew a little graphic here on my paper to help me remember what I thought about, but really came down to communication.

What I did not appreciate at the time, I as auditing, was the level of communication that was outside the company. So you've got not only the auditors talking to the audit committee and management, but you also have functions within management, particularly investor relations, talking to the investor community, talking to fixed income, talking to equity investors, understanding what their issues are.

And it really came home to me last week when I listened to a presentation last week by a very well known CEO last Tuesday. And he said he came back from vacation. And he sat down with investor relations group and had them put down on a piece of paper what were the critical issues that investors were asking about? This whole wide range of different types of investors. He says I want to address each one of those today.

And in doing that, what he did in

literally about 15 minutes was knock off every single critical issue that the large investor base was thinking about.

And the advantage of it to the company is that investors don't all think alike, but they come at each company with a wide range of perspectives. They talk to probably more people at a higher level than a lot of audit firms do.

I know when I was auditor, if I got to talk to the CFO or the CEO, that was a really, really big deal. I was usually dealing much lower in the organization.

As an investor, if I'm not talking to the CEO or CFO, I'm talking to a head of a line of business. Very, very different perspectives. And the communication is very, very different.

So the questions that I'm asking then that the investor relations people would do or diligently recording give you a tremendous perspective on what I think is significant and critical, what will move the stock the next day when they say something.

So what I did was I called around or had some of my team call around to a couple of the large banks that I follow ask them, how do you communicate information questions that we have? And some of them had some very clear routines of not only the CFO and the CEO, but also the board and the audit committee in particular.

Other companies had no real routine. So as I looked at this, I would focus on things like significant and critical, who is it significant and critical to? And how could that massive list of what we think as investors is significant and critical, how can that -- how is that or how could that be effectively communicated, not only through management, the board, and the audit committee, but also to the investor or, excuse me, to the audit firms, again, it comes back to that I wish I had known certain things when I was auditing. It would have given me a lot better sense of what truly was significant and critical.

MR. BAUMAN: Thanks Hal and thanks Mike. One thing I just did want to point out, probably wouldn't beyond me, Mike, to try to back door something into this, but the board wouldn't let me do that.

These issues in paragraph 12 were things that we think should be communicated by the auditor to the audit committee. It's just we we're reflecting our knowledge of practice. And that is that in many cases, management does make these communications. So rather than duplication, we indicated if management makes them the auditor, evaluates them, but we really weren't trying to require a management communication. There were things at least from our perspective in writing the standard, we thought the auditor should communicate. So that was the purpose there.

With that, is that your card, Charley?

MS. RAND: No, it's Denny.

MR. BAUMAN: Oh, Denny.

MR. BERESFORD: I'd like to build on I think both what Mike and Hal said. In my letter, I strongly recommended that you delete paragraph 12B, critical accounting estimates. And there were really a couple of reasons.

Number one, I think that, again, this is part of the overall notion of there's just too much in the requirements, but Hal had an interesting point. And that is that to the extent that some of this information is useful, it's useful on a much broader scale. It might be useful to investors, for example.

In thinking about this, these are new requirements for the most part. Description of the process used by management to develop the critical accounting estimates, have various selections within the range would affect the -- basically the PCAOB is setting accounting and/or disclosure requirements here, except they're not disclosing them to anybody except the audit committee.

And it seems to me that the appropriate way to go about this is that the SEC ought to be thinking about these kinds of things for MDNA, for example. Or the FASB ought to be thinking about them for purposes of footnote disclosures. Frankly, I think that it goes well beyond anything the FASB should be interested in right now, but possibly the

SEC might be interested in some of these things.

But it just doesn’t strike me as the kinds of things that the PCAOB should be asking auditors to be focusing on.

Now I recognize Marty has made this point a couple times already that it’s stated in the context of we really think that management should be thinking of these things. And it’s only if management doesn’t bring in to the attention of the audit committee, then the auditors should.

Frankly, that’s stated as the last part of this paragraph. I would make the change and put that as the first part of the paragraph rather than the last. It think that would be an important emphasis change.

But mainly, I think that these are matters that are getting well beyond what the responsibility of the auditor should be, and are expanding frankly requirements even beyond what management needs to do with respect to most of these things.

These are kind of interesting things in some respects. I don’t really think that it’s very practical. I'd be interested in Arnie and some other people's comments on this, but to the extent that, for example, what various selections within the range of estimates would be, that's -- that could be an endless range of possibilities. I will tell you, for example, for Fannie Mae's loss reserves of $60 billion right now on a $3 trillion book of business, there are lots of possible outcomes of that. And I don't know how many different possibilities that either Deloitte or internal financial management could come up with there, depending on different assumptions that would be made.

And that's obviously an extreme example, but even in the simplest situation, I suspect there would be many different possible outcomes. And I think that each of these is fairly subjective. And they're kind of nice to know types of things, but just go beyond I think what really is necessary and add to the burden.

MS. RAND: Denny, I'd just like to point out, many of the kind of -- and as Steve had mentioned, when we were working on the proposed standard, we looked to the existing standard, the requirements in there now, plus recognizing Sarbanes Oxley and SEC Rules. There were additional communication requirements that aren't reflected in the board's current standard today, but which nonetheless impose a responsibility on auditors to communicate to the audit committees.

So the requirements, I think, when we had expanded on, but regarding critical accounting policies and critical accounting estimates, those were derived from the SEC's rules.

So we incorporated those into the standard to make it easier for auditors to have that direction in one place, make sure they weren't missing any of the communications. But they're largely derived from requirements that exist today, but from the SEC.

MR. BERESFORD: Suggesting that 12B is all required by existing standards? I tried to check back that, and I was not able to do that. It's a little confusing, but I tried very hard to go back and forth between existing standards and existing SEC rules. And 12B kind of eluded me, but I've -- I thought that much of it was new.

MS. VANICH: Yeah, Denny, I just -- 12B, a good part on accounting estimates is relatively new. It would be B 2, 3, and 4. Those are relatively new. I think 1, 2, and 3, are fairly closely tied to what the auditor's required to do now to audit fair value estimates.

It's 13B and 13E that are current requirements in the SEC rules. So critical accounting policies and practices and alternative treatments permissible under GAAP.

MR. BERESFORD: I was speaking more of the communication requirements, not what the auditors' requirements were.

MR. BAUMAN: One of the -- I appreciate the input, again, Denny. It's very valuable. We are observing some of the ways in which FASB's going and communicating to investors is emphasizing the importance of disclosures to investors around ranges. To your point, very difficult to get to that one number of $60 billion I think you said on the multi trillion dollar portfolio. And there's probably a number of reasonable estimates, other than that number. And similarly with respect to fair value and FASB's most recent proposals, is a requirement proposed for disclosures to investors of other reasonable values that could have been selected in addition to the one that was selected.

And I guess the point in there is in communicating to you the audit committee or shareholders that none of these numbers is the precise number. And there are very wide ranges today with these areas of measurement, uncertainty and the better informed that either audit committees or investors to understand how wide those ranges might be, and why management selected the number they did is -- seems to be an important factor in where FASB's headed with some of their disclosures and informing our thinking to some degree here as well, but thank you for those comments.

MS. RAND: Okay, we have several tent cards up. So I'd like to get everyone's thoughts.

Jim Cox?

MR. COMR. BAUMAN: I was going to address Hal’s concern. When I read this, and this could be just the wisdom of the parable about the blind man and the elephant, because we want to make sure the language overcomes the parable.

And that is that when I read and have read significant or critical, I thought it was vis a vis a fair presentation of the financial statements. Not the end user, or not to management, nor to the audit committee, but for the matters for which the auditors are rendering an opinion, which is that the financial statements fairly present the financial position and performance.

And then, on Denny’s point, I think it is true, Denny, that this does not -- is not a mirror image of the SEC rules about this question, which is implementing not just Sarbanes Oxley requirements, but it goes back to earlier to the exchange listing requirements that were there before SOX mirrored this same requirement.

But I think what it’s really seeking, and again, I -- this may just be the blind man and the elephant and maybe we see if we want to clarify that with language, is to make sure that this discussion, which is mandated between the auditor and the audit committee is as intelligent as it possibly can be under the circumstances. And I think that that's why you want to have some emphasis here as to the accounts.

Now the devil's in the details. And about what we mean by significant and critical. And there's lots of methodologies that could be employed there.

And -- but the important thing is that the auditors engage the audit committee in a discussion about how a handful of estimates or judgments or assumptions could very much change the presentation of the firm's performance and position. That's the point, I believe.

MS. RAND: Thanks, Jim. Arnie Hanish?

MR. HANISH: Thanks, Jennifer. A couple of points. So I think that as it was pointed out that these are suggestions and that if management --

these are management's responsibility to a large extent. And if management doesn't do it, then I think the auditor clearly has the responsibility to jump in.

But one of the points on -- as far as the requirement to get to I think it's your second question there around consultations by the auditor outside of the engagement team on significant matters, I'm troubled by what's written on page four, where it says proposed standard also added a new requirement for the auditor to communicate to the audit committee any consultations by the auditor outside the engagement team related to significant accounting matters. I'm really troubled by the use of those words, any consultations. I mean, again, there ought to be a degree of materiality, significance.

There are many requirements today that auditors have to go to their national office for consultation on matters that at least with regard to the companies believe may not be as significant, but they are required to go to their national office, because it's a CYA to some degree.

And so, I would be very cautious with the way these words are written by saying any consultations. So I would suggest that be modified.

I think that I am extremely troubled by the reference with regard to the range of outcomes on accounting estimates. Whether the FASB is headed in one direction or not, I think it's a -- I don't think we've seen the last of the discussions around that as far as providing ranges of outcomes in our financial disclosures. So I think that is fraught with issues. And I would hope that we wouldn't necessarily see alternative numbers appear in our financial reporting disclosures around accounting estimates because then that just opens up a whole can of worms as far as the litigation issues around well, why didn't the company book this number versus this number versus number? These are generally accepted -- these financial statements are fairly presented under GAAP. We all know there's a bunch -- there's a whole host of estimates that embedded in these numbers. And we believe they're reasonably materially correct. Auditors audit those numbers. Agree that they are materially correct and in accordance with GAAP. And that really should be the end of it, in my view.

Again, I think if the audit committee wants to understand what were or what were the thought processes that went into a determination of judgment, whether it's Fannie Reserves or in our case, you know, it was reserve set up for a litigation on product liability cases. It's certainly within the purview of the audit committee to challenge us as management to sit here and review with them the rationale behind how we came to the numbers that we came to, because there are a whole host of assumptions that -- and outcomes that can take place.

But I think for the auditors to have to provide judgment on that, they have provided judgment. They've certified our financial statements. And that should be sufficient in my view. Thank you.

MR. BAUMAN: Thanks, Arnie. Just one

clarification, and you did pick up a good catch with the addition of the word “any” in the briefing paper, which is not in the standard itself. So that was a good catch, reading catch on your part.

But it does go on to say that any consultations related to significant accounting matters. So I agree with you, it’s not -- it’s any consultations didn’t belong near the word any, but the word significant accounting matters does belong there.

But still, I think the point is we did get a number of comments regarding what you said. And that is that there’s a lot of consultations that maybe required by firm policy that the audit committee doesn’t need to hear about. So it’s still an important point for us to rethink as we go through this. Thanks.

MS. RAND: Thanks, Marty. Hal, I think you were trying to get my attention earlier. Maybe to respond to Jim?

MR. SCHROEDER: I just wanted to respond to Jim’s comment about significant. When I think about significant, it really varies from period to period, quarter to quarter, week to week, month to month. I've been somewhat cynical about this. When I talked to our investors, I tell them that, you know, the market generally can only think about one issue per quarter. And that may be even being a little generous.

So significant and I'm thinking about MPAs for banks or net interest margin, they'll pick one issue and really hone in on it.

So if you're -- if the management is dealing with is this a nonperforming asset or not, small -- the degree of significance drops a degree or degree of materiality drops tremendously if the entire market has built up an expectation about something.

If the market is not focused on it, you can actually argue that materiality can widen out and in less will bother the market.

So you're going to map this fair presentation concept against I think market expectations. And then I, again, operate under the assumption that all things are estimates in the balance sheet anyway.

So you know, we may be looking at MPA's and looking for a call in the turn of a market. And we saw this earlier this year. MPA's started to stabilize. And all of a sudden, people got all excited. And they ran banks up for a short while. Was that the right answer? I think that if I were an audit committee, I would be looking at that number and that estimate in that quarter a lot harder than I would have in the middle of when times are very good. So it's a moving -- basically significant and critical are moving targets.

MS. RAND: Okay, thanks. Just for a time check, as I'm sure you're all aware, we are over our estimated time or our agenda for this morning, but this is also very important area that we received comments on. So we want to continue this discussion until noon and then we'll reevaluate our agenda for the afternoon after lunch.

So moving on, Joan Waggoner?

MS. WAGGONER: Thank you, Jennifer. A

couple of things. I first wanted to say that I really enjoyed Arnie's comments on the range of outcomes. And certainly, I'm in agreement with those.

I would also say that with respect to this item alone, I believe there would be a significant cost factor associated with being responsible for the developing of that data should we need to do so.

Secondly, as I was going through paragraphs 12 and 13, I was trying to picture myself in an audit committee meeting on either side. Didn't matter which side it was going to go on. And I was trying to sort of see how is that meeting flowing along? And so, I'm picturing a conversation starting to develop with the discussion of accounting policies and moving on to critical accounting estimates.

And then it comes back, again, to another concept of critical accounting estimates in the next section, and so forth and so on.

And so, I found that I could get really kind of muddled up in terms of what I'm talking about at any particular point in time, and whether or not this section of the meeting would actually be effective in terms of actually achieving a good communication.

What it seems to me that could be done to really significantly improve paragraphs 12 and 13 is to integrate them, so that there is a more natural flow between this concept of significant and critical as you organize it to have just one discussion on the topic, rather than having to go back and forth in terms of identification versus what the auditor thinks about them, and so forth and so on. That just might make for a little bit better of a flow.

And lastly, with respect to consultations outside of the engagement team, and for my size, we are a single office firm. Basically, I kind of am the national office. No disrespect to Mr. Ranzilla, of course. But --

(laughter)

And so, what we have on our publicly held engagements is we have an engagement partner. And we also have the engagement quality reviewer. And I am neither one of those. So I always consult on the financial statement side and review the filings.

So we have three partners that associated with our publicly held filings. And so, just as a matter of course, since we are all in one office, and we can easily find each other, I am consulted fairly frequently in terms of let's just talk it out. Have you ever seen this? I also have what I would call a consultation network, which is outside of the firm, that I also bounce things off, which is calling someone else and said have you experienced this before? And what would you do, which is more in what I would term educational rather than saying in the set of circumstances, what would you do?

And so, someone earlier had suggested that the -- it be written more in terms of the principle involved. What is it -- what issue is it that you really want to address here? What is it that the audit committee wants to know? And I would say what the audit committee probably really wants to know, whether -- which were the close calls, which were the tough call, which were the ones? And certain things about consultations are just going to emanate very naturally from such a discussion like that.

And so, one of the things that struck me in various places throughout the standards that sometimes, you know, the standard -- proposed standard is asking about the source of the issue, rather than the issue itself. And I would say if you wrote the principle to just address the issue itself, it might focus things a little bit more in the meeting. Thank you very much.

MS. RAND: Thank you. Linda Griggs?

MS. GRIGGS: Thank you, Jennifer. I just wanted to point out, I think those criteria in 12B are really consistent with the SEC's MDNA requirements for disclosures about critical accounting estimates. And given that I think critical accounting estimates are the most important thing for the financial statements, it doesn't offend me in one bit to have these identified in the standard as being very important items that should be addressed if either management has not addressed it, or there is something that the auditor wants to supplement.

I do agree with the points about the different outcomes. And unfortunately, the SEC has tried over the years to get good disclosures about what would happen if the assumptions used in critical accounting estimates were changed. How does it -- how would it differ? And by and large, those disclosures are pretty weak. And I don’t know whether this is an exercise that management typically goes through or not. I don’t know, I mean, in the first instance, it should be managing making a judgment as to whether it should be going through that exercise.

I agree that it shouldn’t be the auditor going through that exercise, but to the extent management didn’t go through that exercise as an audit committee member, you probably want to know why, and whether or not withstanding not having gone through the exercise. Everybody was comfortable with the judgment made. Thanks.

MS. RAND: Thanks, Linda. Don

Nicholaisen?

MR. NICHOLAISEN: I'd like to support Mike's comment, which I think other's have as well about the consultations and what's the reason for the consultation as opposed to trying to dictate something too finite.

I also say that from a slightly different perspective. And it may just be my own oddity, but I would be -- one of the things I always do want to know is who else did the auditor consult with? Because my expectation is that there would be broad consultation in areas that are difficult or complex. And that would take place. And it's sort of reaffirming to me to know that they bounced off their national office. They've also talked to some of the other firms. And they have a pretty good idea of what the key elements are that ought to be considered, and that they've thought about it, then they can give a reasoned professional judgment as to why our company is in a range of acceptability.

The other thing that I would comment on is that I think we're looking for those things that are really out of the mainstream. So if there’s an oddity in the accounts that were not where’d you’d expect it to be, that that conversation would take place as well, and that it wouldn’t just be so mechanical sounding. I don’t think that’s the intention here, but you could get there.

It’s not the mechanics. It’s the really living discussion of what took place, what was critical, and what wasn’t important, and what was thought about, and how do we go through those estimates?

The last point that I would make, and it may be outside the parameters of this document, but it troubles me that in financial reporting, in the public world, audited financial statements, that in things like we’ve lived through in subprime mortgages and other areas, there are incredibly different ranges of estimates for precisely the same characteristic securities that appear in financial statements all labeled fair value. And all receiving a clean audit opinion.

And same audit firm for I’m sure signs off many different values for the same security, depending upon what their client is.

And I think that denigrates the value of financial reporting. I think it causes people to be skeptical about what the process is, how it works, why the auditors don't have stronger views, how it gets articulated.

I certainly would want to know where our company falls in the range of what is acceptable to that particular firm

And also, within the industry, but I think so does the investor. But I think it's critically important that at some point, where we have this range of estimates that are out there, that there be sufficient guidance to the audit firms. And I think it has to come from the PCAOB as to what do you accept and what do you not accept? And how broad can that range actually be?

And I know in the early days in '08, that the ranges were just incredibly broad on what was accepted. And it's probably narrow it down now, but that's troubling to those who are trying to rely on financial information.

MS. RAND: Thanks, Don. Gary Kubureck?

MR. KUBURECK: Thanks, Jennifer. It -- in the interest of time, I'm going to limit my comments to only your fourth question about how to clarify what consultations are required to be brought to the attention of the audit committee. And I'll spend almost all the time on I'll call it management consultations as opposed to auditor consultations.

And some of this included in my comment letter, but I would repeat some of it as well, is that I would advise the board to be very careful on how you define who is an accountant that management might have a consultation with. I think it's a no brainer if it's in the form of someone who is a potential to be a new auditor, the opinion shopping type role. And I don't think anyone here would disagree with that.

But then as you start going down to -- there's other accounting firms out there. There's boutique firms that only do accounting research. They have no ability, no intent to practices and auditing CPA firm. Is that the type of accountant you have in mind.

So a company might decide it's cost effective to in effect outsource the really technical research is their view of cost and benefit and skills that are available to them.

I would submit, as long as the managing committee or the board sort of knew that's generally how finance was operating, or organized, I would that would probably be sufficient.

And your question 12 in the March release talked about non accounting firms such as consulting firms. And again I think in the ordinary sense, maybe not in every instance, but the ordinary sense, I wouldn't think those consultations would normally be advised, would not normally need to be advised to the audit committee.

Give you an example. Actuarial firms as you very well know, FAS 87 and 106. And the largest actuarial firms, I would submit, know it better than the national offices do. So that's their job to understand this thing. Likewise, I think the large law firms understand FAS 5 and range of possible outcomes in remote and regional probable litigation settlements and so on.

So I think that's all part of the management process of who you engage to help support your business. And I think there's other examples. There's valuation firms, who may or may not know FAS 157 very well, but they certainly presumably, if they're a proficient firm, understand how to value in some capacity the instrument in front of them.

So, again, I don't think that's something the audit committee would not normally need to hear about absent some significant problem in that area.

One thing I did wrestle with, it's not in my comment letter, is what do you do when you've got a firm on contract to you, who might have an independence issue, but you consult with? Might be best to explain by example. And we've got our independent accounting firm, but we've outsourced a large portion of our internal audit work to another big four firm. And we do routinely talk to them. We actually don't go to them for accounting advice, but it doesn’t mean those questions don’t come up from time to time, the context of an audit finding.

And we have another big four firm who does various go to market activities with us at the moment. So again, I would think in either of those cases, the go to market or the internal audit, they would have a significant independence issue today of which some of it might be able to resolve if I stop into work tomorrow. And some of it might need a block of time before they could potentially, you know, pick up the audit.

So, again, I’m not suggesting what the answer should be, Marty. I’m suggesting it should be addressed if -- otherwise could do an audit, but it’d block from independence reasons that may or not be curable.

And then, with respect to the auditor consultations, I’ll just make it very quickly, I think many of the people in the room have made the point. You really want to hear about the things the audit engagement team wrestled with and lost sleep over. And there’s a lot of routine stuff that goes on, including education amongst the staff members and so on.

And we as a multinational, we view it that we hired the firm. And all the firm's resources, in fact, would strongly encourage national office and other specialty consultations, but it doesn't necessarily immediately follow the audit committee needs to be advised every one of those, because a lot might be routine or ordinary course of business.

And again, you're back to you want to hear about the ones that the firm engagement partner lost sleep over. Thank you.

MS. RAND: Thanks, Gary. I had a just a -- just to make sure I was clear in your point, I think I am. The -- you were talking about management consultations with other accountants, which in paragraph 15 of the standard, I think. And you know, just so everybody's clear, we did not specifically ask that -- we weren't considering that to be included as part of this discussion. And certainly appreciate your views. But we didn't specifically tee that up in the roundtable specific question because we got pretty consistent feedback similar to the comments that were --

MR. KUBURECK: I'm sorry, that's the only place I saw consulting with outsiders in the document. And I just didn't read that closely. I'm sorry.

MS. RAND: Okay, very good. All right.

MR. BAUMAN: Can I just add one more comment. I -- what I've been hearing from a number of parties is it's the language that becomes a little tricky, whether it's the word significant or something else, many of the people around the table are saying they want to hear about that matter that's the close call that's being discussed with national office. And audit committee members want to hear that. They're trying to wrestle whether that all significant consultations on significant accounting matters equals that or not. And so, it's -- I think the important aspect for us to take away on that is, yes, a lot of people want to hear about those close calls. How we articulate what that is in this standard is the challenging thing. So thank you very much for those comments.

MS. RAND: Sam Ranzilla?

MR. RANZILLA: Well, I think that -- I want to make just a couple of points in this area. And I think this was a really opportunity that maybe could be lost of revisiting some of the terms that are used in here. I mean, Hal, I think your count was 24 significant and critical. I'm going to do this at the danger of having two former chief accountants at the SEC in the room, one really close.

(laughter)

But exactly what is the difference between a critical accounting policy and a critical accounting estimate? What is the difference between a critical accounting policy and a significant accounting policy?

And I will tell you having been involved with writing guidance for our people over the years, you know, people will get into debates for days about whether it's a significant accounting policy or a critical accounting estimate, and whether or not you fit into this bucket or that bucket with respect to a particular matter. And then, you know, most of the time, is it important? Yeah. Well, then just get on with it, right? And let's go ahead. It doesn't matter if it's A or it's B. It's important.

And I have struggled with this. I think critical accounting estimates, critical accounting policies have been added to the vernacular as a reaction to a situation. And I just wonder if we could, because I think we all agree, I shouldn't say that, I think some people agree that what paragraphs 12 and 13 really go to, however you structure them is where is an auditor? Did you devote the most significant amount of your time? And where at the end of the day did you, this is a very eloquent term, but did you go?

I say this is a close call. This -- there's a range. I'm not big on ranges, but there's a range with respect to a matter. I might have consulted outside the audit team. I might not have.

But what was the most significant

decisions that you made, and the ones with the most measurement uncertainty associated with it? I think that's what we think audit committees ought to know. And I just think we've cut and paste from a number of different places. And I just think maybe we've lost an opportunity. I think that includes a discussion with the SEC about some of their terms.

As it relates to -- I don't think you've asked this question, so a little value add. I'll tell you one of the things that does concern me about the standard is trying to apply paragraphs 12 and 13 four times a year on each interim period.

I mean, if you just pick out one critical accounting estimate, any significant change to assumptions. I don't know what's critical accounting estimate doesn't have a significant change in assumption?

At least quarterly, maybe not -- maybe actually more often than that. And I think on a quarterly basis, we could have toggled this thing way too tight in terms of compliance on a quarterly basis.

Last item, consultations and reporting. I think the standard as its written, I can implement it to make sense. The only thing I would caution you is for those that do have concerns, we shouldn't do anything in an auditing standard that will reduce people's comfort with consulting outside of their engagement team. Because I have read some comment letters that said, you know, we think this might cause people, because they don't want to communicate when they consult outside the team. They have discomfort with that, that it might reduce consultations.

I have never seen an issue that is benefited by reducing consultation within our firm. There's always limits to what makes sense. But at the end of the day, the more people you talk to, the more knowledgeable people you talk to about an issue, usually, you end up at a better place. And I wouldn't want to see us do anything whether -- I don't feel that concerned within my own firm that that would happen, but I read enough comment letters that I would make sure that that didn't occur in --

whether it’s smaller or different situated type firms. Thanks.

MR. NICHOLAISEN: Not responding as former Chief Accountant, but this -- the thing that as an audit committee member, that I am extremely interested in is does the auditor understand the issues? And did they deal with them? And did they reach a -- did they have the basis? Can they articulate the basis for their considered professional judgment as to the conclusion that they reached.

And so, while in a sense, you’re talking about that level of communication, the communication that I’m trying to understand is I want to be able to evaluate did this audit firm do the job that I’m expecting them to do? And have they covered the areas that I’m particularly interested in? And if the answer to that is no, then we’re back to, you know, it’s not a communications issue. It’s a matter of you got to go back and convince me. You’ve got to build that trust. That relationship really has to be there.

And a lot of that is hard to write in an auditing standard. And I know that the auditors may take offense at, you know, an attempt at communication as being at least one person's tool to use to understand did they get it? Did they -- are they doing the things that they really need to do?

And I just throw that in because I wanted to respond to Sam's point.

MS. RAND: Thank you. Roger Coffin?

MR. COFFIN: Thank you. When you look at over the past 25 years, what are the jobs of the board of directors, probably the first one is to select the CEO and the management team, and to make sure that the CEO and the management team have the proper ability to do their jobs.

And really, nothing in Godfrank (phonetic) or Sarbanes Oxley has supplanted that role. And so, when I look at, and it was discussed a little bit, but to come at it from the -- a perspective of a board member, this concept if management has not adequately communicated some of these disclosures, if I'm a board member, and I'm hearing that, reading this standard, I'm saying to myself, somewhere along the line, my auditing firm has made a judgment that my auditor has not done a good job of either disclosing or has not communicated in some way. And I think what that really get the point to is that I would almost be duty bound at that point to ask why as an audit committee member. Does management not have the appropriate tools, you know, do they not have the budget? Do they, you know, what are they missing? Why am I getting this from you when we all agree that these are good things to understand. And I need to know this to be informed. Upon what basis is your judgment made?

So I'm wondering if there could be some drafting or there could be, I don't know, maybe the way to put it almost like the gateway question into this is that the gateway question is, you know, does in the auditor's judgment, does management have the, you know, what I'd call the suite or the tools to be able to make all of these things? And it gets a little bit I think to what Don was walking about, the peer group, too, because that's another thing that I would like to know. You know, how are our -- how is this being made in relation to peer group estimates and so forth? So I guess that I think from a standpoint of oversight, you would want to know one, why this is happening in this context. And then, the broader question of are there any structural deficiencies in this process from the auditor’s perspective? Thank you.

MR. BAUMAN: Thanks, Roger. I wanted to go back to one thing that Sam raised before, if I may just to clarify a little bit for the rest of the group. And I’m sure Sam knows this. We were -- we tried to be relatively careful not to change the responsibilities of the auditor with respect to interim reporting and the responsibilities on quarterly reporting. But I guess your point is to the extent we changed some of the requirements here in this proposed standard, compared to existing AU 380, that makes the communication at interim some additional communications possibly.

But the context, though, is similar to what is in existing auditing standards today. The standard with respect to interim financial information deals with communications to audit committees. and the existing standard says that, you know, when conducting a review of interim financial information, the accountant should determine whether any of the matters described in existing AU 380 communications with audit committees relate to financial information that the audit committee needs to be aware of, such as how management formulated particularly sensitive accounting estimates, etcetera.

So the concept is still there in the existing interim review requirements by auditors, but I guess the point being that to the extent the requirements are more extensive here, it just makes the interim burden a little bigger. But there is a similar requirement today.

MS. RAND: Lynn Turner?

MR. TURNER: First on the consultation issue, I think Don’s comments I definitely reiterate, and he probably said it better than I could, but on the comments by Sam, I think it probably would be beneficial if you included a sentence or two in here that said something to the effect that the PCAOB does encourage consultation when appropriate.

And actually make a positive statement, because you certainly don’t want to reduce consultation at all.

I don’t think you want to limit, though, just to the national office. I can think of situations where I was chairing audit committees. And it was Bob’s firm. And we went to tax specialists. It was Sam’s firm and we went tax tax shares or valuation specialist.

And it was a good thing. I mean, it wasn’t a weakness in the audit partner. We were trying -- these firms turn around and tell you that they bring a firm to the table, not just an individual audit partner.

And so, when you reach out to other pieces in that firm, and you get that expertise, it would seem to me as an audit committee member you want to get informed about those situations. So having them come with that information to you is extremely helpful. So, again, I really echo what Don was saying in respect to that.

With respect to paragraph 12 and 13, in particular 12B, I'll reiterate and note that the counsel for institutional investors in their comment letter, they were -- there were three things or so that they actually commented on. This was one of them.

And they were extremely supportive, as am I, of the provisions in 12B. In fact, so much so that if someone told me as an audit committee member they aren't getting 12B I 2 through 4 there, I would serious questions about whether that audit committee member is actually doing their job.

Investors have said, and they've clamored more and more for this, because they haven't been able to get the information because the thing Linda teed up about the disclosures, that they want to know what the auditor thinks about where their numbers are coming out in the range.

And in fact, the existing auditing

standard on auditing estimates has a provision in it that says the auditor may very well actually have to do their own calculation of that number, and compare it to what management has done, and make an assessment about that. That's in the existing standard. We aren't creating new things. We aren't creating new costs. In fact, if people aren't doing that, it raised the question as to whether they're complying with GAAS.

And so, as Don said, again, where you have a wide range, and you've got a possibility of picking a number in that wide range, it's not to say that management's picked a wrong number, but investors do like to know where it is. And investors told us on the Treasury ACAP Committee we heard testimony from a number of them, that it's very important to them. We had to -- heard testimony from investors that they want to know what the investor or where the auditor came out o those estimates and what they thought.

Well, if they aren't even sharing that with the audit committee, who's supposed to be overseeing the process, I think very consistent with the council letter, there's something missing here. And there's a big disconnect, a huge disconnect between what investors think the audit committees are doing in their oversight and monitoring role and what is actually occurring.

And so, I think what you've got there is very consistent with the SEC rules. It's very consistent with what investors are asking for. I kind of share Sam's view about critical -- what do you call it, critical or significant, or you know, important. But that's water over the dam. The SEC's got a lot on their plate this year. And so, the possibility of going through that, it's probably, and it shouldn't be a priority to them.

So I think staying consistent with what they've got is probably the best thing you can do, short of just saying talk to us about dam important items.

So -- which I suppose if you did that way, then people would probably understand it.

MS. RAND: Thanks, Lynn. Bob Dohrer?

MR. DOHRER: Thanks, Jennifer, I can be fairly brief here, because actually, very much in line with Roger's earlier comments. And thank the staff for acknowledging perhaps some shortcomings in the drafting around management's responsibilities for some of these communications.

But perhaps to take it a step further, I think it would be very helpful -- nobody disagrees that the audit committee should be provided with any and all information that they need to discharge their oversight responsibilities. But to gloss over management responsibilities, I think is a problem. And I would ask the staff to consider embellishing around the importance of that management communication from a couple of different aspects.

One, not the least of which being is certainly is a deficiency in internal control over financial reporting that shouldn't be glossed over. But equally as important, I think the real value to the audit committee would be having management's perspective, and then the auditors' evaluation or the auditors perspective on these issues, such as what does critical mean and what is significant? And where are we going with those types of things?

And just to simply say that, you know, it’s the auditors’ responsibility to step in, if those communications aren’t made, don’t disagree with that, but really impacts in my mind anyway the effectiveness of how the audit committee can discharge their oversight responsibilities in the absence of management communication.

MS. RAND: Thanks, Bob. Arnie? I’ll let you have the last word.

MS. HANISH: Thanks, Jennifer. Just -- hopefully these won’t be redundant, but you know, I think that responsibility with regard to this 12B and I’ll go the little 4, again to reiterate that management has this responsibility. I think it’s important, however, for the audit committee to understand what decisions and what assumptions where there might have been close calls. And I think either Mike Cook or somebody alluded to that. I don’t recall who it was who made the statement, but I agree that the audit committees need to understand where there were close calls.

One of the things that concerns me as a member of management, however, is that are wide outcomes and wide ranges of outcomes with multiple assumptions. I would hope that if management do an adequate job of communicating changes in basic assumptions, whether it's been changes to the consistency of those assumptions, that the auditors would step in and disclose that appropriately. And that wouldn't trouble me if I as a member of management at least failed to communicate to my audit committee where there were significant changes.

One of the concerns I have is that where those changes, however, where you get into a disagreement, or a judgment factor with your auditors as to where those changes could result in different numbers, then it's a matter of a debate inside of an audit committee as to which number is better. These are management's financial statements. And in a estimate for a liability that could be an outcome which ranges anywhere from $50 to $100 million, you've chosen a number that you think is reasonable and accurate within a framework. What I think would be difficult would be to get into the dialogue within an audit committee discussion as to the distinction between why the auditors felt one number was better than the other, if the assumptions clearly were not wrong on either party.

But it was management's judgment to go one direction versus another. But that's one of the concerns that I have when I read 12B that you can find yourself potentially getting into that debate within an audit committee structure that may put the firm in an awkward position with not only the audit committee, but also with the auditors.

MS. RAND: Thanks, Arnie. Mike, it looks like you had -- you wanted to add something?

MR. COOK: And a suggestion having to do with this area of management responsibility and management communication versus the auditor's communication, just a -- something for you to think about is whether the term adequately is going to be sufficient. It's going to be understood. And whether it is clear here that if the auditor has a different view than management, even if management’s communication is complete, that that disclosure requirement would come into play. Just take a look at that.

And I was taken by Rogers comment that if the auditor is doing the communicating, because management hasn’t or whatever the reason might be, seems to me that ought to be brought to the attention of the audit committee specifically.

I’m talking to you about this because I’m required to do so, because somebody else didn’t. And leading to the question of well, why didn’t somebody else? And whether it’s a lack of competence, an unwillingness, whatever it might be, that’s a really important piece of information for an audit committee to have.

So as you focus on this redrafting as Marty referred to it, and I agree with it, about different responsibilities, if the auditor responsibility comes into play, because management has not carried out their responsibilities, there are implications to that that need to be communicated. I thought it was a very good point.

MR. BAUMAN: Thanks, Mike for that comment. One other point I'd just like to mention. The question was raised earlier during this discussion as to what critical and significant meant -- critical and significant to whom, to the investor, to the auditor, whatever. And I think the answer was in my view was given by Professor Cox that I agreed with. And that was these matters are significant or critical to an understanding of the fair presentation of the financial statements. And so they are critical to an understanding of the fair presentation of financial statements by the auditor, by whomever.

So I think that's the context of which I understand those words. And I just thought I'd share that I think that was the comment made by Professor Cox that I wanted to join in with that interpretation of significant and critical.

MALE SPEAKER: Might be worthwhile to add those words then.

MR. BAUMAN: With that, I think we're ready to take a break. And let's -- we were scheduled to break at 12:00 and get back at 1:00, but let's -- we're a little late on that, but let's still try to get back at 1:00. Thank you.

[break]

Afternoon Session

[1:05 p.m.]

MR. BAUMAN: Since we are about four topics behind, I was asked if we have a plan and the answer is yes. We're not going to divulge that plan yet but we have a plan which includes speaking very fast.

The first topic for this afternoon is a discussion of Two-Way Communications and a requirement that was added in the proposed standard that's not in the existing auditing standard for the auditor to evaluate the effectiveness of the two-way communications between the auditor and the audit committee.

Board Member Bill Gradison is going to make some introductory comments on this issue.

MR. GRADISON: Thank you very much. Just one personal comment and then I'll get right down to business.

I suppose as a regulator my job is to regulate but I have to say I'm troubled by the philosophy behind the staff proposal because there's nothing in this standard that an audit committee can't get now if they ask for it, nothing. It would suggest to me that maybe the challenge here is education. I mean, perhaps we could accomplish the goal by the issuance of an audit alert or something and then encourage the auditors to share the audit with members of the committees and get past some of these difficulties of definition but that's a personal thing. That's not why I was asked to start this thing off.

But I do get to vote on it, if I'm not replaced before we -- those comments in no way lessen the value of effective two-way communication and it's important in assisting the auditor and the audit committee in understanding significant matters, however you define them, related to the audit.

On matters of material misstatements or concerns about accounting and auditing matters, the discussion might contribute to audit quality. I have been struck by the discussion so far. I think I'm the first one to use the term "audit quality."

I may have missed something earlier, but since that's what we're in the business of encouraging, I think that might even be a significant observation.

The Board included a requirement in the proposed standard for the auditor to evaluate the adequacy of the two-way communication between the auditor and the audit committee to emphasize that effective two-way communications are beneficial to achieving the objectives of the audit.

I think it's kind of striking that our goal is effective two-way communications but we're going to do this without two-way evaluation. The evaluation of the audit committee is going to be made by the auditor but nothing is coming back the other way.

Now there's a reason for that because that's up to the SEC. That's not within our purview, but it has led me to think that since our role is limited to the auditor side and the SEC's very comprehensive role includes not only oversight and approval of whatever we do but also the role with regard to the issuer, the Board, the audit committee, I have wondered whether we would be better off in the long run, if this project moves forward, if it were done jointly with the SEC.

In other words, if they were moving something parallel that had to do with the responsibilities of the audit committee, for example, evaluating the communication from the audit committee's point of view which we can't do, at the same time we were doing it from the other direction.

In any event, the purpose of the upcoming discussion is to seek feedback from all of you regarding the importance of effective two-way communication and how or whether these requirements before us should be modified to support the objectives of the audit.

MR. BAUMAN: Thanks, Bill, and there was some questions in that regard in the briefing paper which pretty much went to what Bill has just said that is, how important is effective two-way communications to the audit committee's responsibility and the oversight of the audit.

If it is important, how can the

requirements in the proposed standard be modified to promote effective two-way communication? Additionally, considering that the PCAOB does not have oversight of audit committees, what other ways can the Board promote effective two-way communication without being able to impose requirements on the audit committee?

I should add that when we were thinking about proposing this as a standard, we had a discussion with our SAG and the SAG felt that promoting effective two-way communications was a very important part of any standard we might put out and so that was certainly in our thought processes as we issued this proposed standard.

Some of the other questions are how could the requirement for the auditor's evaluation of whether the communications with the audit committee have been adequate be modified to support the objectives of the audit and, finally, which came up in some of the comments, should the auditor's evaluation of effective two-way communications be expanded to include an evaluation of the communications between management and the audit committee?

Bob Kueppers, I think you want to begin the discussion here.

MR. KUEPPERS: Yes. Thanks, Marty, and I don't want to alarm the group, but I've actually been thinking about this.

You know, let me just remind you quickly what Paragraphs 26 through 28 require and it's under the rubric of adequacy of two-way communications, as we just teed up, but as you go through it, to Board Member Gradison's point, this is really a one-way evaluation. It does not require any, you know, evaluation of the audit committee of how well the auditor is communicating.

So it leads me to believe that the entirety of it will rest on the auditor's perception of whether they're getting information they need to complete the objectives of their audit, of their examination, and if you take it the full distance, through Paragraph 28, it goes to, okay, what happens if the communications have not been adequate and it tees up a couple possibilities: communicating with the full board, perhaps a scope limitation in your opinion, or, you know, the ultimate vote with your feet, withdrawing from the engagement.

As I look at this and just take the construction of those paragraphs and forget the title for a minute, this actually works pretty well if you change it to say consequences on the engagement of inadequate audit committee communication. In other words, what is an auditor to do if they're not getting the engagement they need from the audit committee? Either they're unwilling to talk about fraud risk, they're withholding information that you somehow through your corroboration find out was an issue that they were aware of. All of these things would be very concerning to an auditor.

If that were -- I know that's not your objective in the standard, Marty, but if that were the title of the section and you did a little tweaking, it would all make sense to me. You know, these are the kinds of things you'd look at. If you become aware that you're not receiving adequate communication from your client, from the audit committee, there are consequences of that, and these are the steps you might take.

And the first one, while it's viewed as an option or should consider, to me would be mandatory as it would if I were having difficulty with management, is to communicate with the full board, that that shouldn't be -- I mean that's -- to me, that's step number 1. If the audit committee's not working with you, the next place I go is the full board. If management wasn't working with us, the first place I'd go is the audit committee and I don't think that should -- I think that's absolutely necessary.

Now, where it goes from there could ultimately determine whether you ever get to an opinion, whether you have to modify your opinion or hopefully you would resolve the issue.

My point is, as I look through all the comments from some analyses I saw, you know, investor comment letters, auditors, corporate governance folks, folks on boards, I really didn't see any group that embraced this as a meaningful additional element, but it might be helpful from an auditor's standpoint again if there was some specificity about consequences once you concluded -- you might have some indicia of inadequate communications and say if you conclude they're not adequate, then these are the things you either must do or should consider.

So as I looked at this, it struck me that this really had little to do about two-way communications and the most important thing is what's the end of the story on my engagement if there's this problem?

MR. BAUMAN: Thank you, Bob. Karen Hastie Williams.

MS. WILLIAMS: Thank you. It's important for the Board to make an evaluation about a particular issue. You're hearing one perspective from the person making the presentation but do you see other issues and do you want some feedback from other parts of the corporation, the company that you're dealing with, and I think that's something that audit committees should feel open to raise issues and to get as much information as they can and whether it comes from the external auditor or internal auditor, I think that the issue is you want your board to have as much information as they can absorb with respect to an issue.

And I agree with you, that if you're not getting cooperation from particular individuals or officers in the company, then you go to the CEO and say, look, this is important to us, we need to get this information. So I think that's the way that I would interpret that.

MR. BAUMAN: I'm sorry. Linda Griggs.

MS. GRIGGS: Thank you. I find this part of the standard very confusing. The release talks about the promotion of effective two-way communications as a goal but then Paragraph 3 tees up this evaluation of the audit committee and I'm confused about how this effectiveness of the audit committee two-way communication relates to internal control of financial reporting.

There's a very effective mechanism, it seems to me, for the evaluation of the audit committee's oversight, or the board when there's no audit committee, through the audit of ICFR.

Now, I recognize with Dodd-Frank, we've got a slightly different issue there and I don't know, I haven't thought through how it would affect small businesses, but it does seem to me that the mechanism now in place to evaluate oversight is an appropriate one.

If in fact there's a concern about the effectiveness of two-way communications, does that mean that there is a material weakness in internal control of financial reporting? If so, I'd like to see AS-5 revised. I think AS-5 should provide the guidance.

If in fact we now think that rather than the audit committee's role being incidental, which is the way Auditing Standard 380 talks about the audit communications as being incidental to the audit, we now think these two-way communications are critical, then I think we need to be a little bit clearer about that in the standard.

I think the standard should be to promote effective two-way communications. I agree completely with Bob. If there is a problem with those communications, the auditor needs to go immediately, as soon as he discovers the problem, to the board of directors.

If the board of directors doesn't do something, then I think, you know, the consequences are you've got ineffective internal control because clearly there is not an oversight mechanism to the financial reporting process and then maybe the auditor needs to resign because they can't be comfortable that they can even conduct an audit.

But I think the consequences -- I think that the consequences laid out in Paragraph 28 are really not the focus that the standard should have. I think the standard should be focused on promoting this communication and if there's a problem have a discussion and maybe actually I was wrong.

Maybe the first discussion is the auditor sits down with the audit committee and says, look, we don't think we're really getting this free flow of discussion. We think that's the best way to assure that the financial reporting process works first. So that's really the first step.

If that doesn't work, then you go to the board. If that doesn't work, all right, then there isn't effective oversight, it seems to me, but I do think we need to somehow integrate AS-5 with this standard, if you're going to leave the effectiveness in here, because I just think it's very confusing.

If this yet another standard or is this the same as AS-5? Thanks.

MR. BAUMAN: Thanks, Linda, for those comments.

Let me just make a brief comment and then I'll pass it on to Barbara.

I think your points are good ones and raise interesting challenges for us as we look at the standard. I think, as I said in my opening comments, it clearly was a strong point from our Standing Advisory Group that this standard promote effective two-way communications.

So an interesting comment. I'll be glad to be trying to -- I hope to hear from others, would be are there other ways in which this standard might be able to promote effective two-way communications, other than the manner in which we've done it in the standard so far. So I'll be interested in further comments in that regard.

Barbara, maybe you could just comment very briefly on the intersection between this and AS-5.

MS. VANICH: Sure. Thank you, Marty. Yes. Just to follow up, I guess in the staff's view, this requirement is more narrow than the assessment of the control environment that the auditor would do as part of an integrated audit in AS-5.

The standard does refer the auditor back to AS-5 if the auditor were to determine that the communications haven't been adequate. For this standard, it's really just a part of your overall assessment in AS-5.

Just a couple other points to note. This standard would apply to all audits, whether they would be integrated audits or audits of smaller issuers that would not be subject to AS-5. So this really, I think, is not anywhere near the full scope, the scope of AS-5.

MR. BAUMAN: Thanks, Barbara. George Munoz.

MR. MUNOZ: Thanks, Marty. In terms of another alternative, I would say that, first of all, promoting two-way communication is crucially important. So another way is to simply, if you want to put a standard on the auditors, simply require the auditors to request an executive session at the audit committee, period, and in that executive session, then the auditors should do all of the best practices, all of the kinds of things that are important because in that way that's the only time that -- that's one way that the auditor can force issues, bring up issues and see the reaction and the like, instead of this other way, which I think is more complicated.

So let me address a few things that are on this communication, but before I do, I don't get many opportunities to speak to the PCAOB. So let me expand on this opportunity.

I actually look at PCAOB as a very good check mechanism for the audit committees; that is, if the audit committees know that somebody's auditing the auditors, that is, that the auditors are meeting high levels of certification, qualification, training, education, that there's competition in the profession, that there's more people in the pipeline, that the schools are teaching the right things, that's great for the audit committee. Somebody's doing -- somebody's taking care of that.

We know it's not the SEC. We know it's not the Congress. We know it's not everything else, but the PCAOB to me is a wonderful opportunity. So I have -- the reason why this is relevant is because I have to gauge the priorities and importance of what's before us against what I and from the audit committee would look to.

For example, IFRS, the position that PCAOB -- it has to speak up on IFRS. It has to, because that is going to affect how audits are done and what is looked for and the like and therefore to me that's a higher priority. I'm not saying you're not, but I'm just saying I would hope that this kind of conference is held on that.

On competition, there's only four major companies. I would love to have the PCAOB speak to is there enough competition in there so that we have more auditors to work with. Are they prepared? Are they well-trained? Are the colleges teaching what they're doing?

So in that context, as I look at this rule, I say, all right, so now we're putting a standard out there. Is this the kind of thing that I expect the PCAOB to give some precedence to?

I look at Item Number 10 in Communications, which is -- let me get to it. 10 says, "The auditor should communicate the following matters to the audit committee." That means I'm going to have to put it on the agenda or it's going to take up time and here's Item Number A, "The auditor's determination of whether persons with specialized skill or knowledge are needed for the audit."

Well, of course, I would hope that the auditor is always going to use a special skills, special person, but he doesn't have to take up the audit committee's agenda time to tell us that he's going to call on some special skill. He's got -- we look to the auditor to do that.

The second item is, and this is on the agenda again, "The auditor's consideration of and planned use of the company's internal audit function." That's a judgment call. You know, these are things that now the PCAOB's requiring that there be communication on. So is that the two-way communication? I'm sorry, but it doesn't rise to the level of importance for what that audit committee's fiduciary responsibility is.

I go to Item Number 15 and it says, "Management consultations with other accountants. When the auditor is aware that management consulted with other accountants about auditing or accounting matters, accounting matters is a lot, the auditor should communicate to the audit committee his or her views about significant matters that were the subject of such consultation."

Why? I don't see the relevance, unless the auditor thinks that a particular discussion may be of relevance, but this requires that they do it pretty much regardless of whatever they consider to be significant. So if these were not requirements but, rather, considerations, I would be supportive of it.

So then I go to your question, which is 26. So in Paragraph 26, it requires that somehow the auditor evaluate this two-way communication and that evaluation is going to be in writing, it's going to be the like, and it's almost like the audit committee's the one who's hiring, if you will, engaging the auditor and yet the auditor's going to "report on" the audit committee.

I wonder what -- how that plays in people's minds because that auditor's going to do -- be writing some report card, if you will, and I don't know if that's the way it should be. I'd like the audit committee to be writing the report card on the auditor and I'm not sure that it should work the other way around. Not to say that that's not relevant.

So I would say that I would substitute all this with one standard that says auditors in any case where any of these things exist should request an executive session with the audit committee and speak to that issue.

MR. BAUMAN: Thanks, George. Don Nicolaisen.

MR. NICOLAISEN: I think when you get to the area of effective communication, it's a tough area. I think of the businessman who wants a one-page memorandum that cuts to the chase of what's important, what are the decision points, what do we need to deal with. I think of the general that gave a 28-page memo to his superior that had a covering comment that said I'm sorry this memo is 28 pages, I didn't have time to reduce it to one.

What we've been talking about today is very complicated communications from the auditor to the audit committee that goes on for pages and pages and pages. Typically of the ones that I see, they're 50 to 100 pages. Not all of that is of equal importance. Not all of it, I would think of as conveyance of communications or effective communications, and so I think part of the problem starts there of how do you have effective communication and if one of the requirements is a bookload of information that gets dumped on the audit committee with a view that that's the communication from the auditor, now it's the communication back from the audit committee something that can be effectively evaluated.

I watch my son and his buddies will come over. One of them will look up, three of them will grunt and they'll all go because they know exactly what they're going to do. I see my son talk to his girlfriend for hours and then I see his girlfriend come to mom and say I'm not sure we're communicating.

And so what is effective communication? How do you get there and how do you measure it and if you're asking this party that writes 50-page documents is the communication from the other side effective, I'm not sure they're the right people to be asking that question and then you get into, well, should we have somebody who's actually a moderator who can help the audit committee talk to the auditor, and I don't think we want to go there.

So my view is pretty much I think what I've heard others express. Effective communication is necessary, it's desirable, should be encouraged, but I don't think you can write rules that say if you do this, this, and this, you've had effective communication because I think you can still fail miserably.

MR. BAUMAN: Thanks, Don. Mike Cook.

MR. COOK: Marty, thank you. Maybe a little bit along the lines of what Don was suggesting but then I have a question, also, at the end.

I'm kind of the same place. I could see putting a requirement in place for the auditors to obtain an evaluation of their effectiveness as communicators from the audit committee. I don't quite understand why we would empower and through a standard require auditors to evaluate the effectiveness of somebody else communicating with them in the ordinary sense.

I can understand if there's a breakdown, you need to talk to people and you need to have open dialogue and I'm all in favor of promoting communication. It'd be un-American not to be in favor of promoting communication, but if the burden is on anybody here, we ought to put the burden on the firm to obtain an evaluation of its effectiveness, not the other way around, and I think this is just ass backward, excuse the French, and, I mean, and I don't think it's going to be effective and it's another requirement added on top of others that I don't think is going to stimulate better things but it will certainly take more time, more cost, and I don't know what you get at the end of the day.

I did have one question, however. What we have here all seems to be talking about communication in a non-litigious/non-threatened environment and that is the way the world should be 98 percent of the time, but when you get into special investigations and matters of that type, you get into some very tricky issues, of privilege issues, of timing, of public disclosure, and there are times when it's appropriate for there to be two-way communication and there are other times when people are not free to have two-way communications in advance of other things taking place.

I don't know if you can make that distinction if you choose to retain this notion, but somewhere it ought to say that these broad and general rules about evaluating communication and if you don't get back what you want, you do what Bob Kueppers said you're going to do, you think about whether you have to quit and all those kind of things.

Some of those rules don't work well in a special investigation-type situation where the audit committee is working with outside counsel and there's counsel engaged for the audit committee itself, not for the company, not for other people, and not for the purpose of informing the auditors, and the audit committee understands you've got to keep them informed. You can't shut them out, but you don't just invite them in to these highly-private sessions prematurely and so I don't know if you can make that distinction.

But somewhere this can't be just a general rule that says Bob Kueppers should come visit me in the midst of a special investigation and tell me he wants to know everything that's going on because that doesn't work and Bob would be -- having been involved in a number of them, he'd be the first one to recognize it.

MR. BAUMAN: Thanks for those clear and unambiguous comments, Mike.

Next, we have Alex Mandl.

MR. MANDL: Well, ditto to Mike, frankly. Took the words right out of my mouth.

I think it is backwards, candidly. I mean, we talked about the three-legged stool earlier and the balance of that and the necessary balance of the three-legged stool, and I think this would actually, you know, throw it off balance, would offset that balance in a way that could actually impair or impede the communications that are so important and I fully agree.

I mean, communications between those two groups are critical and if they don't go well, you know, something has to happen. There's no doubt about that. You know, the governance committee can get involved if something doesn't go right. I mean, there are some other means but to have the authority for the auditor to give a report on the audit committee which has implications, you know, of various kinds, I think, throws the whole system out of balance and is -- I would urge us not to do that.

MR. BAUMAN: There is a number of other cards up, but I would want to ask a question. Maybe Bob Kueppers or Sam possibly could add some insight into this. If you can't, then I'll continue with the rest of the cards.

But this is a requirement in the International Standards on Auditing under the IAASB, Communications with audit committees has this same requirement.

I'm wondering. Can you shed any light as to whether this is working in any effective way on audits outside U.S. jurisdictions where this requirement exists already or not?

MR. KUEPPERS: This clearly is a Sam Ranzilla question.

MR. RANZILLA: I don't have an answer to either of those.

I have not -- Marty, I will couch this with it's a question I did not ask in either preparing -- helping our guys prepare a response or preparing for today.

I have not heard any noise out of the system that would lead me to believe that this has been a significant issue. You know, I think it's important to recognize -- well, I don't dispute any -- quite frankly, I don't feel real strongly on this particular, whether it's in or it's out, because auditors already today are required under AS-5 to consider the effectiveness of an audit committee and its assessment as to whether or not internal controls are effective.

This is just one slice of the effectiveness of an audit committee but already that system exists where an auditor is making an assessment and, quite frankly, when AS-2 came out, you know, we had some chuckles thinking that's going to work really well. Those are going to be some interesting conversations if you determine the only material weakness your client has are the people you're delivering that message to.

So I -- and again, I don't think that has been an impediment to effective communication and again we believe audit committees are really important in the conduct of our audits and I don't think that's gotten in the way of it.

So I'd be happy to get back with you with an answer. Unfortunately, I won't be able to share it with everybody, but I'd be happy to follow up on that, if you'd like.

MR. BAUMAN: Thank you very much for that. Because again, like in other aspects of this, trying to get further information about how it's working elsewhere or what are the things that are working is always useful to know.

But as you point out, very appropriately, AS-5 does require the auditor to evaluate the audit committee internationally with internal controls of financial reporting and this is, if you will, an element, an element of that.

Bob Dohrer.

MR. DOHRER: It just strikes me, as we're having this discussion, that perhaps evaluating effectiveness of two-way communication really is somewhat of a fancy way of asking for two separate evaluations.

It seems to me that the audit committee needs to evaluate whether or not they are receiving the information they need from the auditors and I don't think there's much argument about that.

At the same time as an auditor, I don't think it's inappropriate for an evaluation to be made of whether the audit committee is responsive and provides the auditor information that may be relevant to the conduct of the audit going forward.

I'm not sure that's all wrapped up in something we can call effective two-way communication, but perhaps if there was more of a spin to it of both parties need to evaluate whether or not the information required to discharge their individual responsibilities are being obtained, that information is being obtained throughout the engagement, would be a better way to go about it.

For example, in Mike's situation with the ongoing special investigation, you know, one could argue that if Mike responded that he couldn't discuss something that we had not had effective two-way communication, but I think what's more relevant is that the auditor understand the ramifications to the conduct of the audit and the outcome from Mike being in the position that he is at that current time as an audit committee member.

So I wonder if there's a way that we could accomplish, I think, what we're all aiming to get at here, without trying to wrap it around something that's as nebulous as sons talking to girlfriends and trying to evaluate whether communication has been effective or not.

MR. BAUMAN: Thank you. There is two more cards up and as part of our grand plan to get back on schedule, if we can limit the discussion on this particular question to the two cards that are up. Joan Waggoner and then finally Lynn Turner. Thanks.

MS. WAGGONER: Thanks very much, Marty. I think in terms of our practice and the smaller company practice, the issue really kind of drills down what would be on our big wish list here. Our big wish list basically is does -- to understand or to have the audit committee understand is do they feel that it is their responsibility, if they become aware of something that affects financial reporting or the internal controls of financial report, that they have an obligation to share that with the external auditors, and in my view, I think they do.

I think most people would agree that they do. I don't know that all audit committees feel that way, especially in the smaller companies. So that is my big focus in terms of evaluating two-way communication, the one big thing that I would like to see a bit more solidly placed in terms of a communication between the audit committee and the external auditor.

Thank you.

MR. BAUMAN: Good. Thanks. And Lynn.

MR. TURNER: Marty, I think the correct term for this is an upward evaluation and companies, like General Electric, have used upward evaluations for years very successfully.

I have twice on audit companies of public entities used an evaluation where we not only evaluated the auditor but we actually had the auditor do a formal evaluation of the audit committee and at the start of the audit each year, everyone knew that we'd be evaluating them and we also told them they'd be evaluating us. So we asked them to take a look at what we're doing and if we weren't doing things right or could do it better, we'd want to know about that and the evaluation provided them an opportunity to do that.

In both those instances, it actually had a very significant positive impact on the communication between the two sides and actually probably impacted the timing of that communication and brought some of it forward, if you will. So I've found from my experience where we've actually done these type of evaluations, it has been very positive.

I also think that an auditor -- the audit committee just plays a phenomenally important role in the financial reporting process. There's just no question about that, no denying that, and with that, the audit committee oversees not just the auditor but that audit committee oversees the internal auditors, oversees the financial management that we've all talked about, and is a critical, very important control here, and if you're an auditor, I look at these four questions and the actual standard says the auditor's just going to evaluate, but it doesn't say you're going to issue any type of special reports.

So all it does is say the auditor's going to go evaluate that extremely important piece of the overall control and it's not just to deal with the audit but it's to deal with some other very significant parts of the financial reporting process and I looked through the four questions: appropriateness and timeliness of actions taken by this very important audit committee, the openness of it to communicate with auditor.

I mean, the audit committee will not communicate with them. I as an auditor probably have some grave concerns. The willingness and capacity of the audit committee to meet with them in executive session. If they won't do that, there's got to be a problem.

These are very plain Jane, very simple, basic things that are not that difficult, and the fourth question, the extent to which the audit committee probes issues raised by the auditor. You know, as an investor, I certainly hope the audit committees are doing that. If not, we're probably wasting some of our money on those board of director fees.

So there are very simple things and it

just says the auditor's going to go through and evaluate those things and come to a conclusion about where that very significant control is working adequately or not and so to say there's an issue with that, I think, tells you just from a common sense perspective we're missing something in the system and if we're so worried as audit committee members about the auditor looking at those things, then there's probably a bigger issue here that we don't have on the table.

So I think what's here is fine. I've done it before and it's worked well and, if anything, it enhanced and brought the communications to an earlier stage and was very beneficial for us on the audit committee and I think benefited the auditor, as well.

So I think it's very, very solid, very simple, very easy thing to do, and something as an auditor I can't comprehend how you wouldn't do it anyway.

MR. SCHROEDER: Did you do it more than one year or is it just the one year deal?

MR. TURNER: Yeah. The way we actually started this out, the first time I did it was when I was a CFO and to Don's question, I wanted to find out if the auditor thought this was really a good audit to work on. So I required that the auditor, including the staff that actually had to work on the audit, the junior staff even, to fill out an evaluation and you never know. You know, when you do that, you're sitting here going to myself, I'll just get the bejesus beat out of me or not, but if it was, I wanted to know, and I figured it was better to manage the issue and know about it, if there was one, rather than not know it.

So we did it for several years as the CFO and then on the audit committee, yes, we did it each year then. It just became part of the evaluation process and after the first year, what I found was that butterfly feeling in your stomach about how it's going to turn out, after the first year and I did have those concerns, it always went away. It just -- the communication just became very natural. You know, it just -- no one gave it a second thought after that. It just became part of what you did.

MR. BAUMAN: Thanks, Lynn. One more comment.

MR. NICOLAISEN: I just wanted to ask one question. At least the audit committees that I'm on, there's a client satisfaction process that goes both ways which is maybe not as direct as this, but it is more comprehensive, deals with all the issues and hence the surface things, and there's no mention of that any place. Is that -- I just wouldn't -- if you have a process that works and it's effective, I'm not sure that you need to introduce another one and at least if that's done comprehensively, you might want to at least in here, if you decide to go ahead with the requirement, that you acknowledge there may be other ways to accomplish the same objective.

MR. BAUMAN: Thank you very much.

MR. MANDL: The only point was there ought to be some mutuality on how this process works and I guess what you're describing is a mutual process.

What this says, at least the way I read it, this is a one-way process and that was my main concern with the whole issue and I'll stop there.

MR. BAUMAN: Thank you very much. I appreciate it. A lot of very constructive input on an interesting topic that was introduced into this standard that was not an existing standard. So thank you for all of the good feedback.

Another topic where we had a lot of comments again was whether communications should be written or oral and again this was led by a lot of discussions at our SAG meeting, again with some very strong views from our SAG members about this topic.

So, Jennifer, why don't I turn this to you?

MS. RAND: Yes. Thank you, Marty. Actually, I'm going to turn it over to Dan Goelzer, who's agreed to provide some opening remarks.

MR. GOELZER: Okay. Thanks, Jennifer. Like the existing standards, the Board's proposal would allow the auditor, with a few exceptions, to choose between written or oral communication of the information that he or she is required to communicate to the audit committee and, as Jennifer suggested, we did ask for comment on whether that was the appropriate approach.

Views were quite sharply split. While there were exceptions, I would say that, in general, auditors favored the idea of continuing our flexibility to choose between written or oral communication.

On the other hand, audit committees and investors tended to support the idea that the required communications should be in writing.

The proponents of written communication argue that writing provides a record that permits committee members to refer back to what was communicated and avoids the risk of future disputes or misunderstanding. Writing, we were told, is also a more effective way to communicate complex information about topics like critical accounting estimates. Moreover, people pointed out that written communication is more efficient since committee members can consider the information at any time and then use their time at committee members with the auditor to ask questions.

In contrast, those who urged flexibility pointed out that a choice between written and oral communication allows the auditor to determine what's going to work best, based on the facts and circumstances and will best lead to open communication.

In some cases, oral communication may also be more consistent with candor and oral communication minimizes the risk that points will simply be communicated as boilerplate in writing.

So we're hoping that the roundtable will give us some insight into how we ought to resolve this split in views. I would point out that all communications that are required would have to be memorialized in the workpapers, so there would be a record of what was communicated from a workpaper perspective, but beyond that, whether the communications themselves should be written or oral, appreciate your views on what would be most effective.

Thank you.

MS. RAND: Thanks, Dan. We have three discussion questions here and these questions are intended to probe further in trying to get behind the reasons. You know, if you think it should be in writing, what are those reasons? Or orally, if it's made orally, then, you know, what are the reasons to continue with that?

So let me go through the questions and we'll get into the discussion.

First one is should all matters be communicated by the auditor to the audit committee be in writing or only certain matters? If only certain matters should be communicated to the audit committee in writing, what are those matters? And the last one, what are the risks of allowing some of the communications to be made orally?

So if you're in the camp that you believe all communications should be in writing, why do you have that? What risks do you perceive would be out there if some of them are made orally?

Next question. So if the standard

required all communications to be in writing, should the auditor document oral discussions that relate to such written communications?

So we've heard today about robust dialogue and open discussions. If you're someone that believes everything should be in writing, then what's your view on those open robust dialogues? Does that mean that the auditor should go back and document exactly what was said in those oral discussions? Is that what you're intending, as well, if you believe everything should be in writing?

Next question. If all required communications to the audit committee were required to be in writing, would there be any effect on the dialogue between the auditor and the audit committee? Would the dialogue on key matters continue to be robust? In other words, would those discussions still be open and frank or would there be some concern if I've got to document everything, then, you know, you might not want to have -- you know, pass along something that you think is a harsh evaluation but -- for fear because it's in writing or how that might be interpreted.

So would there be any effect? Would it chill, if you will, some of the conversations if everything you said needed to be in writing?

I've asked Don Nicolaisen to provide some opening views to open up the discussion and then we'll open it up to everyone.

So Don.

MR. NICOLAISEN: Great. I think the issues have been well described, Mr. Chairman. Thank you for your comments. I'm somewhat indifferent whether the communication is in oral form or writing for the most part, but when you come to a standard that requires all significant communication to be documented and part of it is shared, documented to me means you've written it and so if you've written it down and you share only a portion of that written piece with the audit committee, and then another portion is maintained somewhere else and the audit committee is not aware that those things were considered significant by the auditor because they were communicated in a different format and perhaps the writing was different than the actual discussion took place, I could imagine situations where certain people are tepid about raising difficult issues but they're not hesitant to put in a memo that I raised it and I discussed it, even though it might have been very cryptic in its explanation.

And so that's my primary concern with this and I'll leave it with that.

MS. RAND: Thank you, Don. I don't see any other tent cards, but we did get significant views.

Here's Linda. Linda Griggs.

MS. GRIGGS: I just had a question. I mean, what are you contemplating, PCAOB, would need to then be documented in the workpapers?

I guess I need to understand what the purpose for that documentation is and would that have to be very extensive or is it just we had a discussion about, you know, the CFO's transgressions and that would be it? I mean, how detailed would that then have to be?

What the standard says is it's to enable an experienced auditor to understand that communications were made to comply with the provisions of the standard.

Well, it might be enough to just say we had this very difficult discussion, but if it has to get into the details, then I guess I'm with Don. I'd want to know what those details were. If it's going to be written down, it seems to me that's something the audit committee should be aware of.

MR. BAUMAN: Well, I'll take a shot at responding to that.

Again, we had lengthy discussions at the SAG meeting and many of the SAG representatives thought that requiring all communications to be in writing would stifle some of the natural dialogue that takes place among the auditor and the audit committee and so in drafting this, we decided to permit the matters to be communicated either in writing or orally.

However, we felt that certainly from an

inspection perspective, if nothing else, if the communications were made orally, we would have no idea whether or not the communications were made or what they might be and so we established a requirement that if they are made orally, they would at least have to be documented to the extent that somebody, an experienced auditor, having no previous connection with the engagement, could understand the communications in sufficient detail to know essentially what would be communicated if the required communications were made in writing.

So, in essence, it would be they could be made in writing or, for one reason or another, if the committee and the auditor decided that some of the communications would be made orally, that we at least felt that the substance and the importance of that still needed to be documented in the auditor's workpapers such that we could understand that the objectives of this standard were met by being able to read that documentation.

I understand the point that Don's raising is, well, then I as an audit committee member, if you didn't send me the written report, well, then maybe send me the memorandum that went to your files because I might not agree with how you characterized them that I think is the issue here.

MS. GRIGGS: If I could also add, I think when we were drafting that language, we were also considering the fact that the engagement quality reviewer needs to be able to determine that the engagement team has complied with the standard and these are matters that are very important for that reviewer maybe to be aware of, also.

MS. RAND: Well, and I also just want to point out that the way our standard is drafted now about if it's made orally, then you document in your workpapers, that exists in the standard today. So that isn't a new concept that we would be adding. The auditors have that today.

MR. BAUMAN: Lisa Gaynor.

MS. GAYNOR: A few years ago, I took part in this research synthesis team and we were asked to address this very issue as to these questions and looked to the academic literature to see what had been done and what we had discovered is nothing had been done in this area, specifically in accounting and auditing.

However, we did make the statement that in communication and there's called communication richness theory and here we keep talking about oral versus written and we've heard throughout this morning that there's so much information that's put in writing, the reports are 50 to 100 pages, that clearly we don't want to add more written information just so it's documented.

But if you go to theory, theory would say that we should be talking not necessarily about oral versus written but about the richness of a communication versus the leanness of the communication.

So you've got the distinction here maybe between effectiveness and the efficiency of a communication. More complex -- I mean, it's pretty simple. More complex thoughts and messages should be in a richer format and a richer format isn't necessarily -- it's usually face to face where you can see expressions.

As you were saying, as Don was saying, you have -- we discussed during a meeting and then they go to -- and they kind of just like skirted the issue in the meeting, but then they get into the documentation stage and so a rich format would include both a face to face or an oral, if that's how you choose to call it, as well as a written format, as well, or just even including the face to face. It's not even just oral because you get into looking at people and seeing expressions and making your own intuitions from there.

So more complex, more rich, less complex, leaner. Thank you.

MR. BAUMAN: Thanks, Lisa. Lynn Turner.

MR. TURNER: Marty, on the committees I've sat on, we have asked auditors to give it to us in writing and they've used graphs or it's taken various forms, whatever worked best for everyone involved. So I think you've got to give flexibility to that. Some of this can be graphed better than it can in just a written word.

So I'm a big fan of putting it in writing. I get very nervous about the point that Don raised about something sitting in the audit workpapers about me as the audit committee that I've never seen before that talks about what they were telling me in a conversation.

There's just something about that I don't like and so I'm a strong supporter of having it in writing. The Blue Ribbon Panel Committee on Audit Committees recommended this type of stuff be in writing.

There was actually some language in it that I think is very good that I'd suggest you consider. It says, "This requirement should be written in a way to encourage open frank discussion and to avoid boilerplate."

I think having a sentence in there like that, even if you leave it optional, is very good to put that in there because I think that's what you're trying to get at.

MR. BAUMAN: Thanks, Lynn. If I can follow up, so if all the communications are in writing and as you know, of course, then there's a robust dialogue and oftentimes there's further inquiry by the audit committee about what the auditor meant by something that he or she put into writing and if there's additional obviously explanations by the auditor about the matters during the committee meeting, would you expect then that those matters would also be then documented in writing and further shared with the audit committee or not?

MR. TURNER: Oh, I can think most recently of a conversation about what the auditor documented on the quality of the accounting practices, the very key critical accounting policies and where they set the line and in that particular case, there was one audit committee member disagreed with the auditor's assessment and at the following meeting there was follow-up by the auditor on that particular point.

So, you know, I think it depends upon what the particular situation is as to what goes with it. I think some of Denny's comments are very relevant in this area. I don't think you want to get a 100-

page document necessarily here. I think you want to get a document that really focuses on the key things and again I think a lot of your questions, a lot of your points are very key things. So I think they'll flow.

But you don't want to have it turning into a CYA document. You want to have it turned into a real dialogue between the audit committee and the auditor and then if there's things that are set up for follow-up, then so be it.

In that particular board, we had a standard process for if something was -- like that got teed up, we would note it in the section of the audit committee minutes or the board minutes, note for follow-up, and the first thing we did at the next board meeting or audit committee meeting was always take on the follow-up items because they're the things that people tend to forget about and drop through a hole. So we had a process for doing that. So we got back to them.

MR. BAUMAN: Thanks very much. Gary Kubureck.

MR. KUBURECK: Thanks, Marty. I'm going to sort of share some thoughts that were in my comment letter but also reading many of the comment letters here, I think, generally consistent with the preparers of the audit committee members here.

I think as a starting point, I would recommend anything of critical importance, you know, should be documented as a very strong general rule and going back from experience, more than once in my time as a preparer and going back far enough when I was an auditor, I can assure you more than once auditors documented something in a private memorandum in the file that no one else in the room remembered or, if they did remember, they didn't agree with the conclusion. We thought the answer was left and they thought it was right or whatever. So I think, if nothing else, to avoid misunderstandings, to have a shared sense of the facts of the matter, it's important to have things documented.

Now, I think there's some flexibility in level of documentation. So as an example, you know, four times a year we do our quarterly earnings review with the audit committee and they get the thing the night before and it's a bulletized list of the things we're going to talk about, you know, reserves, taxes, cash flow or whatever, but there's no details, but at least it's memorialized that you are going to talk about these subjects, you know, earnings release, 10-Q type releases, real-time stuff, and we have five standing meetings a year, couple hours long each, and the pre-read goes out two weeks earlier and there's plenty of time for robust documentation.

Again, I think it can take a lot of forms, a lot of levels of detail. So I would suggest if you're going to write rulemaking on this, the beginning assumption is it is documented and maybe there's exclusions.

I think of executive committees or you're talking individual staff qualifications and stuff. Maybe it's sufficient that you memorialize that the subject was discussed but not necessarily in detail and process that in due course.

But the other thing is I can truly see problems for the PCAOB, for the auditors and management down the line if you allow some things to be done orally and then there's a blow-up a year or two later and there was no requirement to share this critical dialogue in writing with the audit committee or the board of directors, as the case may be, again along the lines of there's a shared understanding of the various views of the issue and the assessment of the facts, the issues of substance.

So I err on the side of more writing is better. Again, I think some flexibility about the level of detail.

MR. BAUMAN: Thanks, Gary. Denny.

MR. BERESFORD: I obviously prefer less than 100 pages of written documents, but having said that, if there is something that's important for the auditor to communicate, I think it's well to have it be in writing and I think specifically of something like an important accounting that was communicated or consulted with the national office.

Generally speaking, when that is the case, I ask the accounting firm or the company, usually the company, to write it up for the accounting firm, so that we can have it in advance, so that we can read about it before the meeting.

These things are complicated, as I think Arnie indicated before, and, generally speaking, if these things are just foisted upon the audit committee verbally at the meeting, the chances of the audit committee members fully understanding and being able to ask intelligent questions are fairly low.

If we've had a chance to look at the material in advance and particularly then ask questions, maybe call or e-mail in advance and ask for a little bit more elaboration, if we wish to, there can be much more robust discussion and more effective discussion at the meeting.

I think, Marty, the idea of having an after-the-fact follow-up with the material, in other words, having the audit committee receive the documents of the accounting firm confirming the discussions kind of defeats the purpose.

It seems to me that if we're going to have something in writing, those materials should go to the members of the committee in advance so that they can be part of the effective communication to lead to better discussions at the committee meetings and enhance the entire process for everyone.

MR. BAUMAN: Great. Thanks, Denny. Kiko.

MS. HARVEY: Yes. Thank you, Marty. I'm having difficulty, having sat in the room with audit committees and auditors and trying to figure out how we're going to operationalize this documentation of oral communications. It just seems problematic, generally speaking, that, you know, there's a free flow of communications. There's a lot of back and forth and questions and answers, and I don't see anybody, other than the secretary, taking the minutes of the meeting, you know, who's a scribe in that process. So I find it difficult to do.

That being said, so I'm a big proponent of having material matters in writing. I don't like this thought of the auditors going back to their desks and documenting a whole bunch of discussions they had with the audit committee and then not -- or with management and then not sharing that information. So I would caution against that.

I do think the matters that should be in writing, if they were oral, if you were going to go down that path, anything that's obviously audit-related, audit conclusions, discussions about issues that they've settled in on, one way or the other, and I do think that it should only be the important communications, certainly not the back and forth and casual communications that we have or we'll have hundreds and tens of hundreds of documents to go through.

MR. BAUMAN: Thank you. Sam Ranzilla.

MR. RANZILLA: I think you run the risk of, if everything's in writing, maybe reducing -- one is I think you run the risk of some boilerplate with some of the more sensitive issues, and I don't think it's boilerplate around things that would already be in the workpapers. The thing that sort of comes to mind for me that would be boilerplate might be around a discussion around your overall view of the quality of the company's financial reporting. You know, is it aggressive, ugly, whatever terms you might use. It's that sort of thing.

I'm not -- I don't -- oral or written, I mean, if you're reaching a conclusion that the loan loss allowance is appropriately stated within the context of the financial statements taken as a whole, you're going to -- that's going to be in your papers just dead on. You're not going to be uncomfortable with reaching that conclusion.

So I think it's around the more subjective areas. I think you run some risk associated with some boilerplate language around it. I don't know if that's the end of the world. We live in a legal environment where boilerplate is sort of a fact of life.

If all the communications were required to be in writing, you know what, at some point we got to stop documenting everything that occurs. I mean, I think that's excessive, to say here are the requirements, put them in writing, and that anything -- discussion that you have around them also has to be documented. I could see -- I mean that's just anarchy.

And again, you know, I think I'm making almost no progress on this, but again am troubled by the writing of auditing standards meant to enhance the inspection of auditors. I don't think that's why -- you write auditing standards to make it easier for your inspectors to do their work and I'll leave it at that.

MR. BAUMAN: Were there any other comments? I'm sorry.

MR. COOK: I just wanted to make one suggestion and I agree with most of what was said about the value of written communications, but would you please, as you put this together, be practical and think about the realities of spontaneous communications and the advantages of something other than a written letter reviewed and all of those things?

Maybe a PowerPoint slide or two might get the job done in a particular case. Just try to keep this as general as you can, still meeting whatever objective you're trying to accomplish and particularly, while I agree 100 percent with what Denny said, it's so much more effective if you have it in writing in advance, a chance to read it, but spontaneous communication in executive sessions and elsewhere is invaluable, and the last thing you want is somebody who says, well, I'm sorry, I can't talk to you about that because I have to go put it in writing and I'll send it to you next week.

So allow for subsequent documentation of conversations or as much flexibility as you can if you're headed down that road.

MR. BAUMAN: Thanks, Mike. Arnie Hanish.

MR. HANISH: Yes. Marty, just one comment, and I went back and in preparation for this, I went back and looked at our auditor communications that take place already and I guess it wasn't clear to me, and I haven't commented previously, as to what problem are we trying to fix here with this issue because I look at the communications that take place between our auditor and the audit committee.

It's, for the most part, everything fairly detailed and in writing in advance, goes out in advance. It covers most of what everything everybody's talked about here and I guess I question what's really broken in my mind with the way the communications are today in writing.

You know, there may be ad hoc communications that take place that are not part of this document that take place -- that get sent out in advance, but, generally speaking, the corporate secretary will minute a lot of that at a reasonably high level as to what takes place in the course of the conversations inside the audit committee meeting and that seems to be, at least in my mind, an adequate level of documentation.

If there was something additional that was critical that maybe wasn't captured, maybe that could be incorporated inside the minutes of the audit committee by the corporate secretary. I'm just not sure why you need to have the auditors writing voluminous additional memos for the files documenting maybe what was said in an ad hoc manner.

MS. VANICH: Arnie, just to respond to that briefly, we appreciate your comments. One of the things we considered in drafting this language was some findings that were reported in the Board's 4010 Report on Triennially-Reviewed Firms and there were some instances where firms were not making all the required communications or it wasn't evidenced in any way in the workpapers. So I think we tried to strike a balance between some firms that we see do a pretty robust good presentation and a good job versus those who are not doing even what's required now.

MR. BAUMAN: I think I see two more -- one card and one hand up here. So in keeping with the spirit of trying to get all these topics covered, George Munoz and then Bob.

MR. MUNOZ: Just very quickly, Arnie, Arnie asked about, you know, what's broken, and I think we always have to ask ourselves that, but just did the PCAOB do a study on whether the accounting firms that audit the public firms that got in trouble, whether the accounting firms had any issues with their requirements that the PCAOB oversees was part of the problem?

MR. BAUMAN: I'm probably not going to answer the question anyway, but I wasn't sure I understood it.

MR. MUNOZ: Okay. I guess we got a proposal before us because somehow somebody thinks something's broken or could be greatly improved and that's why it's worth a cost and worth all these extra procedures and putting things on the agenda.

So I assume did that stem from a study that the PCAOB did in terms of the fiasco that, you know, our companies went through a year and a half ago or so?

MR. BAUMAN: I'd say that the standard, the proposed standard on auditor communications with audit committees reflected a number of things and that was observations from our inspections process, observations of some of the best practices we were seeing where there were communications with audit committees, but they weren't in our standard that some firms were doing but on certain engagements but not on all, and observations from what other standard-setters were doing.

So there were a variety of things that input into our thinking as to this proposed standard. So I wouldn't say there was a particular study done but just a lot of variety of factors that influenced our thinking.

Alex, you okay? Well, thanks for the lively discussion on this topic. I think it gave us a lot of things to think about regarding a subject that doesn't sound that complex about whether it should be written or oral but there's a lot of strong views on it and a lot of different views and balancing, I think, that comes into play, as well. So thanks for your thoughts.

The next topic is audit committee responsibilities and the engagement letter.

The existing PCAOB standards require that the auditor establish an understanding with the client regarding the audit and given changes in

Sarbanes-Oxley where the audit committee was put in the middle between the auditor and the audit client with the responsibility of the auditor dealing with the audit committee, we made a change, proposed change in the standard that the auditor should establish a mutual understanding of the terms of the engagement with the audit committee in connection with the audit as opposed to typically that letter was so the engagement understanding was with management, and the mutual understanding includes communicating to the audit committee the objectives of the audit, the responsibilities of the auditor, responsibilities of management, etcetera.

Several commenters actually stated that the mutual understanding should include the audit committee's responsibilities related to the audit, as well, and that those responsibilities should be included in the engagement letter and one commenter, included a briefing paper here on Page 8, gave a number of suggestions as to what should be included in that letter.

So that's the next topic of discussion and that is, the question is should the engagement letter include the responsibilities of the audit committee, in addition to those of the auditor and management, and, if so, what should those responsibilities be?

And I've asked two people to address this topic, Bob Dohrer and Jim Cox and maybe, Bob, you could start us off.

MR. DOHRER: Sure. Thanks, Marty, and actually I think this dovetails nicely with some of the prior discussion we've had around the effectiveness of two-way communication and other issues surrounding who does what in an audit and who's responsible.

As we know, the proposed standard includes, among other objectives, objectives for the auditor to communicate to the audit committee the responsibilities of the auditor and to, as Marty alluded to, establish a mutual understanding of the terms of the engagement, as well as to evaluate the adequacy of the two-way communication.

Today, the engagement letter essentially lays out the responsibilities of the auditor and of management, but, of course, is currently void of any description of the responsibilities of the audit committee and I harken back to earlier today, the description of the three-legged stool and one of those legs are completely missing in the engagement letter.

So in the spirit of promoting effective two-way communication, I think the question needs to be asked whether or not a well-articulated and mutually-agreed-upon description of the responsibilities of the audit committee contained in the engagement letter would actually facilitate or enhance in any way the effectiveness of the two-way communication, and if the answer to that is yes, I don't think -- you know, I'm quite sure the Sarbanes-Oxley Act doesn't go into any detail about what the responsibilities are, other than for oversight of the audit process, but actually taking -- drawing from the proposed standard some of the items that were discussed there, I think the list potentially for the audit committee responsibilities is not long and not prescriptive, other than, you know, naturally to provide oversight to the financial reporting process, to inform the auditor about anything the audit committee knows that would be relevant to the audit would certainly be expected and then getting into kind of some of the elements or criteria that were laid out that would be useful and effective in evaluating the effectiveness of the two-way communication could also be included perhaps in the engagement letter.

Things like taking timely and appropriate actions and willingness to meet in the absence of management with the auditor, so on and so forth. So the question then in our mind is whether or not clearly-articulated and mutually-agreed-upon responsibilities of all three parties in this scenario would actually enhance more effective communication.

Thank you, Marty.

MR. BAUMAN: Thank you. Jim Cox.

MR. COX: Yes. Thank you. I think I can be brief.

All the letters did point out what Bob was saying and that is, that all the letters commenting on the proposal, the importance of the engagement letter generally and the audit committee's missing from that, for perhaps historical reasons.

In a way, the audit committee's really not missing from that at all because audit committees customarily have -- I think the percentages are very high -- a charter that sets forth what their obligations are.

So when I looked at this proposal and thought about it, I was trying to figure out what would really be added by adding something to the engagement letter that was already in a charter at some location. You know, the only thing I could come up with is that the ritual is important, but I think that that's of momentary importance.

It did make me think that what would happen in the instance in which there was an audit of a firm that for some reason a very small group that didn't have a charter at which point that then I think a reasonable auditor would then ask the questions about, well, what do you envision your role as since it's not memorialized, etcetera, and if you just visit our website we can provide you with a charter and we can take care of this in a nanosecond.

So at the end, being an academic, I'll end on this ponderous note and that is, I'm not sure what this would really address that wouldn't be already addressed in any fashion anyway through reasonable standards. It's not clear to me that it's a problem that's broken nor is it a problem that's really missing something, this third prong of the stool, because it's in likely the charter.

MR. BAUMAN: Thanks for those comments and let's take some cards around the table. I think, George, yours was up first.

MR. MUNOZ: Yes. Thank you, Marty. I think I'd question if the engagement letter which is a contract now includes some obligations on the part of the audit committee on a contractual basis, whether there's a potential conflict with the fiduciary duty that the audit committee has to the -

- and this contractual arrangement that it now has with the auditor and what the real purpose of that is and throughout this whole thing what we have to keep in mind is that there are maybe 90 percent other ways that the audit committee is engaging with management, engaging with the board, engaging with the other parties that the auditor's not in the loop for and does not need to be in the loop for.

So somehow, you know, these requirements of reporting and communication and assessing seems to indicate as if the auditor needs to be present throughout all those situations and I just would be cautious.

I don't know what the answer is, but if there's a potential conflict of fiduciary duty with the contractual agreement, I think we have to be cognizant of that.

It also sets a precedent; that is, once you include something in that engagement letter of "obligation" on the part -- a contractual obligation on the part of the audit committee, you've opened up the door to that kind of add-ons and it doesn't take long before the audit team -- the auditor starts saying you know what, I want them on the hook, I want this, I want that, and the next thing you know -- so there's a potential conflict.

Isn't the bottom line that the auditor here is supposed to be independent; that is, they call it as they see it. It's like an umpire. They come in, they do the work, they assess everything else, and they call it as they see it. There's a weakness or there's a problem or the audit committee is weak, there's an issue, and they report on that, and I think that's the way it should be stated as opposed to a contract, the way it's proposed.

MR. BAUMAN: Thanks. Well, just to be clear, in the proposed standard, there was not a requirement for the engagement letter to include responsibilities of the audit committee. That was a suggestion that was made by several commenters to us, just to make sure that that point was clear.

Roger Coffin.

MR. COFFIN: Thank you. I think that the innovation in Sarbanes-Oxley to put the audit committee in control of the audit process in my judgment was probably one of the most significant in corporate governance in a long time and therefore when I approached this standard and what we're talking about now is the concept that you mentioned, Marty, of defining the roles of the audit committee in an engagement letter, I think in a perfect world, it has some attraction and it sounds like a good idea, but the more that I thought about it, the more that I thought that the concept of the charter, for example, and which, by the way, I mean anyone who takes a look at audit company charters will know how long and how defined they are.

When I teach this in my class, I'll take a bunch of audit company charters and go through them with students and they'll say you mean this is not a full-time job. I mean, they're very lengthy.

And when I think about how this might play out and given that there are over 12,000 public companies and thinking about what all these contracts might say, I guess I come down on that this might be a box that you might not want to go down.

I think it's a fair question to ask whether or not, you know, because you do want to have this concept that's clear and delineated, what the roles and responsibilities of all sides, but I think you have to leave the audit committee's roles and responsibilities to the governance process; that is to say, to the shareholders as it's set forth in their charter, subject to various, you know, other rules of perhaps the SEC or the listing standards and leave that piece out of it for want of just getting into something that is going to cause I think ultimately the PCAOB more trouble than it's worth.

Thank you.

MR. BAUMAN: Linda Griggs.

MS. GRIGGS: My only observation is that often these engagement letters are not actually something that's negotiated, unlike most contracts which are negotiated and the words are worked out.

You normally are handed an engagement letter by the accounting firm and you take it or leave it and when you try to raise comments, they're frequently rejected because this is our form.

So while I think it would be a great idea if you really did have a back and forth and you sat down and the auditors said to the audit committee I'm really expecting you to do this, that, and the other and you actually had a meeting of the mind and a mutual agreement on responsibilities, that would be great. In the real world that won't happen. We'll be handed the engagement letter and we'll take it.

So I think I'm with Jim. We've got a charter. The charters are very robust. If audit committees aren't fulfilling the terms of their charter, like I said before, it seems to me the auditors should sit down and talk with them and say, look, we think there's some inadequacies in our communication, but I don't think this is the way to do it.

MR. BAUMAN: Okay. Thanks. I think we've gotten some pretty clear views on that question and in keeping with our grand plan to get us on schedule and out of here by 3 o'clock, Topic 6 on Management Communications which we're going to ask Gary Kubureck to lead the discussion. Gary agreed with us that we probably covered management communications extensively this morning, as our entire discussion about communications and what should be communicated by management versus the auditor.

So we're zooming right past Topic 6, unless there's any objections. If somebody was really, you know, waiting to get a comment out on that, and we're going to Topic 7 on -- I'm sorry. Larry Salva.

MR. SALVA: Can I just ask a question because I noticed that in between Paragraph 12 and 13, you had the note after 12 basically acknowledging things communicated by the management need not be repeated, but to the extent that management has covered anything in Paragraph 13, shouldn't that same guidance apply?

MS. VANICH: Larry, I think that the way it's bifurcated now leads to we do believe what's in

13 should be communicated by the auditor because in most instances it represents the auditor's views and so the auditor's views should be coming from the auditor.

A few of the other matters in Paragraph 13 are similar to the SEC requirements. The SEC requires the auditor to report critical accounting policies and alternative treatments under GAAP and therefore we picked up the same type of language.

MR. BAUMAN: So Paragraph 12 was more about the financial statements, critical estimates that were in the financial statements. 13 is more about the auditor's qualitative assessment of the adequacy of disclosures and the propriety of the accounting policies given the situation in the industry, etcetera.

MR. MUNOZ: I guess maybe I just -- I'll take issue with that and think that, just as a general matter, especially if it's a collaborative kind of, you know, working relationship between auditor, audit committee and management, that to the extent that the management has made a presentation and often the audit committee will turn to the auditors and ask them if they have additional comments, that's when we hear them and if we don't hear them, then I assume that they're going in executive session and supplementing the comments if they don't want to make them in front of me.

But, you know, I just think that, to the extent they're made by management, they need not be repeated.

MR. BAUMAN: Thanks. And I agree. We've had a lot of input today about Paragraph 12 requirements and who should make those communications and Paragraph 13. So we've gotten a lot of valuable input on that during the day.

Moving to Topic 7, Jennifer.

MS. RAND: Thanks, Marty. So the next and last discussion topic is on Uncorrected Misstatements.

Just to remind everybody, the proposed standard requires the auditor to provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that was presented to management.

We included this requirement in the standard because we believe it's consistent with the requirement of the SEC which requires the auditor to report to the audit committee material written communications to management and they include unadjusted differences as one of those items.

In addition, although management and the auditor may have concluded that these misstatements are immaterial to the financial statements, misstatements could be material in future periods, especially to the extent they result from a control deficiency which is not mitigated.

So that's another reason we thought it was appropriate to share those types of issues for the audit committee's considerations.

A number of commenters didn't object to this requirement. However, some did object to it and felt that the requirement resulted in providing the audit committee with too much detail on adjustments that do not have a material effect on the financial statements.

So we're seeking views on whether or not the schedule -- you know, this requirement should be included in the final standard and we'd asked Arnie Hanish to open up the discussion with his views.

MR. HANISH: Thank you, Jennifer. I'll try to be brief, and the issues that at least I see around this center more on clarification of materiality. While I don't disagree at all, it's important that auditors provide a list of unadjusted misstatements, uncorrected misstatements to management as well as the audit committees.

I just want to make sure that it's perfectly clear and concise within the proposal that this will be done based upon materiality levels. We all have thresholds that are provided to us. Auditors go through an analytical analysis as to what those thresholds will be as to what would get communicated. It varies from company to company, based upon the size of the company, income of the company, relative size of the balance sheet.

I just believe that we need to be consistent in keeping with those levels of materiality and not necessarily encumber the audit committee with a degree of detail that would be, quite frankly, inappropriate as far as a level of some items which might be uncovered as part of the audit as uncorrected misstatements.

I do believe that items that result and would have resulted in, if left uncorrected, significant deficiencies, material weaknesses, or could have suggested that there were trends from year to year clearly need to be communicated and that's something that I believe needs to be made clear in the statement, as well, with regard to the impact that these left uncorrected would have on the degree of controls relative to significant deficiencies or material weaknesses.

So that is pretty much the degree of comments that I wanted to make as far as introductory remarks to try to set the stage. It's not that I would necessarily personally object. I believe that it's important to have communications of that sort to the audit committee. It's really the degree and the amount and the number of uncorrected misstatements and I guess one other point is I would -- I don't believe it's necessary, again unless it would result in a controlled deficiency and a significant controlled deficiency to report to the audit committee those items that management has corrected that were discovered by management during the normal course of their audit.

I think, quite frankly, if management finds things during the normal course -- I'm sorry -- not of its audit, of its closing process. To me, that's a positive in the sense that management has the appropriate controls in place to detect items and has found them and corrected them appropriately and again, unless it was pervasive and suggested that there was a control breakdown or a significant deficiency or material weakness in internal controls, other than that, I really don't believe it's necessary for an auditor to communicate those items that management has detected during its closing process.

MS. RAND: Thanks, Arnie. Denny Beresford, you had your card up.

MR. BERESFORD: I think this is a useful disclosure for audit committee members.

The one thing I would ask you to consider adding in this case is some guidance on disclosures; that that is, I've seen remarkable amount of inconsistency in my limited board experience on what information auditors feel they have to provide to audit committee members with respect to omitted disclosures and I just don't think that people understand right now what the ground rules are and in theory, I guess, if you went down the typical GAAP checklist, there could be scores, if not hundreds, of omitted disclosures on the basis of materiality and that's clearly not going to be very helpful to audit committee members.

But I think it is something that's not covered at all in the existing auditing standard and I suggest that it's something you should give some consideration to.

MS. RAND: Arnie, can I ask a follow-up question regarding your last point on disclosures? I'm just curious if you've seen any or had any communications or best practices of how omitted disclosures would have been presented to you as an audit committee member, chair, any suggestions in that area?

MR. BURNS: What I can say is that in one of my boards, one of the firms has simply listed omitted disclosures, said that these were ones that they thought were technically required under GAAP that were omitted on the basis of immateriality. On the other boards, there was no such listing. They just never said anything about any disclosures that were omitted. I don't know if any of the other audit committee members have seen any listings of omitted disclosures.

MS. RAND: Thanks, Denny. Kiko Harvey.

MS. HARVEY: Yes. I generally support the submission of the uncorrected misstatements to the audit committee. I think that's probably pretty common practice anyway.

But on this matter of corrected misstatements, I agree that if management is identifying them as part of the normal closing process, I don't believe that those require any disclosures of the audit committee.

The ones I would be a little bit more concerned about, though, are those that are caught that relate to a prior accounting period that's already been filed. Obviously that would beg the question of whether or not that's an issue under ICFR, but I really -- you know, I -- because of the materiality, I just don't know how that's captured in practice, as well, and I would like to see some emphasis in that area.

MS. RAND: Thank you. Just as far as your point on corrected misstatements that are picked up through the normal close process, we didn't include that as a requirement. It's just ones picked up by the auditor. So I think that's come up a couple of times.

George Munoz.

MR. MUNOZ: This is, I think, a good requirement and that's because the audit committee is not only looking at the financial statement, the current financial statement but it's evaluating --

it's evaluating management and it's evaluating the outside auditor and so as it gets information about uncorrected misstatements or the like, over time, so I would favor that it doesn't have to be material because over time the audit committee can be better positioned to evaluate or judge the work and the interactions between management and the outside auditor and even qualifications.

So from that perspective, I would not restrict it only to materiality but this is a good requirement.

MS. RAND: Thank you. Gary Kubureck.

MR. KUBURECK: Thanks, Jennifer. I'll be quick. First of all, I'd echo Arnie's comments on stuff found by management in the ordinary course of the close which will be hard to define what is ordinary closing adjustment versus sound controls versus something that's significant deficiency material weakness which probably should be brought to the auditor's attention, to the audit committee's attention.

I do support a SUD, you know, being

presented to the audit committee. I'm actually hanging on the one word, "the same schedule of uncorrected differences." I would -- I don't think that they really mean the same schedule, looking at us as a multinational company.

There's many schedules, subsidiary and business unit levels, and some of which you've got postings significance of very small dollars, small subsidiary because, you know, a statutory audit report's coming versus what affects the consolidated financial statements taken as a whole.

So I would be careful in the use of the word "same" and then likewise even if it's the same items, the one presented to management might be the more granular level of detail as what specific account number does it belong to and again that's sort of irrelevant at the consolidated level. So just be careful on the use of the word "same."

My last comment is regarding disclosure omissions. The FASB, as you may know, has a project on disclosure framework and what should a disclosure framework look like and one of the things that working group is wrestling with is what is the answer to the question.

As you know, every FASB standard, the last box said, you know, this can be omitted, you know, doesn't have to be applied to individual items. Well, does that mean if you omit it, it's perfect, it's GAAP, or does it mean no, it's still not GAAP, even if it's small, but we're just not going to make a big deal out of it, and they're wrestling with what is the answer to that question.

If you say if it's immaterial and the conclusion is it's GAAP to omit it, if it's immaterial, then there is no issue. So they're wrestling with that and my only advice, Jennifer and Marty, would be to sort of stick close with the FASB's project team on this. I don't know where they're going to come out but they are working it.

MS. RAND: Thanks, Gary. I wanted to comment on one of the things you said which was the word "same." I think you were suggesting that maybe not the same schedule needed to be presented to the audit committee as management and the way we drafted the requirement in the proposed standard is it is the same.

We are aware of some instances, have concerns or could be others, that a different type of schedule might be -- you know, would be presented to the audit committee that is misleading to the -- you know, that may net some of the adjustments that appear better than it really may have been or just isn't giving a true or fair presentation of what happens. So that's a reason why we use the word "the same" so that that might not happen.

Lynn Turner.

MR. TURNER: I'd just like to say I agree with what Denny was saying about a list of omitted disclosures. I think we've seen times where people have left information on pension plans out of footnotes and that type of stuff and so requiring that, I think, would be helpful, in addition to the unadjusted entry score sheet, which I would have just the auditor things on it. I wouldn't -- I agree with Arnie. I wouldn't throw everything on it that management finds. I think that's part of the overall internal control analysis.

MS. RAND: Okay. Thank you. Mary Hartman Morris.

MS. MORRIS: Thank you, Jennifer. I just wanted to point out a couple things that people have said and that was, I do agree that it should be included, uncorrected misstatements, and it should be provided to the audit committee because I think that all of us have gone through, you know, different divisions have to go through and correct or look at some of these issues and deal with it through management and I don't know necessarily the audit committee sees the big picture and, you know, cumulative effect and so I think that that would be helpful because I think it was brought up about whether or not there's some trends or pervasiveness.

So I think that, you know, just seeing that, you know, is not something that the audit committee has to deal with a lot or work with it, but just seeing that year over year they might get that feeling of, okay, are there some issues that are underlying that need to be addressed. So I think that is important.

MS. RAND: Thank you. Arnie.

MR. HANISH: Jennifer, just one point of clarification and just to make sure that I didn't misrepresent anything in my opening remarks, that we're talking about here, at least what I'm talking about are those items that are above what I'll call the threshold, that I mean I would hope that we're not looking to have the auditors -- again just to restate what I said earlier, that I'm hoping we're not looking to have the auditors provide whatever detailed lists there might be of things that are below a certain threshold.

I think it's important to, in the aggregate, maybe indicate to the audit committee what those items were. I think it's important to indicate if they're all going one way, but if it nets out if they were below the threshold and the aggregate was not above a threshold that had been established for levels of materiality, I guess it troubles me that we would provide that kind of list of what I would consider to be very immaterial, especially if it was in the aggregate below the level of materiality that had been established, either at the balance sheet level or the income statement level.

MS. RAND: Our standards on evaluating on differences of materiality would indicate that the auditor would record those things that are above being considered clearly trivial. So if it's clearly trivial, it does not need to go on the list, but otherwise individually in the aggregate if it's above clearly trivial, then those type of things would be recorded. So that might help some of your concerns.

Harold Schroeder.

MR. SCHROEDER: I was just going to add, having gone through that enough times in my 13 years of auditing, there tended to be some games that get played with this type of issue, oh, well, we'll put this on the schedule, we won't put this on the schedule, what are we going to say, is it judgment, is it just application, is it a factual error, is it a misapplication of accounting.

There are all sorts of different types of these misstatements and I'm clearly in the camp of this is a good -- some type of summary level, telling an audit committee we had generally these types of issues, half of them fell in the judgment, half of them fell in the systems or cutoff issues, whatever, just to give them a sense and feel because I think it's a strong educational purpose, you know, certainly not providing all of the individual layers and detail, some high level, I think just a good education.

MS. RAND: Don Nicolaisen.

MR. NICOLAISEN: I would just echo that. I think one of the things that is helpful -- one of the things that's not helpful is a whole lot of data that gets provided, photocopies of schedules that are uncorrected errors and misstatements and omissions and whatever else that are just sort of dumped on the audit committee. It's sort of the same thing where there's random walks through we've got a lot of estimates and the estimates are difficult and it could be this or it could be that.

What you're really looking for, at least what I'm really looking for, from the auditor is some interpretative guidance that says this is meaningful. We've never seen this many errors that have gone uncorrected in our history of our firm. You really ought to deal with this. That's helpful.

To just dump them on us and say here's a bunch of stuff that we found during our audit and we photocopied it and here you are and we're required to give this to you, I'm not sure is a particularly meaningful exercise.

MR. BAUMAN: Don, was that a real-life experience you were --

MR. NICOLAISEN: No, but it could happen. You never know.

MS. RAND: Charley.

MR. NIEMEIER: Yes. Just one follow-up comment related to disclosure and I appreciate, Gary, your comments about FASB's project.

I just want to highlight this because I think disclosure is going to become a big challenge when it comes to determining materiality. I'm not sure there's any real set rules on that the way that we deal with misstatements and correcting numbers and one thing about FASB -- I'm not sure that FASB has the ability to actually determine what is material in that regard, even though it may present some interesting information about that.

In the end, I think what a reasonable investor believes is material under the securities laws is what's going to be governing and it's just -- I only point that out because I think this is an area that's going to be a moving target.

What may have been deemed to be not material as a disclosure item may actually become material in the near future.

MS. RAND: Larry, you had a comment.

MR. SALVA: Yes. I would just make the point in terms of summary of past disclosures, if you will, is that I think what drives that, at least in my experience, in seeing what the auditors put on our lists, are the things that are clearly not the ones that are getting there because they're immaterial disclosures and they agree with that conclusion and that it's not a tough conclusion to get there.

It's the ones where there is a bit of judgment involved in reaching that conclusion that that omitted disclosure is not significant to a potential user of the financial statements.

I think there's a judgment being made by the auditors as to what they post on to that schedule. There are clearly -- like we've taken approaches that I've discussed with the SEC staff of not making every required disclosure in our pension footnote because we have frozen pension plans and it's just not all that significant, but we make certain disclosures there and the auditors, you know, will reference that point because that's kind of, you know, somewhat aggressive position, not quite -- I don't think it's aggressive at all. I think that's using the box at the back of the standard that says if it's immaterial, don't include it, but that makes it on to the list.

There are a couple -- a few minor other things that make it on to the list, but they're clearly not putting every item that shows up on the disclosure checklist where they've made a note that said it was immaterial.

MS. RAND: Thanks, Larry. Mike.

MR. COOK: Very quick observation on this. I could have made this observation on at least a half a dozen items before this, would be I think it would be just fine to say that the auditors should reach an understanding with the chairman of the audit committee or with the audit committee on the degree of information and detail prepared here or provided here to meet the needs of the audit committee within the boundaries of the standard and then if you wanted to go on and say in the absence of such an agreement, you can or can't give the same schedule.

It's true of so many things, I think we've been talking about, is really kind of wonder why the auditors or the standard-setters for the auditors are deciding what the audit committee ought to get, as long as the standards are complied with, and I'm not suggesting anything different than that, but right in this one, just talk about it, see what it is that the committee needs and provide it. It doesn't seem too difficult.

MS. RAND: Thank you. I think, Mike, you ended the session on that for us, and I don't see any other tent cards.

We are getting close to 3, which is our closing time. So we'll move into the wrap-up section, and I'll turn it over to Dan Goelzer to provide a wrap-up and summary.

MR. GOELZER: Well, thank you, Jennifer. Marty did have to leave early because of a family matter and asked me to do the wrap-up, but I am going to be mercifully brief. I think we've had a very busy and active day and so the only wrap-up I would like to give is to thank everyone for their participation, for their advice and for the ideas that you've given us.

I think we certainly have a lot to think about in terms of the standard. I don't know if I would go so far as to say that there was a consensus on anything, except possibly whether the audit committee's responsibilities ought to be described in the engagement letter or not, but we certainly will carefully consider everything that we've heard here today, and I think you'll see the results of this meeting as we go forward with this project.

As I said in my opening remarks this morning, I think the success of our standard-setting is very much dependent upon the willingness of those who have firsthand experience in the matters that we deal with and give us the benefit of their views and advice and from that perspective, I think this has been a very effective roundtable.

So again, thank you very much to all of you and I will adjourn the roundtable. Thank you.

[Whereupon, at 2:56 p.m., the roundtable was adjourned.]

* * * * *

1666 K Street, NW
Washington, D.C. 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES;

RELATED AMENDMENTS TO PCAOB STANDARDS;

AND TRANSITIONAL AMENDMENTS TO AU SEC. 380

PCAOB Release No. 2011-008
December 20, 2011

PCAOB Rulemaking
Docket Matter No. 030

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is proposing transitional amendments to AU sec. 380, *Communication With Audit Committees,* and reproposing an auditing standard, *Communications with Audit Committees,* that would supersede the Board's interim standards AU sec. 380 and AU sec. 310, *Appointment of the Independent Auditor*, and related amendments to PCAOB standards. The proposed auditing standard and other amendments would be applicable to all audits conducted in accordance with PCAOB standards.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by email to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 030 in the subject or reference line and should be received by the Board no later than 5:00 PM (EST) on February 29, 2012.

Board Contacts: Jennifer Rand, Deputy Chief Auditor (202/207-9206, randj@pcaobus.org), Jessica Watts, Associate Chief Auditor (202/207-9376, wattsj@pcaobus.org), and Hasnat Ahmad, Assistant Chief Auditor (202/207-9349, ahmadh@pcaobus.org).

*****

I. Introduction

The Board is reproposing a new auditing standard, *Communications with Audit Committees* (the "new proposed standard"), and related amendments that would replace interim standards AU sec. 380, *Communication With Audit Committees* ("AU sec. 380"), and AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310"). The new proposed standard, if adopted, would benefit investors by establishing requirements that enhance the relevance and quality of the communications between the auditor and the audit committee.[1/] The requirements in the standard are aligned with the requirements of the Sarbanes-Oxley Act of 2002 (the "Act") and enhance the requirements in the Board's existing standards.

Communications with the audit committee help the auditor improve the audit[2/] by (i) informing the audit committee, which has responsibility for the oversight of financial reporting, about significant matters related to the audit and the financial statements, (ii) enabling the auditor to obtain the audit committee's insights and information about transactions and events, (iii) enabling the auditor to learn about complaints regarding accounting or auditing matters, and (iv) assisting the auditor in gaining a better understanding of the company and its control environment, among other things. For many public companies, the Act served to strengthen and expand the role of the audit committee in the financial reporting process. For example, the Act requires that audit committee members of listed companies be independent and that audit committees be responsible for the appointment, compensation, and oversight of the work of the external auditor for the purpose of preparing or issuing an

---

1/ The term "audit committee," as used in the new proposed standard and this release, refers to a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to a company, the entire board of directors of the company. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to a company, those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

2/ For purposes of this standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

audit report or related work.[3/] These requirements place the audit committee at the center of the relationship between management of a public company and its auditor.

Audit committees play an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to company shareholders and others to oversee the integrity of a company's financial statements and the financial reporting process. An audit committee that is well-informed about accounting and disclosure matters relating to the audit may be better able to carry out this role. One way the audit committee may be informed of accounting and disclosure matters is by receiving communications containing the auditor's evaluations of matters that are significant to the financial statements. Therefore, the new proposed standard requires the auditor to communicate certain matters regarding the audit and the financial statements to the audit committee, which should assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Effective two-way communication between the auditor and the audit committee on such relevant matters will benefit the auditor in performing an effective audit.

Effective communication between the auditor and the audit committee may involve many forms of communication, such as presentations, charts, written reports, or robust discussions. As described in the new proposed standard, the term, "communicate to" is meant to encourage effective two-way communications between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit. Communications that are tailored to the circumstances and informative, rather than "boiler-plate" or standardized, will enable the auditor and the audit committee to engage in a dialogue that is more likely to benefit the audit committee in conducting its oversight responsibilities and the auditor in conducting an effective audit.

II. Background

On March 29, 2010, the Board proposed a standard, *Communications with Audit Committees* (the "original proposed standard"), to enhance the relevance and effectiveness of the communications between the auditor and

---

[3/] *See* Section 301 of the Act of 2002, section 301 and Section 10A (m)(2) and (3) of the Securities Exchange Act of 1934 ("Exchange Act").

the audit committee.[4/] The Board received 35 comment letters on the original proposed standard.[5/]

Most commenters were supportive of the original proposed standard, although several commenters suggested that additional outreach to stakeholders might be beneficial. The comments received were discussed with the Board's Standing Advisory Group ("SAG") on July 15, 2010.[6/] Additionally, on September 21, 2010, the Board held a roundtable to obtain additional insight from stakeholders, including investors, audit committee members, auditors, and preparers.[7/] The roundtable discussion explored many key issues that commenters had raised in response to the original proposed standard regarding:

i. Communications beneficial to audit committees,

ii. Accounting policies, practices, and estimates,

iii. Effective two-way communication between the auditor and the audit committee,

iv. Balance between written and oral communications,

v. Audit committee responsibilities in the engagement letter,

vi. Management communications, and

4/ PCAOB Release No. 2010-001, *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards* (March 29, 2010).

5/ Comments on the original proposed standard are available on the Board's Web site at: http://pcaobus.org/Rules/Rulemaking/Pages/Docket030Comments.aspx.

6/ A transcript of the portion of the meeting related to the original proposed standard is available on the Board's Web site at: http://pcaobus.org/Rules/Rulemaking/Docket030/Communications_with_Audit_Committees.pdf.

7/ A transcript of the roundtable is available on the Board's Web site at: http://pcaobus.org/Rules/Rulemaking/Docket030/Roundtable_Transcript.pdf.

vii. Uncorrected misstatements.

To provide all interested parties with an opportunity for additional comments on the topics discussed at the roundtable, the Board reopened the public comment period on the original proposed standard. The Board received eight additional comment letters during this extended comment period. Many commenters offered suggestions about how to improve the original proposed standard, which the Board has carefully analyzed.

The original proposed standard was revised in response to comments received in comment letters and at the roundtable. These revisions are described in Appendix 4 to this Release. The Board is reproposing the *Communications with Audit Committees* standard for the following reasons:

- On August 5, 2010, subsequent to the original proposal, the Board adopted eight standards, the "risk assessment standards" that serve as a foundation for future standard-setting.[8/] The new proposed standard aligns the audit committee communication requirements with the auditor performance requirements included in the risk assessment standards. Reproposing provides commenters with the opportunity to consider the new proposed standard in relation to the performance requirements in the risk assessment standards.

- On July 21, 2010, the Board was granted oversight of the audits of brokers and dealers registered with the U.S. Securities and Exchange Commission ("SEC" or "Commission").[9/] Specifically, the PCAOB now has the authority to carry out the same type of oversight responsibilities with respect to audits of brokers and dealers that it has carried out with respect to audits of issuers, including standard-setting. Reproposing the *Communications with Audit Committees* standard provides brokers and dealers,

[8/] *See* PCAOB Release No. 2010-004, *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (August 5, 2010).

[9/] Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amended various provisions of the Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

their auditors, and board members of brokers and dealers with an opportunity to comment on the new proposed standard.

- The new proposed standard adds a requirement for the auditor to communicate to the audit committee significant unusual transactions that are outside the normal course of business for the company or that otherwise appear to be unusual and to communicate the auditor's understanding of the business rationale for such transactions.

III. Improvements to PCAOB Standards

Like the original proposed standard, the new proposed standard builds on the Act's definition of audit committee as a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the auditor's communication would be to those persons designated to oversee the accounting and financial reporting processes of the company and audits of financial statements of the company.

The new proposed standard improves the current requirements regarding auditor communications with the audit committee by linking the communication requirements to the related performance requirements in other auditing standards. It does not otherwise impose new performance requirements other than communications.

The new proposed standard improves and enhances current auditor communication requirements by:

- Requiring the auditor to establish an understanding of the terms of the audit engagement with the audit committee, record the terms of the engagement in an engagement letter, and have the engagement letter signed by the appropriate party or parties on behalf of the company and determine that the audit committee has acknowledged and agreed to the terms;

- Enhancing the auditor's inquiries of the audit committee regarding matters relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters;

- Requiring the auditor to communicate to the audit committee an overview of the overall audit strategy, including the significant risks the auditor identified, and to update the audit committee regarding significant changes to the planned audit strategy or identified risks;

- Requiring the auditor to communicate to the audit committee information about other independent public accounting firms or persons not employed by the auditor that are involved in the audit, if applicable;

- Requiring the auditor to communicate the basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit will be performed by other auditors;

- Enhancing auditor communication with the audit committee regarding the company's accounting policies, practices, and estimates by aligning the communication requirements with auditor's performance requirements;

- Requiring the auditor to communicate to the audit committee difficult or contentious matters for which the auditor consulted outside the engagement team;

- Enhancing the communication with the audit committee regarding the auditor's evaluation of the quality of the company's financial reporting by aligning the communication requirements with the risk assessment standards and incorporating certain SEC communication requirements;

- Requiring the auditor to communicate significant unusual transactions and the auditor's understanding of the business rationale for such transactions;

- Enhancing the requirement for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management consulted with other accountants about such matters and the auditor has identified a concern regarding these matters;

- Requiring the auditor to communicate to the audit committee his or her evaluation of going concern, if applicable;

- Requiring the auditor to communicate to the audit committee those situations in which the auditor concludes that a departure from the standard auditor's report is necessary;

- Requiring the auditor to communicate to the audit committee complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit;

- Requiring the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process; and

- Requiring the communications with the audit committee to occur before the issuance of the audit report.

In addition to the communication requirements included in the new proposed standard, other PCAOB standards and rules require the auditor to communicate specific matters to the audit committee, which are referenced in Appendix B to the new proposed standard. While the new proposed standard establishes certain requirements regarding auditor communications to the audit committee, the new proposed standard does not preclude the auditor from providing additional information to the audit committee. Nor does the new proposed standard preclude the audit committee from requesting additional information from the auditor.

IV. Audits of Brokers and Dealers

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[10/] gave the Board oversight of the audits of brokers and dealers

---

[10/] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

registered with the SEC. In September 2010, the Commission issued interpretive guidance clarifying that the "references in Commission rules and staff guidance and in the federal securities laws to [Generally Accepted Auditing Standards] GAAS or to specific standards under GAAS, as they relate to non-issuer brokers or dealers, should continue to be understood to mean" the auditing and attestation standards established by the American Institute of Certified Public Accountants (the "AICPA"), but noted that it intended to revisit this interpretation in connection with a Commission rulemaking project to update the audit and attestation requirements for brokers and dealers in light of the Dodd-Frank Act.[11/] On June 15, 2011, the SEC proposed to amend its rules to require, among other things, that audits of brokers' and dealers' financial statements and examinations of reports regarding compliance with SEC requirements be performed in accordance with the standards of the PCAOB.[12/] If the SEC adopts its proposed amendments to SEC Rule 17a-5, or provides other direction that auditors of brokers and dealers are to comply with PCAOB professional standards, the Board's auditing, attestation, quality control, and, where applicable, independence standards would then apply to audits of brokers and dealers required by Section 17 of the Exchange Act and SEC Rule 17a-5.

The Board's current interim standard, AU sec. 380, which was last amended in 1999, is not applicable to audits of brokers and dealers if the broker or dealer does not have an audit committee[13/] or is registered only because of Section 15(a) of the Exchange Act.[14/] Under current requirements

---

11/ SEC, *Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers*, Exchange Act Release No. 62991 (September 24, 2010).

12/ Exchange Act Release No. 34-64676 (June 15, 2011).

13/ AU sec. 380.01 states that the communications required by AU sec. 380 are applicable to entities that either have an audit committee or that have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee (such as a finance committee or budget committee).

14/ See AU sec. 380.01, which states that the communications required by the standard "are applicable to . . . all Securities and Exchange Commission (SEC) engagements." As noted in footnote 2 to AU sec. 380.01, contained in SAS 114, *The Auditor's Communication With Those Charged With Governance,* which was issued by the AICPA in 2006, auditor communication requirements are applicable to audits of brokers and dealers.[15/] Because of this difference in the applicability of the standards to the audits of brokers and dealers, there could be a gap in audit committee communications if the SEC amendments to SEC Rule 17a-5 are adopted and become effective prior to the effectiveness of the new proposed standard. To eliminate this gap, the Board is proposing a transitional amendment to revise its interim standard, AU sec. 380, to delete the current exception for audits of brokers and dealers that do not have an audit committee or are registered with the Commission only because of Section 15(a) of the Exchange Act. The proposed transitional amendment, which is contained in Appendix 2 to this release, would make the communication requirements in AU sec. 380 applicable to audits of issuers and brokers and dealers, as those terms are defined in the Act. This would eliminate the above referenced gap in audit committee communications.

The new proposed standard, which would supersede AU sec. 380, does not contain any exception as to applicability to audits of brokers and dealers. Accordingly, the communication requirements under the new proposed standard would be applicable to the audits of brokers and dealers.

---

the audits of brokers and dealers do not fall within an SEC engagement as defined in AU sec. 380 if the broker or dealer is registered only because of Section 15(a) of the Exchange Act.

15/ See paragraph 1 of SAS 114, *The Auditor's Communication With Those Charged With Governance,* which states "[t]his statement . . . establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements", and section 5.129 of the *AICPA Audit & Accounting Guide: Brokers and Dealers in Securities* (July 2010), which states, in part: "AU section 380, *The Auditor's Communication with Those Charged with Governance* … has been updated for the issuance of SAS No. 114…. AU 380 is applicable to all broker-dealers being audited under GAAS, regardless of their governance structure or size."

V. Appendices

Appendix 1 to this release contains the text of the new proposed standard, *Communications with Audit Committees,* which has three appendices:

(1) Appendix A - Definitions,

(2) Appendix B - Communications with Audit Committees Required by Other PCAOB Rules and Standards, and

(3) Appendix C - Matters Included in the Audit Engagement Letter.

Appendix 2 to this release contains the transitional amendments to AU sec. 380. Appendix 3 to this release contains amendments to other existing PCAOB standards to conform them to the requirements in the new proposed standard. Appendix 4 provides additional discussion of the new proposed standard, the amendments to other PCAOB standards, and comments received on the original proposed standard. Appendix 5 to this release provides a comparison of the key objectives and requirements of the standard to the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants. In developing the new proposed standard, the Board considered the requirements of the relevant standards of the IAASB and the ASB.

VI. Questions

The Board requests comments on all aspects of the new proposed standard and is particularly interested in responses to the specific questions below.

1. Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

2. The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be

communicated to the audit committee that also are based on existing auditor performance obligations?

3. The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

   a. Is the requirement in the standard clear?

   b. As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

6. Are the amendments to other PCAOB standards appropriate? If not, why?

7. The Board requests comments regarding the audits of brokers and dealers on the following matters:

   a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?

b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

VII. Effective Date

The Board anticipates that the proposed transitional amendments to AU sec. 380 included in Appendix 2 would be effective, subject to SEC approval, for the periods that PCAOB standards become applicable to audits of brokers and dealers as designated by the SEC upon adoption of its amendments to Rule 17a-5.

The Board anticipates that the new proposed standard and related amendments will be effective, subject to SEC approval, for audits with fiscal years beginning on or after December 15, 2012.

VIII. Opportunity for Public Comment

The Board is seeking comments on the transitional amendments to AU sec. 380 and the new proposed standard and related amendments. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 030 in the subject or reference line and should be received by the Board no later than 5:00 PM (EST) on February 29, 2012.

The Board will consider all comments received. Following the close of the comment period, the Board will determine whether to adopt final rules, with or without amendments. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of the Act, proposed rules of the Board do not take effect unless approved by the SEC. Standards are rules of the Board under the Act.

On the 20th day of December, in the year 2011, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

APPENDIX 1

Proposed Auditing Standard

Communications with Audit Committees

Supersedes AU sec. 380, Communication With Audit Committees, and AU sec. 310, Appointment of the Independent Auditor

Introduction

1. This standard requires the auditor to communicate certain matters related to the conduct of an audit[1/] to a company's **audit committee**[2/] and to obtain certain information from the audit committee relevant to the audit. "Communicate to," as used in this standard, is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit. This standard also requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee and to record that understanding in an engagement letter.

2. Other Public Company Accounting Oversight Board ("PCAOB") rules and standards identify additional matters to be communicated to a company's audit committee (see Appendix B). Various laws or regulations also require the auditor to communicate other matters to the audit committee.[3/] The communication requirements of this standard do not modify or replace communications to the audit committee required by such other PCAOB rules

---

[1/] For purposes of this standard, an audit is either a financial statement audit or an audit of internal control over financial reporting that is integrated with an audit of financial statements.

[2/] Terms defined in Appendix A, *Definitions,* are set in **boldface type** the first time they appear.

[3/] *See* e.g., Section 10A(k) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 2-07 of Regulation S-X, 17 CFR 210.2-07, and Rule 10A-3 under the Exchange Act, 17 CFR 240.10A-3.

and standards, laws, or regulations. Nothing in this standard precludes the auditor from communicating other matters to the audit committee.

Objectives

3. The objectives of the auditor are to:

   a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

   b. Obtain information from the audit committee relevant to the audit;

   c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

   d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

Appointment and Retention

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

4. The auditor should discuss with the audit committee any significant issues discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

Establish an Understanding of the Terms of the Audit

5. The auditor should establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the following:

   a. The objective of the audit,

   b. The responsibilities of the auditor, and

   c. The responsibilities of management.

6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually. The auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[4/] If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

> Note: Appendix C describes matters that the auditor should include in the engagement letter about the terms of the audit engagement.

7. If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept, continue, or perform the engagement.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

8. The auditor should inquire of the audit committee whether it is aware of matters that might be relevant to the audit,[5/] including, but not limited to, knowledge of violations or possible violations of laws or regulations[6/] and complaints or concerns raised regarding financial reporting matters.[7/]

[4/] Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

[5/] In addition to this inquiry, paragraph 54 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* requires the auditor to inquire of the audit committee, or equivalent, or its chair regarding the audit committee's knowledge of the risks of material misstatement, including fraud risks.

[6/] *See* AU sec. 317, *Illegal Acts by Clients*, for a description of the auditor's responsibilities when a possible illegal act is detected. For audits of issuers, *see also* Rule 10A-1 under the Exchange Act, 17 CFR 240.10A-1.

[7/] *See* Paragraph 56.b.(3) of Auditing Standard No. 12, which requires the auditor to inquire of the audit committee or equivalent, or its chair, regarding whether the audit committee is aware of tips or complaints regarding

Overall Audit Strategy and Timing of the Audit

9. The auditor should communicate to the audit committee an overview of the overall audit strategy,[8/] including a discussion of the significant risks[9/] identified during the auditor's risk assessment procedures and the timing of the audit.

Note: This overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures.

10. As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;[10/]

---

the company's financial reporting (including those received through the audit committee's internal whistleblower program) and, if so, the audit committee's responses to such tips and complaints.

8/ *See* paragraphs 7-9 of Auditing Standard No. 9, *Audit Planning,* for a description of the auditor's responsibilities for establishing an overall audit strategy.

9/ Auditing Standard No. 12 requires the auditor to determine whether identified and assessed risks are significant risks. A significant risk is defined as a risk of material misstatement that requires special audit consideration.

10/ *See* paragraph 16 of Auditing Standard No. 9 for a description of the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

b. The extent to which the auditor plans to use the work of the company's internal audit function in an audit of financial statements;[11/]

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;[12/]

d. The names, locations, planned roles, and responsibilities, including the scope of audit procedures,[13/] of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

> Note: The term "firms" in the context of this communication includes other auditors, affiliates of the accounting firm (including member firms in the network), and non-affiliated firms that perform audit procedures.

[11/] *See* AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* which describes the auditor's responsibilities related to the work of internal auditors.

[12/] *See generally*, paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* which describe the auditor's responsibility related to using the work of others in an audit of internal control over financial reporting.

[13/] *See* paragraphs 8-14 of Auditing Standard No. 9, which discuss the auditor's responsibility for determining the audit strategy, audit plan, and multi-location engagements.

e. The basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit will be performed by other auditors.[14/]

> Note: The basis for the auditor's determination that he or she can serve as principal auditor includes situations in which the work is performed by affiliates of the auditor or non-affiliates.

11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

Results of the Audit

Accounting Policies, Practices, and Estimates

12. The auditor should communicate to the audit committee the following matters regarding accounting policies, practices, and estimates:

a. Significant accounting policies and practices.[15/]

(1) Management's initial selection of, and changes in significant accounting policies, or the application of such policies in the current period;

(2) The methods management used to account for significant unusual transactions; and

---

[14/] AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, discusses the professional judgments the auditor makes in deciding whether he or she may serve as principal auditor.

[15/] *See,* e.g., Financial Accounting Standards Board, Accounting Standards Codification, Notes to Financial Statements Topic, paragraph 235-10-50-1, which requires the entity to disclose a description of all significant accounting policies as an integral part of the financial statements and paragraph 235-10-50-3, which describes what should be disclosed.

(3) The effect of significant accounting policies on financial statements or disclosures in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

b. **Critical accounting policies and practices**. All critical accounting policies and practices, to be used, including:[16/]

(1) The reasons certain policies and practices are considered critical; and

(2) How current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

Note: Critical accounting policies and practices, as defined in Appendix A, are the company's accounting policies and practices that are both most important to the portrayal of the company's financial position and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. Critical accounting policies and practices are tailored to specific events in the current year and the accounting policies and practices that are considered critical might change from year to year.

c. **Critical accounting estimates**.

(1) A description of the process management used to develop critical accounting estimates;

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and

(3) Any significant changes management made to the processes used to develop critical accounting estimates or

---

[16/] *See also* Rule 2-07(a)(1) of Regulation S-X, 17 CFR 210.2-07(a)(1).

significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.[17/]

Note: As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, and estimates in paragraph 12. If management communicates any of these matters, the auditor does not need to communicate them at the same level of detail as management, as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor should communicate any omitted or inadequately described matters to the audit committee.

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

13. The auditor should communicate to the audit committee the following matters:

a. Qualitative aspects of significant accounting policies and practices. The results of the auditor's evaluation of and conclusions about the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements;[18/]

Note: The auditor should communicate to the audit committee situations in which the results of his or her

---

[17/] *See generally,* Securities Act Release No. 8350, Section V (December 29, 2003).

[18/] *See generally*, paragraphs 24-27 of Auditing Standard No. 14, *Evaluating Audit Results,* which describe the auditor's responsibility related to evaluating the qualitative aspects of the company's accounting practices.

evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, indicate a possible bias on the part of the company's management.[19/]

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make;

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates;

d. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth;[20/]

e. Matters for which the auditor consulted. Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are

---

19/ *See* paragraph 27 of Auditing Standard No. 14.

20/ *See* paragraphs 30 and 31 of Auditing Standard No. 14, which describe the auditor's responsibility related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Other PCAOB standards, such as AU sec. 334, *Related Parties,* and AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, describe the auditor's responsibility related to evaluation of specific disclosures in financial statements.

relevant to the audit committee's oversight of the financial reporting process;

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting;

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor;[21/] and

h. Material written communications. Other material written communications between the auditor and management.[22/]

Significant Unusual Transactions

14. The auditor should communicate to the audit committee significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature.[23/] Such communication should include the auditor's understanding of the business rationale for such transactions.[24/]

[21/] *See also* Rule 2-07(a)(2) of Regulation S-X, 17 CFR 210.2-07(a)(2).

[22/] *See also* Rule 2-07(a)(3) of Regulation S-X, 17 CFR 210.2-07 (a)(3).

[23/] *See* paragraph 71.g. of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*, which describes a significant unusual transaction.

[24/] *See* paragraph 66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* which describes the auditor's responsibilities related to significant unusual transactions.

Other Information in Documents Containing Audited Financial Statements

15. When other information is presented in documents containing audited financial statements, the auditor should communicate to the audit committee his or her responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.[25/]

Management Consultation with Other Accountants

16. When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, the auditor should communicate to the audit committee his or her views about such matters that were the subject of such consultation.

Going Concern

17. The auditor should communicate to the audit committee, when applicable, the following matters relating to his or her evaluation of the company's ability to continue as a going concern:[26/]

a. The conditions and events the auditor identified that, when considered in the aggregate, indicate that there could be substantial doubt about the company's ability to continue as a going concern for a reasonable period of time;[27/]

[25/] *See generally*, AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.* In addition to AU sec. 550, discussion of the auditor's consideration of other information is included in AU sec. 558, *Required Supplementary Information,* AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents,* and AU sec. 711, *Filings Under Federal Securities Statutes.*

[26/] *See* AU sec. 341 for the requirements regarding an auditor's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited.

[27/] *See* AU sec. 341.03a, which discusses the auditor's consideration of factors that indicate there could be substantial doubt about the company's ability to continue as a going concern.

b. If the auditor's doubt is mitigated, the information that mitigated the auditor's doubt, including, if applicable, a discussion of management's plans.

c. If the auditor concludes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time:[28/]

1. The effects, if any, on the financial statements and the adequacy of the related disclosure;[29/] and

2. The effects on the auditor's report.[30/]

Uncorrected and Corrected Misstatements

18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures[31/] that the auditor presented to management.[32/] The auditor should discuss with the audit committee, or determine that management has adequately discussed with the

---

[28/] *See* AU sec. 341.03b-c, which discuss the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

[29/] *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

[30/] *See* AU secs. 341.12-.16, which discuss the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

[31/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements also include omission and presentation of inaccurate or incomplete disclosures.

[32/] *See* Section 13(i) of the Exchange Act, which states, in part, that financial statements prepared in accordance with generally accepted accounting principles and filed with the Securities and Exchange Commission "shall reflect all material correcting adjustments that have been identified by a registered public accounting firm …."

audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[33/] considered. The auditor also should communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could cause future period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

19. The auditor should communicate to the audit committee those corrected misstatements that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

Departure from the Standard Auditor's Report

20. The auditor should communicate to the audit committee the following matters related to the auditor's report:

a. When the auditor expects to modify the opinion in the auditor's report, the reasons for the modification and the wording of the report; and

b. When the auditor expects to include explanatory language or an explanatory paragraph in the auditor's report, the reasons for the explanatory language or paragraph and the wording of the explanatory language or paragraph.

Disagreements with Management

21. The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report.

[33/] Appendix B of Auditing Standard No. 14 discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

Note: Disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved prior to the issuance of the auditor's report.

Difficulties Encountered in Performing the Audit

22. The auditor should communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

a. Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;

b. An unreasonably brief time within which to complete the audit;

c. Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;

d. Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and

e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

Note: Difficulties encountered by the auditor during the audit could represent a scope limitation,[34/] which may result in the auditor modifying the auditor's opinion or withdrawing from the engagement.

Other Matters

23. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes complaints or concerns regarding accounting or auditing matters that have come to the

---

[34/] *See* paragraphs .22-.32 of AU sec. 508, *Reports on Audited Financial Statements,* for a discussion of scope limitations.

auditor's attention during the audit and the results of the auditor's procedures regarding such matters.[35/]

Form and Documentation of Communications

24. The auditor should communicate to the audit committee the matters in this standard, either orally or in writing,[36/] unless otherwise specified in this standard. The auditor must document the communications in the workpapers, whether such communications took place orally or in writing.[37/]

> Note: If management communicated matters identified in paragraphs 12 or 18, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.

Timing

25. All audit committee communications required by this standard should be made in a timely manner and prior to the issuance of the auditor's report.[38/] The appropriate timing of a particular communication to the audit committee

---

[35/] Paragraphs .79-.81 of AU sec. 316 and AU sec. 317.17 include specific communication requirements relating to fraud or illegal acts.

[36/] *See* paragraphs .07-.11 of AU sec. 532, *Restricting the Use of an Auditor's Report,* which apply to certain reports on matters coming to the auditor's attention during the course of the audit.

[37/] Consistent with the requirements of Auditing Standard No. 3, *Audit Documentation*, the audit documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of this standard.

[38/] Consistent with Rule 2-07 of Regulation S-X, 17 CFR 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the rules or regulations of the Securities and Exchange Commission.

> Note: An auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit. The auditor, however, should communicate such matters to the full audit committee prior to the issuance of the auditor's report.

APPENDIX ***A – Definitions***

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Audit committee – a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

A3. Critical accounting estimate – an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

A4. Critical accounting policies and practices – a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

APPENDIX B – Communications with Audit Committees Required by Other PCAOB Rules and Standards

This appendix identifies other PCAOB rules and standards that require communication of specific matters between the auditor and the audit committee.

- Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist,* paragraphs 60, 62, and 64

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* paragraphs 78 - 81, 91, C7, and C14

- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* paragraphs 54 and 56

- PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*

- PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting*

- PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*

- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* paragraphs .79-.81

- AU sec. 317, *Illegal Acts by Clients,* paragraphs .08 and .17

- AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* paragraphs 4 - 7 and 9

- AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* paragraph .50

- AU sec. 333, *Management Representations*, paragraph .05
- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*, paragraphs .04 and .06
- AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*, paragraph .09
- AU sec. 711, *Filings Under Federal Securities Statutes*, paragraph .13
- AU sec. 722, *Interim Financial Information*, paragraphs .08, .09, .30, .31, and .33 - .36

Appendix C – Matters Included in the Audit Engagement Letter

C1. The auditor should include the following matters in the engagement letter.[1/] The auditor's description of these matters will vary depending on whether the auditor is engaged in a financial statement audit or in an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

a. The objective of the audit is:

1. Integrated audit: The expression of an opinion on both the effectiveness of internal control over financial reporting and the financial statements.

2. Audit of financial statements: The expression of an opinion on the financial statements.

b. Auditor's responsibilities:

1. The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

a. Integrated audit: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, an integrated audit is not

---

[1/] Certain matters should not be included in an engagement letter; e.g., under Section 602.02.f.i. of the Codification of Financial Reporting Policies, indemnification provisions are not permissible for audits of issuers.

designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

b. <u>Audit of financial statements:</u> Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

2. An audit includes:

a. <u>Integrated audit:</u> In fulfillment of the responsibilities noted above, the auditor should communicate:

1. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit in writing.

2. To the audit committee: all significant deficiencies identified during the audit in writing and inform the audit committee when

the auditor has informed management of all internal control deficiencies.

3. To management: all internal control deficiencies identified during the audit and not previously communicated in writing by the auditor or by others, including internal auditors or others within the company.

4. To the board of directors: any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, in writing.

b. Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed.[2/] An audit of financial statements is not designed to provide assurance on internal control or to identify internal control deficiencies. However, the auditor is responsible for communicating:

1. To the audit committee and management: all significant deficiencies and material weaknesses identified during the audit, in writing.

2. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion, in writing.

[2/] AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, provides direction on control deficiencies identified in an audit of financial statements.

c. Management's responsibilities:

1. Management is responsible for the company's financial statements, including disclosures.

2. Management is responsible for establishing and maintaining effective internal control over financial reporting.

3. Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities.

4. Management is responsible for making all financial records and relevant information available to the auditor.

5. At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.

6. Management is responsible for adjusting the financial statements to correct material misstatements relating to accounts or disclosures and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

C2. In connection with a review of interim financial information, to confirm and document the understanding, the auditor should either: (a) document in the audit engagement letter the nature and objectives of the engagement to review interim financial information and the responsibilities of management and the auditor or (b) issue a separate engagement letter that addresses such matters.[3/]

[3/] Paragraphs .08-.09 of AU sec. 722, *Interim Financial Information*, discuss the auditor's responsibilities related to establishing an understanding with the audit committee in connection with a review of the company's interim financial information.

APPENDIX 2

Proposed Amendments to AU sec. 380, Communication With Audit Committees

Auditing Standard

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is amended as follows:

a. The last sentence of paragraph .01 is replaced with:

> The communications required by this section are applicable to the audits of (i) issuers and (ii) brokers and dealers, as those terms are defined in the Sarbanes-Oxley Act of 2002, as amended.[2]

b. Footnote 2 to paragraph .01 is replaced with:

> *See* Sections 2(a)(7), 110(3) and 110(4) of the Sarbanes-Oxley Act of 2002.

APPENDIX 3

Proposed Amendments to PCAOB Standards

Auditing Standards

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, as amended, is amended as follows:

a. The following sentence is added at the end of paragraph 80:

   This communication should be made in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

b. The following sentence is added after the first sentence of paragraph 81:

   The auditor should communicate this information to the audit committee in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

Auditing Standard No. 9, *Audit Planning*

Auditing Standard No. 9, *Audit Planning*, is amended as follows:

a. Paragraph 6.c. is replaced with:

   Establish an understanding of the terms of the audit engagement with the audit committee in accordance with the proposed auditing standard, *Communications with Audit Committees.*

b. Footnote 4 to paragraph 6 is deleted.

c. In footnote 7 to paragraph 9.a., the references to AU sec. 310 and AU sec. 380, *Communication with Audit Committees*, are replaced with a reference to the proposed auditing standard, *Communications with Audit Committees*.

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, is amended as follows:

The note to paragraph 5.d. is deleted

AU sec. 310, "Appointment of the Independent Auditor"

SAS No. 1, "Codification of Auditing Standards and Procedures" section 310, "Appointment of the Independent Auditor" (AU sec. 310, "Appointment of the Independent Auditor"), as amended, is superseded.

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), as amended is amended as follows:

a. The third sentence of paragraph .79 is replaced with:

   Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to the audit committee in a timely manner and prior to the issuance of the auditor's report.

b. The second sentence of paragraph .81 is replaced with:

   Such a communication may be a part of an overall communication to the audit committee of business and financial statement risks affecting the entity and/or in conjunction with the auditor communication about the qualitative aspects of the entity's accounting policies and practices (see paragraphs 12 – 13 of proposed auditing standard, *Communications with Audit Committees*). The auditor should communicate these matters to the audit committee in a timely manner and prior to the issuance of the auditor's report.

c. Within footnote 10 to paragraph .88, the reference to section 380, *Communications With Audit Committees*, is replaced with a reference to the proposed auditing standard, *Communications with Audit Committees*.

AU sec. 317, "Illegal Acts by Clients"

SAS No. 54, "Illegal Acts by Clients" (AU sec. 317, "Illegal Acts by Clients"), as amended, is amended as follows:

a. The fourth sentence of paragraph .08 is replaced with:

The auditor should make inquiries of management and the audit committee[1] concerning the client's compliance with laws and regulations and knowledge of violations or possible violations of laws or regulations.

b. Footnote 1 is added to paragraph .08 after the term audit committee:

For this standard, audit committee is defined as a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, those persons designated to oversee the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.

c. The first sentence of paragraph .17 is replaced with:

The auditor should assure himself that the audit committee is adequately informed as soon as practicable and prior to the issuance of the auditor's report with respect to illegal acts that come to the auditor's attention.

d. Footnote 1 to paragraph .17 is deleted.

AU sec. 328, "Auditing Fair Value Measurements and Disclosures"

SAS No. 101, "Auditing Fair Value Measurements and Disclosures" (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), as amended, is amended as follows:

Paragraph .50 is replaced with:

Paragraphs 12-13 of the proposed auditing standard, *Communications with Audit Committees,* require the auditor to communicate to the audit committee matters related to critical accounting estimates, which may include fair value measurements.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows:

The following sentence is added as the last sentence of paragraph .05:

The auditor should provide a copy of the representation letter to the audit committee if management has not already provided the representation letter to the audit committee.

AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"

SAS No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), as amended, is amended as follows:

Paragraph .17A is added, along with the heading preceding this paragraph:

Communications with Audit Committees

Paragraph 17 of the proposed auditing standard, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the auditor's evaluation of a company's ability to continue as a going concern for a reasonable period of time.

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" *(*AU sec. 380*,* "Communication With Audit Committees"), as amended, is superseded.

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380"

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380," is superseded.

AU sec. 532, "Restricting the Use of an Auditor's Report"

SAS No. 87, "Restricting the Use of an Auditor's Report (AU sec. 532, "Restricting the Use of an Auditor's Report"), as amended, is amended as follows:

> In the second bullet point of paragraph .07, the reference to Section 380, *Communication With Audit Committees,* is replaced with a reference to the proposed auditing standard, *Communications with Audit Committees.*

AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"

SAS No. 8, "Other Information in Documents Containing Audited Financial Statements" (AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"), as amended, is amended as follows:

a. The sixth sentence of paragraph .04 is replaced with:

> If the other information is not revised to eliminate the material inconsistency, he should communicate the material inconsistency to the audit committee and consider other actions, such as revising his report to include an explanatory paragraph describing the material inconsistency, withholding the use of his report in the document, and withdrawing from the engagement.

b. The second sentence of paragraph .06 is replaced with:

> He should communicate the material misstatement of fact to the client and the audit committee in writing and consider consulting his legal counsel as to further appropriate action in the circumstances.

AU sec. 551, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents"

SAS No. 29, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents" (AU sec. 551, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents"), as amended, is amended as follows:

The second sentence of paragraph .09 is replaced with:

> If the client will not agree to revision of the accompanying information, the auditor should communicate the material misstatement to the audit committee and should either modify his report on the accompanying information and describe the misstatement or refuse to include the information in the document.

AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), as amended, is amended as follows:

The last sentence of paragraph .13 is replaced with:

> In either case, the accountant should communicate the matter to the audit committee and also consider withholding his consent to the use of his report on the audited financial statements in the registration statement.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), as amended, is amended as follows:

a. The heading preceding paragraph .08, "Establishing an Understanding With the Client" is replaced with the heading, "Establishing an Understanding with the Audit Committee."

b. Paragraph .08 is replaced with:

The accountant should establish an understanding of the terms of an engagement to review interim financial information with the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee).[6] This understanding includes the objective of the review of interim financial information, the responsibilities of the accountant, and the responsibilities of management. Such an understanding reduces the risk that either the accountant or the audit committee may misinterpret the needs or expectations of the other party. The accountant should record this understanding of the terms of the engagement in an engagement letter and should provide the engagement letter to the audit committee. The accountant should have the engagement letter executed by the appropriate party or parties. If the accountant believes he or she cannot establish an understanding of the terms of an engagement to review interim financial information with the audit committee, the accountant should decline to accept or perform the engagement.

c. Footnote 6 to paragraph .08 is replaced with:

See paragraph 16 of Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

d. In the first sentence of paragraph .09, the word "client" is replaced with the words "audit committee."

e. Paragraph .30 is replaced with:

If management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should communicate these matters to the audit committee as soon as practicable and before the registrant files its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 24 of proposed auditing standard, *Communications with Audit Committees.*

f. The following sentence is added at the end of paragraph .33:

The accountant should communicate significant deficiencies or material weaknesses of which that the accountant has become aware to the audit committee or those responsible for oversight of the company's financial reporting in a timely manner and prior to the registrant filing its periodic report with the SEC.

g. Paragraph .34 is replaced with:

When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in the proposed auditing standard, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee in a timely manner and prior to the registrant filing its periodic report with the SEC. For example, the accountant should communicate a description of the process management used to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that management determined to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole.[23] As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, and estimates in paragraph 12 of proposed auditing standard, *Communications with the Audit Committees*. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as the accountant (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the accountant considers critical. The accountant should communicate any omitted or inadequately described matters to the audit committee.

h. Footnote 23 to paragraph .34 is replaced with:

The schedule of uncorrected misstatements related to accounts and disclosures provided to the audit committee should be same schedule that was included in or attached to the management representation letter that is described in paragraph .24(*k*) of this section.

i. The last two sentences of paragraph .35 are replaced with:

Therefore, any communication the accountant may make about the entity's accounting policies, practices, and estimates as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the qualitative aspects of the entity's accounting policies and practices that would be identified as a result of an audit.

j. Paragraph .36 is replaced with:

If the accountant has identified matters to be communicated to the audit committee, the accountant should communicate such matters to the audit committee, or at least its chair, in a timely manner and before the registrant files its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 24 of proposed auditing standard, *Communications with Audit Committees.*

Quality Control Standards

QC sec. 20, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice"

QC sec. 20, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice," as amended, is amended as follows:

In paragraph .16:

- In the first sentence, the word "client" is replaced with the words "audit committee."
- The last sentence is deleted.

APPENDIX 4

Additional Discussion of the New Proposed Standard, Amendments to PCAOB Standards, and Comments on the Original Proposed Standard

This appendix discusses *Communications with Audit Committees* (the "new proposed standard"), presented in Appendix 1, and the related proposed amendments to PCAOB standards in Appendix 3. In particular, this appendix provides additional background information for certain requirements in the new proposed standard and related amendments.

On March 29, 2010, the Board issued a proposed standard (the "original proposed standard") on communications with audit committees,[1/] reopened the comment period on September 7, 2010, and held a public roundtable on September 21, 2010. This appendix discusses the Board's responses to comments received on the original proposed standard, including comments at the roundtable ("commenters"), as well as the basis for the Board's preliminary determinations regarding certain requirements.

I. Definition of Audit Committee

The original proposed standard incorporated the definition of "audit committee" from section 2(a)(3) of the Sarbanes-Oxley Act of 2002 (the "Act"), which states that an audit committee is a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; if no such committee exists with respect to an issuer, the entire board of directors of the issuer.[2/] The new proposed standard includes a modified version of that definition as discussed below.

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[3/] granted the Board oversight of the audits of brokers and

---

[1/] PCAOB Release No. 2010-001, *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards* (March 29, 2010).

[2/] Section 2(a)(3) of the Act.

[3/] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

dealers registered with the U.S. Securities and Exchange Commission ("SEC"). On June 15, 2011, the SEC proposed[4/] to amend its rules to require, among other things, that audits of brokers' and dealers' financial statements and examinations and reviews of reports regarding compliance with SEC requirements be performed in accordance with the standards of the PCAOB. The Board recognizes, however, that some brokers and dealers may have governance structures that do not include boards of directors or audit committees. For the auditor communication requirements to apply to the audits of brokers and dealers or other nonissuers, the definition of audit committee has been modified to add " for the audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to a company, those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company."

The revised definition of "audit committee" would require the auditor to identify the bodies or persons that oversee the company's accounting, auditing and financial reporting processes to find the appropriate recipient of the communications under the standard.[5/] For issuers, the proposed definition is the same as the definition included in the Act.[6/] For nonissuers, the proposed definition contains three categories of bodies or persons, with the first two being the same the definition for an issuer and the third category covering situations in which the company does not have a board of directors or equivalent body, such as certain non-public brokers and dealers.

The term "audit committee," for the purposes of the new proposed standard, therefore, would be the committee (or equivalent body) established by the board of directors to oversee the accounting and financial reporting processes of the company and audits of the entities of the financial statements.

[4/] See Broker-Dealer Reports, Exchange Act Release No. 64676.

[5/] The Board’s proposed definition is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, or an entity’s governing documents regarding the establishment, approval, or ratification of boards of directors or audit committees, or the delegation of responsibilities of such a committee or board.

[6/] Section 2(a)(3) of the Act.

If no such committee exists then, consistent with the Act, the term "audit committee" would refer to the entire board of directors. For nonissuers, if there is no audit committee or board (or equivalent body), then the term "audit committee" in the new proposed standard would refer to those designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company. The Board is proposing to include the parenthetical phrase "or equivalent body" after the term "board of directors" to clarify that entities with bodies performing a function similar to that of a corporate board of directors would fit within this category. There would be no need for a formal "designation" of the persons in the third category. The word "designated" is meant to imply that senior persons with decision making authority and responsibility in such circumstances should be the recipients of the auditor communications.[7/]

II. Objectives

The original proposed standard stated that the objectives of the auditor are (a) communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee; (b) communicating to the audit committee an overview of the audit strategy and timing of the audit; (c) providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and (d) evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit.

Most commenters indicated that the objectives stated in the original proposed standard were appropriate. Some commenters indicated that it is important for the auditor to obtain information that is relevant to the audit from the audit committee and that the objectives should emphasize the importance of receiving such information. The Board agrees and has added this as another objective of the auditor in the new proposed standard. Additionally, in response to commenter's concerns, the auditor's evaluation of the adequacy of the two-way communications between the auditor and the audit committee was

---

[7/] For example, in an owner-managed entity, the designated person would be the owner. For a limited partnership, the designated person may be the managing or general partner responsible for preparation of the financial statements.

removed from the objectives to be consistent with the removal of the related requirement in the standard.[8/]

Several commenters indicated that the objectives listed in the original proposed standard only summarize the requirements of the original proposed standard. These commenters suggested that the objectives should be revised to assist the auditor in understanding the requirements of the original proposed standard, not just repeating them. The objectives of the standard are intended to highlight the overall context for the requirements in the standard. Accordingly, the objectives of the new proposed standard were revised to reflect the revisions made to the original proposed standard.

III. Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

The original proposed standard retained the requirement in AU sec. 380, *Communication With Audit Committees*, for the auditor to discuss with the audit committee any significant issues that were discussed with management in connection with the initial appointment or retention of the auditor, including any discussions regarding the application of accounting principles and auditing standards.[9/] Several commenters indicated that it was not necessary to retain this requirement since auditors of listed companies are hired by the audit committee subsequent to the Act.[10/] The requirement in AU sec. 380 was written prior to the Act. The Board retained this requirement because the audit committee might ask management for its views concerning the appointment or retention of the auditor based on the interaction between the auditor and

[8/] See further discussion of the removal of this requirement in section XX, Adequacy of the Two-Way Communication Process, of this appendix.

[9/] Paragraph 15 of AU sec. 380.

[10/] The Act directed the SEC to promulgate rules that require the audit committee of issuers with securities listed on a national securities exchange or in an automated inter-dealer quotation system through a national securities association be directly responsible for the appointment, compensation, and oversight of the work of the auditors (*see* Section 301 of the Act).

management. Additionally, management's views might be influenced by the auditor's evaluations and conclusions regarding the application of accounting principles or auditing standards.

One commenter suggested that the communication should be limited to significant discussions regarding the application of accounting principles or auditing standards. Accordingly, the wording in the original proposed standard was revised from "any discussions regarding the application of accounting principles and auditing standards" to "significant discussions" in order to narrow the scope of the communications to only the most important matters that might influence the appointment or retention of the auditor.

IV. Establish an Understanding of the Terms of the Audit

The original proposed standard included a specific requirement for the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee. This requirement was included to ensure that the auditor and the audit committee understand the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management.

Some commenters indicated that in addition to the responsibilities of the auditor and management, the engagement letter also should include the responsibilities of the audit committee related to the audit. Other commenters indicated that the audit committee's responsibilities are already set out in the audit committee charter and that those responsibilities should be left to the governance process, subject to the rules of the SEC or the stock exchange governance rules. The Board considered this suggestion and did not change the standard to include the responsibilities of the audit committee, as those responsibilities are governed by other rules.

Several commenters noted that the original proposed standard did not specifically state that the engagement letter should be provided to the audit committee annually. Under the timing section of the original proposed standard, all communications required by the original proposed standard should be made annually, including the engagement letter. However, to clarify the requirement, the new proposed standard was revised to specifically require that the engagement letter be provided to the audit committee annually.

Another commenter indicated that it was unclear whether the Board's intent was for the engagement letter to be prepared annually or provided annually to the audit committee. In establishing this requirement, it is not the Board's intent to have the auditor prepare a new engagement letter every year if there is no change from the prior year. Rather the Board's intention is for the auditor to confirm his or her understanding of the terms of the audit engagement with the audit committee by providing them with the engagement letter annually.

The original proposed standard required the auditor to have the engagement letter executed by the appropriate party or parties.[11/] The new proposed standard adds that if the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement. Obtaining the audit committee members' signatures, or its chair's signature on behalf of the audit committee, or the audit committee's acknowledgement regarding the terms of the audit engagement reduces the risk that either the auditor or the audit committee might misinterpret the expectations of the other party.

The acknowledgement by the audit committee may be provided orally to the auditor or may be demonstrated through other means, such as the minutes of the audit committee meeting. An acknowledgement by the audit committee or the signature of the audit committee members, or the signature of its chair on behalf of the audit committee, on the engagement letter is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, or the company's governing documents, regarding the authority or lack of authority, of the audit committee to enter into any contract or agreement with the auditor.

Other commenters suggested that the auditor should highlight the changes in the engagement letter from the prior year. The Board did not consider it necessary to establish a requirement for the auditor to highlight changes in the engagement letter; however, auditors might wish to do so and the audit committees might make such a request of the auditors.

Appendix C of the original proposed standard described matters that should be included in an engagement letter, including the objective of the audit

---

[11/] Absent evidence to the contrary, the auditor may rely on the company’s identification of the appropriate party or parties to execute the engagement letter.

and the responsibilities of the auditor and management. Some commenters suggested adding additional matters to be communicated in the audit engagement letter, such as the audit fees and the timing of the audit. The Board considered the suggested changes to Appendix C and determined that it would be impractical for the standard to list all matters that could be included in an engagement letter. However, other matters could be included, as agreed upon by the auditor and the audit committee, so long as those matters are not in violation of other standards or rules, e.g., independence requirements.

V. Obtaining Information Related to the Audit

The original proposed standard included a requirement for the auditor to inquire of the audit committee about whether it is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. This inquiry would complement the requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks, in accordance with Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.[12/] This requirement was included in the original proposed standard because, in addition to the inquiries required as part of the risk assessment procedures, audit committees may be aware of other matters that might be relevant to the auditor in planning and performing audit procedures (e.g., strategic decisions that might significantly affect the nature, timing, and extent of audit procedures).

Additionally, complaints or concerns may come to the audit committee's attention through the audit committee's process for reporting ethics violations or concerns related to financial reporting[13/] that are relevant to the audit. It is important that the auditor's discussions of these matters with the audit committee be robust and substantive. The new proposed standard does not provide specific timing for these inquiries to be made; however, information provided by the audit committee could require the auditor to adjust planned audit procedures. Therefore, performing these inquiries early in the audit

---

12/ *See* paragraph 54 of Auditing Standard No. 12.

13/ *See generally*, Section 10A(m)(4) of the Exchange Act, and Rule10A-3(b)(3) of the Exchange Act 17 CFR 240.10A-3(b)(3).

process would enable the auditor to incorporate the information received from the audit committee into the audit strategy.

Several commenters suggested that the standard should emphasize that inquiries of the audit committee should not be limited to matters that arise from complaints or concerns regarding accounting or auditing matters. Those commenters suggested that the inquiries of the audit committee should be expanded to include other matters, such as noncompliance with laws and regulations, knowledge of illegal acts or potential illegal acts, complaints or concerns during a client's enterprise risk management assessment, and issues brought forward that may impact internal controls. The requirement in the original proposed standard was not meant to be limited only to matters that arise from complaints or concerns raised regarding accounting or auditing matters. Therefore, the new proposed standard was revised to require the auditor to inquire of the audit committee about matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters.

One commenter suggested that the responses from the audit committee should be documented in an audit committee representation letter addressed to the auditor. The commenter indicated that the letter would provide written confirmation of the audit committee's awareness of certain matters relating to the audit, which is similar to the management representation letter. AU sec. 333, *Management Representations,* requires the auditor to obtain written representation from management to complement other auditing procedures, ordinarily to confirm representations explicitly or implicitly given to the auditor. Typically, written representations are obtained from those responsible for the preparation of the financial statements. Due to its responsibility for the preparation of the financial statements and its responsibilities for the company's operations, management would be expected to have sufficient knowledge of the preparation of the financial statements in order to provide written representation. The audit committee's responsibilities are typically different from management's responsibilities for the preparation of the financial statements and the conduct of the company's operations. Therefore, it was not considered necessary to include a requirement to obtain representation from the audit committee that is similar to that obtained from management. However, neither the new proposed standard nor PCAOB rules preclude an auditor from requesting a representation letter from the audit committee. Additionally, AU sec. 333 currently states that, in certain circumstances, the auditor may want to obtain written representations from other individuals (such as to verify completeness of meetings of stockholders, directors, and committees).

One commenter suggested that when the audit committee is not made up of entirely independent directors, but primarily includes management directors, the auditor should employ a greater degree of skepticism than would be applied if the audit committee consisted entirely of independent directors. Auditing standards require the auditor to exercise professional skepticism regarding gathering and evaluating audit evidence.[14/] Because the auditor is required to exercise professional skepticism in the performance of an audit, creating different degrees of skepticism in this standard based on the make-up of the audit committee was not deemed necessary or appropriate. Additionally, Auditing Standard No. 12 requires that, when evaluating management's responses to inquiries about fraud risks and determining when it is necessary to corroborate management's responses, the auditor should take into account the fact that management is often in the best position to commit fraud and the auditor should obtain evidence to address inconsistencies in responses to inquiries.[15/] Therefore, the new proposed standard was not revised to discuss situations in which the audit committee consists primarily of management directors.

VI. Overall Audit Strategy and Timing of the Audit

The original proposed standard included a requirement for the auditor to communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified by the auditor,[16/] and the timing of the audit. Under this requirement the auditor communicates to the audit committee the results of audit procedures performed in accordance with

---

[14/] *See* paragraph .07 of AU sec. 230, *Due Professional Care in the Performance of Work*, and paragraph 7 of Auditing Standard No. 13, *The Auditor’s Responses to the Risks of Material Misstatement*.

[15/] *See* paragraph 58 of Auditing Standard No. 12.

[16/] *See* paragraph A5 of Auditing Standard No. 12, which defines significant risk.

other PCAOB standards, such as Auditing Standard No. 9, *Audit Planning,* which requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan.

One commenter suggested that management should lead the discussion regarding significant risks, with the auditor's involvement. As part of the auditor's risk assessment process, the auditor is required to identify and assess the risk of material misstatement, including significant risks.[17/] A significant risk is a risk of material misstatement that requires special audit consideration.[18/] These risks may be similar to risks that management identifies, but the auditor's communication to the audit committee is specific to the significant risks the auditor has identified in accordance with Auditing Standard No. 12. Therefore, the new proposed standard was not revised.

Several commenters suggested that the communication of the audit strategy and significant risks should be made as early as possible in the audit process. The original proposed standard required that the communications be made in a timely manner, which depends on factors such as the significance of the matter and corrective or follow-up action needed. Therefore, further specification in the new proposed standard regarding timing was not considered necessary because facts and circumstances may vary from audit to audit. However, early communication of these matters might enable the audit committee to understand the auditor's views regarding risk and thereby provide an opportunity for the audit committee to communicate insights regarding additional risks that the auditor did not identify and allow the auditor to incorporate the additional risks in a timely manner into the audit strategy.

The original proposed standard also included a requirement for the auditor to communicate, in a timely manner, significant changes to the planned audit strategy or the significant risks initially identified. One commenter suggested that the statement "due to the results of audit procedures or in response to external factors," which was included in the release accompanying

---

17/ *See* paragraphs 59, 70, and 71 of the Auditing Standard No. 12.

18/ The factors the auditor should evaluate in determining which risks are significant risks are included in paragraph 71 of Auditing Standard No. 12.

the original proposed standard, also should be included in the standard. This additional language was not added to the new proposed standard as there could be other circumstances that might require changes to the planned audit strategy or significant risks, such as changes in the company's performance or subsequent events. This communication will inform the audit committee of the matters that might impact the audit procedures or timing of the audit procedures to be performed.

A. Specialized Skill or Knowledge

The original proposed standard included a requirement for the auditor to communicate 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.[19/] Several commenters suggested that the communication about persons with specialized skill or knowledge should focus on specialists whose work merits the audit committee's attention based on the nature of the specialist's involvement and the relative complexity and significance of the financial reporting area for which the specialist is involved. Commenters also suggested that the communication should not include the firm's tax and information technology specialists. The requirement in the new proposed standard is designed to communicate the determination the auditor is required to make as part of developing the audit strategy in Auditing Standard No. 9. In response to commenters, the new proposed standard was revised to limit the communication to specialized skill or knowledge needed related to significant risks.

Other commenters indicated that the proposed standard was unclear regarding whether the Board intended this requirement to apply to all specialists or only to those specialists outside the audit firm. Many audit firms have employees with specialized skill or knowledge that the engagement team can utilize. However, other firms might not have such in-house expertise. The focus of this requirement is on the communication about the need for specialized skill or knowledge, regardless of whether the specialist is from

[19/] See paragraph 16 of Auditing Standard No. 9 for the description of the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

within the firm or outside the firm. Therefore, the language from the original proposed standard was retained.

B. Internal Audit

The original proposed standard required the auditor to communicate to the audit committee the auditor's consideration of, and planned use of, the company's internal audit function to perform audit procedures in an audit of financial statements. In addition, the original proposed standard required that the auditor communicate the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting.

One commenter suggested that the original proposed standard implied that the auditor can use the internal audit staff without limit and without regard to other mandated responsibilities. Therefore, the commenter suggested that the standard should focus on the auditor's use of the internal auditor's work, including a cooperative and coordinated relationship, and that the audit strategy should include the approach to risk assessment and evaluation of the control environment. Auditing Standard No. 9 requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan, including the nature, timing, and extent of resources necessary to perform the engagement. Other standards, including AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* and Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, provide additional requirements and impose limits on the use of internal audit staff. The requirement in the new proposed standard is to communicate to the audit committee the extent to which the auditor plans to use the work of the company's internal audit function, as determined in the audit plan. That communication requirement does not impact the limitations imposed by other standards on the auditor's use of the internal audit function.

C. Firms or Other Accountants Performing Audit Procedures

The original proposed standard required the auditor to communicate to the audit committee the roles, responsibilities, and locations of firms participating in the audit. In planning and performing an audit, an auditor determines the locations or business units at which to perform audit procedures. Auditors might anticipate using affiliated or network firms, non-affiliated firms or other persons to perform audit procedures at individual locations, business units or specific audit areas.

Several commenters suggested that the standard should clarify which firms are covered by this requirement. The new proposed standard was revised to require that the auditor communicate the names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period. Additionally, the standard includes a note to clarify that this communication includes other auditors, affiliates of the accounting firm (including member firms in the network), and non-affiliated firms that perform audit procedures. The requirement for the auditor to communicate the names, locations, planned roles, and responsibilities of such firms and other accountants would provide information to the audit committee regarding the parties involved in the audit. This requirement also might facilitate a discussion of how the work of other parties would affect the audit.

Another commenter suggested that the requirement should not include the locations or business units for which only a statutory audit is performed. The communication requirement in the new proposed standard relates to the audit of the consolidated financial statements, which may or may not include reliance on audit procedures performed as part of statutory audits. The Board's intention is for the auditor to communicate to the audit committee the roles and responsibilities of firms whose work the auditor plans to use in the audit to form the basis for his or her opinion on the consolidated financial statements.

One commenter suggested that the proposed standard should require the auditor to disclose the percentage of audit work performed by each firm based on assets, revenues, or other criteria. The communication requirement regarding the work performed by other firms is related to the names, locations, planned roles, and responsibilities, but does not include a requirement for the auditor to communicate the percentage of audit work performed by each firm. It should be noted however that the Board has proposed amendments to AU sec. 508, *Reports on Audited Financial Statements*,[20] that would require the auditor to disclose in the auditor's report the names, locations, and percentage of hours attributable to the audits or audit procedures performed by the other participants in the audit in relation to the total audit hours in the most recent period's audit. If, at the conclusion of that rulemaking project, the Board adopts the proposed disclosure requirements for the auditor's report, the Board may consider, in a future rulemaking project, amending the *Communications with Audit Committees* standard to require the auditor to communicate these matters to the audit committee.

One commenter indicated that communication regarding affiliated or network firms participating in the audit might put local, regional, and national firms at a disadvantage to large international firms due to their lack of singular branded audit name recognition. The requirement to communicate other participants in the audit was retained, because the audit committee should be aware of other independent public accounting firms or other persons involved in the audit, whether the audit is performed by affiliates of the auditor or non-affiliates.

D. Principal Auditor

The original proposed standard required the auditor to communicate the basis for the auditor's determination that he or she can serve as principal auditor. Several commenters noted that, in many circumstances, this determination does not require significant consideration given the relative insignificance of the involvement of other auditors. These commenters suggested that this issue is unlikely to merit the attention of the audit committee. Therefore, the requirement related to serving as principal auditor was revised to require the auditor to communicate to the audit committee the basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit would be performed by other auditors, whether such work is performed by affiliates of the auditor or non-affiliates.

---

[20] *See* amendments to AU sec. 508 proposed by PCAOB Release No. 2011-007, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2* (October 11, 2011).

E. Other Matters Related to the Overall Audit Strategy and Timing of the Audit

The original proposed standard noted that the overview of the audit strategy is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures. Communicating certain details might reduce the effectiveness of those audit procedures.

Several commenters suggested that the auditing standard should identify certain matters that should not be communicated to the audit committee, such as materiality levels, tolerable error, amounts below which audit differences are not accumulated, and the extent and detailed scope of tests and procedures. The original proposed standard did not require the communication of these matters, rather, it left the matters to be communicated and the level of detail to the discretion of the auditor. However, as noted in the original proposed standard, the information communicated should not provide specific details that would compromise the effectiveness of the audit procedures. Therefore, the new proposed standard was not revised.

Several commenters suggested that audit committee members are interested in an assessment of the "tone at the top" of the organization, including financial management. However, these same commenters indicated that the Board should not make this assessment a requirement in the standard. In accordance with other PCAOB standards, the auditor is required to evaluate the control environment of the company[21/] including:

- Whether management philosophy and operating style promote effective internal control over financial reporting; and
- Whether sound integrity and ethical values, particularly of top management, are developed and understood.

If, based on this evaluation, the auditor determines that a significant deficiency or material weakness exists, the auditor must communicate these

---

21/ *See* paragraph 25 of Auditing Standard No. 5 and paragraph 23 of Auditing Standard No. 12.

matters to the audit committee.[22] Additionally, if the auditor determines that a significant risk exists related to "tone at the top" at the company, the new proposed standard requires the auditor to communicate to the audit committee significant risks identified. Therefore, it was not necessary to revise the new proposed standard to require the auditor to communicate an assessment of "tone at the top." In any event, the new proposed standard does not preclude an auditor from responding to the audit committee's request for the auditor to comment on "tone at the top."

VII. Accounting Policies, Practices, and Estimates

The original proposed standard required the auditor to communicate certain matters related to the company's accounting policies, practices, and estimates.

A. Accounting Policies and Practices

The original proposed standard required the communication to the audit committee of the company's significant accounting policies and practices and also the critical accounting policies and practices. The original proposed standard defined critical accounting policies and practices using the same definition that the SEC uses.

Some commenters indicated that the standard should define both significant and critical accounting policies and practices, while other commenters suggested that adding examples to differentiate between significant accounting policies and practices and critical accounting policies and practices might be helpful. Another commenter indicated that the original proposed standard is consistent with current PCAOB and SEC requirements as they relate to the difference between significant accounting policies and practices and critical accounting policies and practices.

The Board has retained both the term "significant accounting policies and practices" and "critical accounting policies and practices." The term "significant accounting policies and practices" is consistent with AU sec. 380 and understood in practice and therefore has not been separately defined. The

---

[22] *See* paragraph 4 of AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, and paragraph 78 and 80 of Auditing Standard No. 5.

PCAOB
Public Company Accounting Oversight Board

Financial Accounting Standards Board's ("FASB"), Accounting Standards Codification ("ASC") and the International Accounting Standards Board ("IASB"), require the company to disclose a description of all significant accounting policies as an integral part of the financial statements.[23/] For example, the FASB ASC recognizes that an entity's description of its significant accounting policies is an integral part of its financial statements.[24/]

The term "critical accounting policies and practices" is defined by the SEC as a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.[25/] The selection of significant accounting policies and practices involves a broader range of transactions and events over time, while the selection of critical accounting policies and practices is tailored to specific events in the current year. Therefore, critical accounting policies and practices might essentially be viewed as a subset of significant accounting policies and practices.

23/ *See* FASB, ASC, Notes to Financial Statements Topic, section 235-10-50. As part of this disclosure, the entity is required to disclose accounting policies and to describe the accounting principles followed by the entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations. Additionally, *see* paragraph 117 of International Accounting Standard 1, *Presentation of Financial Statements,* which requires the entity to disclose the summary of significant accounting policies, including measurement basis used in preparing the financial statements and other accounting policies that are relevant to understanding the financial statements.

24/ *See* FASB ASC paragraph 235-10-50-1 through ASC paragraph 235-10-50-6.

25/ *See* Securities Act of 1933 ("Securities Act"), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Release No. 8183 (March 27, 2003).

1. Significant Accounting Policies and Practices

The new proposed standard generally retains the requirements from AU sec. 380 related to communication of the company's significant accounting policies and practices, including:

- Management's initial selection of, and changes in significant accounting policies, or the application of such policies in the current period;
- The methods management used to account for significant unusual transactions; and
- The effect of significant accounting policies on financial statements or disclosures in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

The original proposed standard included a requirement for the auditor to communicate to the audit committee the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. The word "emerging" was removed from the new proposed standard as there might be areas for which there is a lack of authoritative guidance or consensus, or diversity in practice that are no longer emerging that warrant the attention of the audit committee.

The new proposed standard requires the auditor to communicate significant accounting policies and practices to the audit committee, whereas AU sec. 380 required the auditor only to determine that the audit committee was "informed." This change in wording is intended to promote the auditor's active participation in the communication of the significant accounting policies and practices, rather than just the determination that the audit committee was informed.

2. Critical Accounting Policies and Practices

The original proposed standard required 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. Some commenters indicated that the Board should clarify whether this requirement is intended for the auditor to communicate matters in addition to the existing requirements in AU sec. 380 and the SEC's Rule 2-07 of Regulation S-X.[26/] Some commenters recommended deleting the requirement for communicating anticipated future events since the auditor cannot predict the future.

The new proposed standard retains the SEC requirements from the original proposed standard regarding communication of anticipated future events related to critical accounting policies and practices. The new proposed standard also notes that critical accounting policies and practices are tailored to specific events in the current year and that the accounting policies and practices that are considered critical might change from year to year. For example, a significant merger or acquisition may result in the related accounting policy being considered critical in the year in which the related transaction occurs, but not in subsequent years.

B. Critical Accounting Estimates

The original proposed standard retained existing requirements regarding accounting estimates from AU sec. 380.08. The original proposed standard also included the following new requirements for the auditor to communicate:

a. How management subsequently monitors critical accounting estimates;

b. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;

c. Any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes; and

d. When critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and

---

[26/] 17 CFR 210.2-07, Section 10A(k) of the Exchange Act also requires the auditor to report this information to the audit committee.

how various selections within the range would affect the company's financial statements.

As the term "critical accounting estimate" implies, the communication is not designed to encompass a long list of accounting estimates resulting from the application of accounting policies that cover a substantial number of line items in the company's financial statements. Rather, the original proposed standard defined the term "critical accounting estimate" as an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (b) the impact of the estimate on financial condition or operating performance is material. This definition of critical accounting estimate is the same definition the SEC uses in connection with management's discussion and analysis of the company's financial condition and results of operations.[27/] The term critical accounting estimate is used to help focus the communication to the audit committee on those estimates, including certain fair value estimates, that might be subject to a higher risk of material misstatement. The definition of a critical accounting estimate is intended to include those estimates deemed "particularly sensitive" under AU sec. 380.[28/]

Some commenters supported the communication requirements regarding critical accounting estimates as presented in the original proposed standard. Other commenters expressed concern regarding the amount of communication requirements in the original proposed standard related to critical accounting estimates. One commenter indicated that the required communications for critical accounting estimates were overly prescriptive and would be challenging to implement. Additionally, some commenters suggested that how management subsequently monitors critical accounting estimates should be solely management's responsibility and not the responsibility of the

---

[27/] *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (December 19, 2003).

[28/] See AU sec. 380.08, which states in part, "certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments."

auditor. Some commenters also suggested that, instead of requiring the auditor to determine how various selections within a range would affect the company's financial statements, the auditor should supplement management's communications by providing the audit committee with the auditor's views regarding the reasonableness of management's critical accounting estimates as well as the auditor's concerns regarding management bias, if any. Some commenters indicated that the standard should provide additional guidance that allows for the auditor's consideration of when communications regarding critical accounting estimates merit the attention of the audit committee.

In response to comments received, the original proposed requirements to communicate how management subsequently monitors critical accounting estimates and to communicate when critical accounting estimates involve a range and how various selections within the range would affect the company's financial statements were removed from the new proposed standard.

Although these requirements were removed from the new proposed standard, the Board notes that the SEC has stated that management should disclose in management's discussion and analysis ("MD&A") section of the Form 10-K the company's critical accounting estimates.[29/] According to the related SEC release, management's discussion should present, among other matters, the company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time and analyze an estimate's specific sensitivity to change based on other outcomes that are reasonably likely to occur and would have a material effect.[30/] AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires the auditor to read the other information in documents containing audited financial statements and consider whether the information, or the manner of its presentation, is materially inconsistent with information in the financial statements or is a material misstatement of fact.[31/]

[29/] *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (December 19, 2003).

[30/] Ibid.

[31/] AU secs. 550.04-.05.

The new proposed standard includes a requirement for the auditor to communicate to the audit committee the results of such procedures (see Section X. Other Information in Documents Containing Audited Financial Statements for further discussion).

C. Consideration of Communications Made by Management

The original proposed standard retained the substance of the communication requirements in AU sec. 380 regarding accounting policies, practices, and estimates. Similar to AU sec. 380, the original proposed standard acknowledged that management also may be communicating certain matters related to the financial reporting process to the audit committee. The original proposed standard required the auditor to communicate certain matters but also provided that, if management communicated the matters to the audit committee, the auditor should determine whether all the matters were adequately described. If not, the original proposed standard required the auditor to communicate any omitted or inadequately described matters to the audit committee.

The original proposed standard included a requirement that was consistent with Section 10A(k) of the Exchange Act, which requires auditors of issuers and certain registered investment companies to report all critical accounting policies and practices to the issuer's audit committee.[32/] Some commenters suggested that management, rather than the auditor, should communicate to the audit committee the company's critical accounting policies and practices. One commenter indicated that, despite the statutory requirement in the Exchange Act, the communication of critical accounting estimates is the responsibility of management. The commenter also indicated that the auditor should supplement management's communications by providing his or her views about the quality and reasonableness of management's selection, application, and disclosure of critical accounting estimates, as well as his or her concerns regarding potential bias in management's estimates. Some commenters indicated that the requirements for auditors to communicate the accounting policies, practices, and estimates would be duplicative of management's communication. Another commenter, however, indicated that the auditor should communicate these matters to the audit committee even if management has already described these matters to the audit committee.

32/ *See also* Rule 2-07 of Regulation S-X, 17 CFR 210.2-07.

The Board recognizes that management as well as the auditor might discuss accounting policies, practices, and estimates with the audit committee and that it would not be cost-effective or practical for the audit committee to listen to essentially the same presentation twice. Therefore, the new proposed standard indicates that the auditor communication requirement under the standard would be met if the auditor (1) participates[33/] in management's discussion with the audit committee about accounting policies, practices, and estimates; (2) affirmatively confirms to the audit committee that management has adequately discussed the company's accounting policies, practices, and estimates in the meeting; and (3) identifies for the audit committee those accounting policies and practices that the auditor considers critical.

In situations in which management makes those communications to the audit committee, in order to satisfy the communication requirement in the new proposed standard, the auditor would be required to participate during discussions between management and the audit committee regarding accounting policies, practices, and estimates, which may include discussions of the importance of critical accounting policies, practices or estimates, or the difficult, subjective, or complex nature of the judgment involved in the selection or application of each accounting policy, practice, or estimate. The requirements for the auditor to identify the accounting policies and practices that the auditor considers critical to the portrayal of the company's financial condition and results and affirmatively confirm that management has adequately communicated each of the accounting policies, practices, and estimates to the audit committee in the meeting in which the auditor participated would be deemed to satisfy the requirement for the auditor to report all critical accounting policies and practices to the audit committee, without the need for the auditor to repeat management's presentation on the same topic.

Conversely, if the auditor (1) did not participate in management's meeting with the audit committee in which communication regarding accounting policies, practices, and estimates occurred, (2) did not affirmatively confirm that accounting policies, practices, and estimates had been discussed adequately by management, or (3) did not identify those accounting policies and practices that the auditor considers critical, then the auditor would be required to communicate to the audit committee the matters described in paragraph 12 of

---

33/ The auditor's participation in management's discussion with the audit committee could be satisfied in-person or via audio or video conference.

the new proposed standard, regardless of any management communication regarding those accounting policies, practices, and estimates.

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

The original proposed standard required the auditor to communicate certain matters to the audit committee regarding the auditor's views of the audit and the financial statements as described below.

A. Qualitative Aspects of Significant Accounting Policies and Practices

The original proposed standard required the auditor to communicate to the audit committee situations in which the auditor determines that potential bias exists in management's accounting estimates.[34/] This communication requirement is similar to a previous requirement which had been part of an audit interpretation, AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* for the auditor to consider whether matters related to management bias should be communicated to the audit committee.[35/]

Some commenters suggested that reporting potential management bias is unworkable and that all estimates involve some form of bias. One commenter suggested that the determination of bias should be related to critical accounting estimates instead of accounting estimates.

Auditing Standard No. 14 requires the auditor to, among other things, evaluate the qualitative aspects of the company's accounting practices[36/]

[34/] See paragraph 27 of the Auditing Standard No. 14, *Evaluating Audit Results,* which includes requirements regarding the auditor's evaluation of bias in accounting estimates.

[35/] Following the original proposal of this standard, AU sec. 9312 was superseded when the Board adopted the risk assessment standards. The requirement of AU sec. 9312, however, was substantially included in the risk assessment standards.

[36/] *See* paragraphs 24 to 27 of Auditing Standard No. 14.

including potential bias in management's judgments about the amounts and disclosures in the financial statements.[37/] The new proposed standard was revised to require the auditor to communicate the results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements.[38/]

Additionally, as part of this communication, the auditor should communicate situations in which the results of his or her evaluation of the differences between (i) estimates best supported by audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, indicate a possible bias on the part of the company's management. This communication is designed for the auditor to discuss the results of the auditor's evaluation of these matters as required under Auditing Standard No. 14. By linking these communication requirements with performance requirements in Auditing Standard No. 14, the new proposed standard provides context regarding the matters to be communicated. Further, the new proposed standard requires the auditor to communicate the results of procedures required under Auditing Standard No. 14, which makes it clear that matters to be communicated are the responsibility of the auditor and not management.

B. Conclusions Regarding Critical Accounting Estimates

The original proposed standard required the auditor to communicate his or her evaluation regarding the reasonableness of the process used by management to develop critical accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates. This requirement is similar to a requirement in AU sec. 380.[39/]

Some commenters indicated that the requirement for the auditor to communicate the evaluation of the reasonableness of the process used by

---

[37/] *See* paragraphs 30 to 31 of Auditing Standard No. 14.

[38/] *See generally* paragraphs 24-27 of Auditing Standard No. 14, which describe the auditor's responsibility relating to evaluating the qualitative aspects of the company's accounting practices.

[39/] *See* AU sec. 380.08.

management to develop critical accounting estimates might create the appearance that the auditor is making decisions on behalf of management. Additionally, another commenter indicated that the requirement was redundant of other communication requirements, such as the description of the process management used to develop critical accounting estimates and the basis for the auditor's conclusions regarding such estimates. Therefore, the requirement for the auditor to communicate the evaluation of the reasonableness of the process used by management to develop critical accounting estimates was removed from the new proposed standard. However, the requirement for the auditor to communicate the basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates was retained.

C. Financial Statement Presentation

Similar to AU sec. 380.11, the original proposed standard required the auditor to communicate the auditor's evaluation of the quality, not just the acceptability under the applicable financial reporting framework, of the company's significant accounting policies and practices. This communication included a discussion of the (i) quality, clarity, and completeness of the company's financial statements, which includes related disclosures and (ii) consistency of the company's disclosures and of its selection and application of significant accounting policies and practices.

In general, commenters expressed concerns regarding the application of these requirements and what should be included in the communications to the audit committee. They indicated that it is not clear what is meant by the quality, clarity, and completeness of the company's financial statements and related disclosures. Some commenters indicated that the original proposed standard should retain the requirement from AU sec. 380[40/] related to the quality, clarity, and completeness of the company's financial statements, which include related disclosures.

After considering the concerns raised by commenters, the Board has included in the new proposed standard a requirement for the auditor to communicate to the audit committee the results of the auditor's evaluation of whether the presentation of the financial statements and related disclosures are in conformity with the applicable financial reporting framework, including the auditor's consideration of the form, arrangement, and content of the financial

---

40/ *See* AU sec. 380.11.

statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, classification of items, and bases of amounts set forth. This communication requirement results from the auditor's evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, as required by Auditing Standard No. 14.[41/]

D. Matters for which the Auditor Consulted

The original proposed standard included a new requirement for the auditor to communicate to the audit committee significant accounting matters for which the auditor has consulted outside the engagement team. These consultations could include discussions with the firm's national office or industry specialists, or consultations with external parties. The original proposed standard noted that consultations were not intended to include discussions with the engagement quality reviewer.

Several commenters supported this new requirement. Other commenters indicated that this requirement might cause the engagement team to decrease consultations. This requirement is not intended to discourage consultation.

Also, some commenters noted that consultations vary across firms, which might include a brief mention of issues in passing, chatting in the corridor, or consultation with the national office or with industry specialists. Therefore, commenters suggested that not all the consultations should be required to be communicated and that the standard should clarify that only consultations related to complex transactions that may be high risk, controversial, contentious, or relate to unusual financial reporting matters should be communicated. Other commenters indicated that such communication to the audit committee is unnecessary.

In order to narrow the communication to the most important matters, the new proposed standard requires the auditor to communicate matters that are difficult or contentious for which the auditor consulted outside the engagement

---

[41/] See paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibility relating to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process. Such matters can be complex or unusual, and the auditor believes it is necessary to consult with the firm's national office or industry specialist, or with external parties. Difficult or contentious issues might arise in various stages of the audit, including in the auditor's evaluation of management's judgments, estimates, accounting policies, or an assessment of identified control deficiencies. Difficult or contentious issues might be described as those critical matters that have concerned the auditor when he or she is making the final assessment of whether the financial statements are presented fairly.

A difficult issue might not always be synonymous with a contentious issue. Rather, a difficult issue might be a matter that requires significant consultation. A contentious issue might be a matter that not only requires significant consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management. Audit committees might better appreciate the importance of difficult or contentious matters if they are aware that such consultations took place.

Additionally, the note in the original proposed standard that indicated that these consultations were not intended to include discussions with the engagement quality reviewer was removed from the new proposed standard. The focus of the revised communication requirement is on the matters on which the auditor consulted, not on the parties involved in the consultation.

E. New Accounting Pronouncements

The original proposed standard included a new requirement for the auditor to communicate, or determine that management has adequately communicated, to the audit committee the anticipated application of new accounting or regulatory pronouncements that are not yet effective, but which, upon adoption, may have a significant effect on the company's financial reporting. Companies generally disclose the potential effects of adoption of accounting standards that have been issued but not yet adopted in filings with the SEC.[42/]

[42/] *See* Codification of Staff Accounting Bulletins, Topic 11.M and *Interpretive Release About Disclosure Considerations Relating to Foreign Operations and Foreign Currency Translation Effects*, Securities Act Release No. 6436 (November 18, 1982).

Some commenters supported the requirement to inform the audit committee about the effects of applying proposed or anticipated new accounting standards or regulatory pronouncements. However, other commenters indicated that this requirement is sufficiently covered through the current disclosures in the financial statements that provide information about the applicability of and effect of new accounting standards upon the company's adoption. Therefore, these commenters suggested that this requirement is not needed. Another commenter indicated that it seems unreasonable to require the auditor to anticipate the impact of future application of new accounting or regulatory pronouncements. Several commenters indicated that the wording of this requirement should be revised to state "the potential effects of adoption of accounting pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting."

In response to commenters, the new proposed standard has been revised to require the auditor to communicate to the audit committee situations in which, as a result of the audit procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. This revised requirement is based on the auditor's procedures and situations in which the auditor has identified a concern regarding the anticipated application of a new accounting pronouncement. Management generally discloses in the financial statements the potential effects of adoption of accounting standards; therefore, the auditor would not be required to repeat management's disclosures. The auditor might be concerned about changes to accounting or disclosure processes, or systems that could affect financial reporting or whether management has devoted adequate resources to the pending adoption. Requiring the timely discussion of such matters is intended to allow time for the audit committee to properly consider the effects on future financial statements.

F. SEC Requirements, Alternative Accounting Treatments, and Material Written Communications

In addition to the requirement for the auditor to communicate critical accounting policies and practices, the original proposed standard also included a requirement that was consistent with the SEC's Rule 2-07[43/] of regulation S-X. for the auditor to communicate alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items discussed with management.

Many commenters supported including these SEC requirements in the original proposed auditing standard. Other commenters indicated that the SEC requirements should be incorporated into the standard by reference only, because if the SEC changes its requirement in the future, incorporating by reference only would avoid potential inconsistencies between PCAOB standards and the SEC requirements. Another commenter suggested that a statement indicating that Rule 2-07 requires the auditor to communicate all critical accounting policies and practices as well as certain other matters should be included in a footnote to the original proposed standard.

In response to commenters, paragraph 13 of the new proposed standard was revised to more clearly articulate the requirement for the auditor to communicate his or her assessment of management's disclosures related to critical accounting policies and practices, along with any significant modifications to the disclosures of those policies and practices proposed by the auditor that management did not make. The new proposed standard retained the requirement for the auditor to communicate alternative accounting treatments permissible under the applicable financial reporting framework.

The original proposed standard did not incorporate the SEC's requirement for the auditor to communicate to the audit committee other material written communications between the auditor and management. Some commenters suggested this requirement should be included in the standard to capture other possible material written communications that might occur but are not addressed by requirements in the original proposed standard or by other PCAOB standards, such as the management representation letter. Therefore, the new proposed standard was revised to also incorporate the communication to the audit committee of other material written communications between the auditor and management.

[43/] 17 CFR 210.2-07, Section 10A(k) of the Exchange Act also requires the auditor to report this information to the audit committee.

IX. Significant Unusual Transactions

Some commenters suggested the auditor should communicate to the audit committee information regarding significant unusual transactions that are outside the normal course of business for the company. The new proposed standard includes a requirement for the auditor to communicate to the audit committee significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature.[44/] Under the new proposed standard, the communication would include the auditor's understanding of the business rationale for such transactions.[45/] The communication requirement is aligned with the performance requirement in AU sec. 316 which requires the auditor to gain an understanding of the business rationale regarding significant transactions that are outside the normal course of business or that otherwise appear unusual. This communication could provide the audit committee with an opportunity to receive the auditor's perspective of management's intentions regarding such transactions.

X. Other Information in Documents Containing Audited Financial Statements

The original proposed standard retained the requirement in AU sec. 380.12 for the auditor to communicate to the audit committee the auditor's responsibility for other information presented in documents containing audited financial statements, any related procedures performed, and the results of such procedures.[46/]

One commenter suggested that this responsibility should be incorporated into the engagement letter. The auditor's responsibility under AU

[44/] *See* paragraph 71.g. of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement.*

[45/] *See* Paragraph .66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

[46/] *See generally*, paragraphs .04-.07 of AU sec. 550, which require that the auditor read the information and consider whether it is materially inconsistent with information in the financial statements or whether it contains any material misstatements.

sec. 550 requires the auditor to read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation in the financial statements.

The Board considered the suggested change and decided not to include a requirement in the new proposed standard for the auditor to include this information in the engagement letter, because auditors, at times, perform additional procedures on the other information beyond reading the information for material inconsistencies. In addition, requiring the auditor to include the auditor's responsibilities for other information presented in documents containing audited financial statements to be included in the engagement letter may imply that the auditor was limited to only those procedures.

XI. Management Consultations with Other Accountants

The original proposed standard carried forward the requirement from AU sec. 380.14 for the auditor to communicate to the audit committee when the auditor is aware that management consulted with other accountants about auditing or accounting matters (e.g., management might consult with other accountants about the appropriate accounting for a transaction). In those situations, the original proposed standard required the auditor to communicate to the audit committee his or her views about significant matters that were the subject of such consultation.

Several commenters suggested that this requirement was no longer necessary, noting that the requirement in AU sec. 380 relating to discussion of management consultation with other accountants originated from a concern regarding "opinion shopping" by management. One commenter also noted that since accounting rules are becoming more complex and technical, it is considered good practice for management to consult with other accountants as experts to assist them.

The Board is not seeking to discourage consultations on complex accounting issues, but only to recognize that such consultations could warrant the audit committee's attention. Therefore, the Board revised the requirement in the new proposed standard to reflect that, when the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, the auditor should communicate to the audit committee his or her views about such matters that were the subject of such consultation.

XII. Going Concern

The original proposed standard required the auditor to communicate to the audit committee, when applicable, certain matters relating to his or her evaluation of a company's ability to continue as a going concern. This communication might provide the audit committee with an "early warning" of the auditor's views regarding certain events and conditions that might affect the company's ability to continue as a going concern.

Some commenters indicated that including "could be substantial doubt" as the threshold for communication to the audit committee might result in the auditor communicating his or her consideration in situations in which the auditor does not have a significant doubt about the company's ability to continue as a going concern and would not provide the audit committee with meaningful information. The commenters suggested that the threshold for communication to the audit committee should be when the auditor believes there "is substantial doubt" about the company's ability to continue as a going concern. However, some commenters support the "could be" threshold, as it might provide an early warning to audit committee members of future problems.

In accordance with AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* the auditor has a responsibility to evaluate whether there is substantial doubt about the company's ability to continue as a going concern[47/] for a reasonable period of time.[48/] The auditor's evaluation is based on, among other things, his or her knowledge of relevant conditions and events that exist at or occurred prior to the date of the auditor's report. AU sec. 341.03a notes that the auditor may identify information about certain conditions and events that, when considered in the aggregate, indicate

---

47/ The PCAOB and the Financial Accounting Standards Board have ongoing projects regarding accounting and auditing issues related to a company's ability to continue as a going concern. If appropriate, the PCAOB might reconsider communication with the audit committee regarding such issues in connection that project.

48/ AU sec. 341.02.

there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.[49/] Examples of such conditions and events are negative trends, indicators of possible financial difficulties, internal difficulties, or external matters that have occurred. The significance of these conditions and events depends on the circumstances. The auditor might obtain additional information about such conditions and events, as well as appropriate evidential matter, to support information that mitigates the auditor's doubt.

The new proposed standard requires the auditor to communicate the conditions and events the auditor identified that, when considered in the aggregate, indicate there could be substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. The remaining matters related to going concern to be communicated depend on the auditor's conclusion.

If the auditor's doubt is mitigated, the new proposed standard requires the auditor to communicate the information that mitigates the auditor's doubt, including, if applicable, a discussion of management's plans. The auditor's doubt might be mitigated by obtaining more information about the conditions and events or by considering management's plans for dealing with the adverse effects of the conditions and events and whether such plans can be effectively implemented. If the auditor concludes that there is substantial doubt about a company's ability to continue as a going concern, the auditor should communicate to the audit committee the effects, if any, on the financial statements and the adequacy of the related disclosure and the effects on the auditor's report.[50/]

Several commenters were concerned that the original proposed standard did not adequately describe that management initially considers a company's ability to continue as a going concern and the auditor would then evaluate management's consideration. Under AU sec. 341, the responsibility of the auditor is to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. Therefore, the new proposed standard was not revised to indicate that

---

[49/] A reasonable period of time as described in AU sec. 341.02 is not to exceed one year beyond the date of the financial statements being audited.

[50/] *See generally*, AU secs. 341.12-.16.

the consideration of a company's ability to continue as a going concern is initially made by management and evaluated by the auditor.

XIII. Uncorrected and Corrected Misstatements

The original proposed standard required the auditor to provide the audit committee with the schedule of uncorrected misstatements[51/] relating to accounts and disclosures that was presented to management. Several commenters indicated that audit committees would not find value in information presented at the same level of detail as presented to management. The Board decided to retain the requirement because presenting a schedule that shows only the net effect of the uncorrected misstatements rather than the individual misstatements may be misleading. The new proposed standard is not a significant change from AU sec. 380.10, which required the presentation to the audit committee of a schedule of uncorrected misstatements. This schedule is similar to the summary of uncorrected misstatements included in or attached to the management representation letter.

Several commenters suggested that the standard needed to clarify what is meant by uncorrected misstatements relating to disclosures. Commenters suggested that there was no need for the auditor to communicate a long list of disclosures that were not made because the matters were immaterial or not present in the company's circumstances. Auditing Standard No. 14 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial, and communicate those to management on a timely basis.[52/] According to Auditing Standard No. 14, a misstatement may relate to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that should be reported in conformity with the applicable financial reporting framework.[53/] The requirement to communicate misstatements related to disclosures would refer only to those misstatements

---

[51/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include both omissions and the presentation of inaccurate or incomplete disclosures.

[52/] *See* paragraphs 10 and 15 of Auditing Standard No. 14.

[53/] *See* paragraph A2 of Auditing Standard No. 14.

that the auditor has accumulated throughout the audit that are not clearly trivial and have been reported to management. Therefore, the Board retained the requirement as originally proposed.

The original proposed standard also required the auditor to communicate the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative factors[54/] considered. Many commenters noted that management has responsibility for evaluating, quantitatively and qualitatively, the materiality of uncorrected misstatements and communicating its conclusions to the audit committee. Therefore, the new proposed standard was revised to require the auditor to discuss with the audit committee, or determine that management has adequately discussed, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[55/] considered.

The original proposed standard also required the auditor to communicate those corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications that such corrected misstatements might have on the financial reporting process.

Several commenters noted that it appears that this requirement relates to the auditor's consideration of the impact a misstatement might have on an auditor's consideration of a company's internal control over financial reporting. Commenters also noted that the Board already has communication requirements related to significant deficiencies and material weaknesses for integrated audits in Auditing Standard No. 5 and for audits of financial statement only in AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements.* The Board recognizes that there are already auditing standards regarding communication of significant deficiencies and material weaknesses; however, the intent of this requirement is to inform the audit committee of misstatements that were only detected through audit procedures.

54/ *See* generally, Appendix B of Auditing Standard No. 14, which discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

55/ Ibid.

Some commenters suggested that the standard should specifically require the auditor to request management to correct the uncorrected misstatements. The Board did not make this change because management has its own legal responsibilities in relation to the preparation and maintenance of the company's books, records, and financial statements. Section 13(i) of the Exchange Act, requires the financial statements filed with the SEC to reflect all material correcting adjustments identified by the auditor.

The release accompanying the original proposed standard included a question that asked whether all corrected misstatements, including those detected by management, should be communicated to the audit committee. Several commenters supported communicating misstatements detected by management to the audit committee, as they may indicate challenges within the financial reporting process that the board or management should address. However, many commenters were not supportive of the auditor communicating misstatements detected by management, because the auditor may not have knowledge of all such adjustments due to the nature of a company's financial statement close process and the timing of the auditor's procedures. Commenters suggested that such a requirement would likely result in the auditor expending significant effort to identify misstatements that the company's internal controls previously identified in the financial close process. Accordingly, the new proposed standard does not include a requirement for the auditor to communicate misstatements detected by management.

XIV. Departure from the Standard Auditor's Report

The original proposed standard included a requirement for the auditor to communicate to the audit committee when the auditor expects to modify the opinion in the auditor's report or include an explanatory paragraph.[56/] The original proposed requirement indicated that the communication would include the reasons for the modification or explanatory paragraph and the proposed wording of the report. The requirement was intended to provide the basis for a discussion between the auditor and the audit committee in those circumstances in which the auditor expects to depart from the standard auditor's report.

Such communication enables the audit committee to be aware of the nature of any specific matters that the auditor expects to highlight in the

---

56/ See AU secs. 508.11-74 and .76.

auditor's report. In addition, these communications provide the audit committee with an opportunity to obtain further clarification from the auditor about the modification. Additionally, this communication also provides the audit committee with an opportunity to provide the auditor with further information and explanations regarding the matters that are expected to be included in the auditor's report.

Several commenters suggested excluding from the communication requirement those report modifications related to the emphasis of a matter or the adoption of a new accounting principle because these matters are subject to other communication requirements or are clearly disclosed in the financial statements. For example, AU sec. 508, provides several reasons that an audit report might be modified, including a change in accounting principle or an emphasis of a matter. In fulfilling its responsibility to oversee the audit and the financial reporting process, it is important for the audit committee to understand the reasons an auditor might depart from the standard auditor's report. Accordingly, the requirement was not changed.

XV. Disagreements with Management

The original proposed standard included a requirement for the auditor to communicate to the audit committee any disagreements with management, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the financial statements or the auditor's report. This requirement was retained from AU sec. 380.13. Examples of disagreements might include disagreements with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report. This communication requirement does not include differences of opinion based on incomplete facts or preliminary information that are later resolved prior to the issuance of the auditor's report.

Some commenters suggested changing the standard to include examples clarifying what is meant by "matters." The term "matters" appears in AU sec. 380.13 and has been used in practice. In order not to inadvertently change practice in this area, the Board is not adding any examples to the standard.

Other commenters suggested including a reference to the SEC's requirement to report disagreements upon a change in the auditor. The new proposed standard was not revised because the communication requirement in the standard relates to disagreements occurring during the current audit period. However, the SEC requires reporting of the disagreement only upon the resignation or dismissal of the auditor or the auditor's refusal to stand for reappointment within the subsequent two-year period. A reference to the SEC requirement was not included in the new proposed standard, because including such reference in the standard might lead the auditor to communicate disagreements to the audit committee only upon the auditor's resignation, dismissal, or refusal to stand for reelection.

XVI. Difficulties Encountered in Performing the Audit

The original proposed standard included the requirement from AU sec. 380.16 for the auditor to inform the audit committee of any significant difficulties encountered during the audit. Some commenters suggested adding additional matters, moving other matters elsewhere within the original proposed standard, or making specific revisions to the language of the standard. The Board considered the suggested changes to the original proposed standard and revised certain language. However, the Board also determined that some changes would not substantially improve the standard; therefore, the new proposed standard was not revised for those changes.

In the new proposed standard significant difficulties encountered during the audit include, but are not limited to:

- Significant delays by management, the unavailability or company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;

- An unreasonably brief time within which to complete the audit;

- Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;

- Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and

- Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

One commenter suggested adding additional matters to the standard that should be communicated to the audit committee, such as a requirement to communicate information regarding related party transactions. Whether the auditor should be required to communicate information regarding the company's related party transactions depends on whether the transactions fall within one of the categories identified in the new proposed standard, such as a significant risk, the subject of an explanatory paragraph, a disagreement with management, or a difficulty encountered in performing the audit. In addition, nothing in the new proposed standard prohibits the auditor from communicating such information to the audit committee. Whether to require additional auditor communication to the audit committee regarding related party transactions will be considered through the Board's related party standard-setting project.

XVII. Other Matters

The original proposed standard included a requirement for 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, including situations in which the auditor is aware of complaints or concerns raised regarding accounting or auditing matters. This requirement acknowledges that there are other matters that may be beneficial to the audit committee's oversight of the financial reporting process when communicated to the audit committee. This communication could provide the audit committee with an opportunity to better understand management's intentions regarding such transactions.

The Act requires the audit committees of listed companies to establish procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting control, or auditing matters, and the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters. Some commenters suggested that the original proposed standard be revised to clarify that the communication does not include 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. The Board does not expect that the auditor would repeat information provided to him or her by the audit committee in fulfilling this requirement. Further, if the auditor determines that a matter not addressed in the standard is significant to the oversight of the company's financial reporting process and should be communicated to the audit committee, the fact that management previously has communicated the matter in some fashion to the audit committee should not prevent the auditor from making a separate communication on that matter. Accordingly, the language from the original proposed standard was retained.

The new proposed standard requires the auditor to inquire of the audit committee about whether it is aware of complaints or concerns regarding accounting or auditing matters. Similarly, the auditor also might become aware of additional complaints or concerns regarding accounting or auditing matters that were not received through the company's process, and therefore, the audit committee might be better able to exercise its oversight activities if the auditor informed the audit committee of these matters. The new proposed standard requires the auditor to communicate these matters to the audit committee.

AU sec. 380 required the auditor to ensure that the audit committee receives additional information regarding the scope and results of the audit that may assist the audit committee in overseeing the financial reporting and disclosure process. The new proposed standard takes the additional step of requiring the auditor to communicate to the audit committee complaints or concerns that have come to the auditor's attention.

One commenter suggested specifying that the complaints or concerns may indicate the existence of fraud or illegal acts. The footnote in the original proposed standard acknowledged that complaints or concerns might relate to fraud or illegal acts and that the auditor has specific communication requirements for those matters in AU sec. 316, and AU sec. 317, *Illegal Acts by Clients*.[57/] Accordingly, no change was made to the requirement.

One commenter noted that the auditor might not be knowledgeable as to what is significant regarding the rules, regulations, laws, and duties governing the audit committee's oversight of the financial reporting process and suggested changing "significant" to "might be relevant." The Board did not

---

[57/] Additionally, Rule 13(b)(2)(iv) under the Exchange Act 17 CFR 240.13(b)(2)(iv) states that management shall not coerce, manipulate, mislead, or fraudulently influence the auditor, including preventing the auditor from communicating matters to the company's audit committee.

make this change, because through the comments, audit committee members indicated that they are primarily interested in the communication of significant matters related to the financial reporting process. Communicating other matters that "might be relevant" could lead to the communication of matters that might be trivial to the audit committee.

The new proposed standard requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.

XVIII. Form and Documentation of Communications

The original proposed standard retained the requirement for auditors to communicate to the audit committee in writing or orally the matters required to be communicated, unless otherwise specified in the original proposed standard. Some commenters suggested that the standard should require all communications to be in writing, while other commenters indicated that the standard should continue to provide flexibility in the manner of communication.

The new proposed standard was not revised to require all communications to be in writing. The Board's intention is to promote effective two-way communication between the auditor and the audit committee, whether through presentations, written reports, or interactive discussions. Written communications might provide the auditor with a basis to lead an active two-way discussion with the audit committee. The form of communication may depend on the nature of the matter to be communicated. For example, written information often makes it easier for the audit committee to understand highly complex information (e.g., information about critical accounting estimates). However, having a dialogue on key matters often is an important factor in effective communications between the auditor and the audit committee.

Several commenters suggested the standard should retain the provision in AU sec. 380.03 that written communications to the audit committee are intended solely for the information and use of the audit committee, board of directors, and management, if appropriate, and are not intended to be and should not be used by anyone other than those specified parties. Commenters were concerned that the absence of such a requirement might 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 could result in another party inappropriately relying on the written information without the appropriate context. The original proposed standard included a footnote reference to AU sec. 532, *Restricting the Use of an Auditor's Report*, which applies to certain reports, including those provided to the audit committee, on matters coming to the auditor's attention during the audit. The new proposed standard was not revised to include additional language regarding the restriction of the audit committee communication; however, the new proposed standard retains the footnote reference to AU sec. 532.

XIX. Timing

The Board considers communications with audit committees to be an integral part of the audit process. AU sec. 380 stated that audit committee communications are incidental to the audit and are not required to occur before the issuance of the auditor's report on the entity's financial statements so long as the communications occur on a timely basis.[58/] The original proposed standard required the auditor to communicate the matters required by the standard in a timely manner and prior to the issuance of the auditor's report.

Commenters generally agreed that audit committee communications should occur in a timely manner and prior to the issuance of the auditor's report. One commenter suggested that the original proposed standard should specify the timing of certain communications, because, if the auditor only communicates matters shortly before the issuance of the auditor's report it may be too late to be considered timely. Another commenter suggested that the original 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. Another commenter was concerned that the auditor might not have completed necessary audit procedures until after the last audit committee meeting and that the auditor could follow-up on the resolution of open audit issues after the audit report is issued.

[58/] AU sec. 380.04.

The new proposed standard does not emphasize the specific timing of certain communications because the appropriate timing might vary depending on the circumstances. As noted in the new proposed standard, the appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and any corrective or follow-up action needed. However, the timing of the communication should be prior to the issuance of the auditor's report. The new proposed standard retains the requirement as originally proposed for communications to occur in a timely manner and prior to the issuance of the auditor's report. However, as noted above, the auditor may wish to consider whether the required communications will affect the audit strategy and adjust the timing of those communications accordingly.

Some commenters also suggested that the original proposed standard should not impose requirements that would require the auditor to communicate the same matters from year to year. AU sec. 380 stated that, generally, it is not necessary to repeat the communication of recurring matters each year.[59/] However, the new proposed standard requires the auditor to communicate all communications required by the standard to the audit committee prior to the issuance of the auditor's report, which occurs at least annually, because the matters covered by the standard are limited to significant matters and these matters may change based on changes in the economy, the volume of transactions, or their significance to the audit or financial statements. Although the communications are required to be made at least annually, the time spent on the discussion of matters presented could vary from year-to-year based on circumstances or other factors, such as a change in the members of the audit committee.

Providing these required communications to the audit committee in a timely manner and prior to the issuance of the auditor's report will allow the audit committee the opportunity to take any action it may deem appropriate to address the matters communicated prior to the issuance of the auditor's report.

Several commenters suggested that the original proposed standard should discuss the timing of audit committee communications regarding interim reviews. One commenter also suggested that the required communications regarding interim reviews should include discussion of the nature and extent of interim review procedures and that these procedures are based on a level of

---

59/ AU sec. 380.05.

work less robust than that performed during the annual audit. The original proposed standard included an amendment to paragraph .36 of AU sec. 722, *Interim Financial Information,* to require that the auditor complete any necessary communications with the audit committee prior to the company's filing of its interim financial information with a regulatory agency, such as the SEC. Accordingly, no change was made to the new proposed standard.

XX. Adequacy of the Two-Way Communication Process

The original proposed standard included a requirement for the auditor to evaluate whether the two-way communication between the auditor and the audit committee was adequate to support the objective of the audit. If those communications were not effective, the original proposed standard required the auditor to evaluate the effects, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence. That requirement was included to emphasize that effective two-way communication is beneficial to achieving the objectives of the audit.

Many commenters acknowledged that inadequate two-way communication could have an effect on the auditor's assessment of the risks of material misstatement, which might impact the nature, timing, and extent of audit procedures. However, several commenters suggested that an evaluation of the adequacy of the two-way communication can only be adequate if both parties are involved. These commenters suggested that if only the auditor evaluates the effectiveness based on his or her understanding of what was communicated, that evaluation would not provide information about the audit committee's understanding of that communication. Commenters did not believe that the evaluation by the auditor would promote two-way communication between the auditor and audit committee. Other commenters suggested expanding the requirement to require the auditor to evaluate the adequacy of the two-way communication between management and the audit committee.

As suggested by commenters, the requirement to evaluate whether the two-way communications between the auditor and the audit committee have been adequate was removed from the new proposed standard. However, as part of understanding the company's control environment in Auditing Standard No. 12, the auditor assesses whether the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control.[60] Other PCAOB standards require that, in an audit of financial statements, if the auditor becomes aware, or in an integrated audit, the auditor concludes, that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that information in writing to the board of directors.[61] Therefore, removing the requirement from this standard does not change the auditor's responsibility for assessing the audit committee's effectiveness under existing PCAOB standards.

XXI. Amendments to PCAOB Standards

The original proposed standard amended AU sec. 722 to be consistent with the original proposed standard. Several commenters were concerned that the amendments to AU sec. 722 increased the communication requirements related to an interim review. Additionally, some commenters suggested the amendments to AU sec. 722 could be redundant and unnecessary on an interim basis for ongoing issues that are communicated as part of the annual audit. Commenters also indicated that, due to the nature of the procedures performed in the interim review, the auditor may be unable to provide the audit committee with the same level of detail as compared to communications that are based on information obtained during the annual audit. The original proposed standard did not amend paragraph .35 of AU sec. 722, which limits the communications to the audit committee in an interim review to the effect of significant, events, transactions, and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. Additionally, the amendments do not require the auditor to repeat communications that were made as part of the annual audit. Therefore, the amendments to AU sec. 722 are retained from the original proposed standard.

Technical conforming changes are being made to the following standards. The amendments are consistent with a requirement in the original proposed standard and the new proposed standard for the auditor to communicate to the audit committee (i) in a timely manner before the issuance of the auditor's report and (ii) the results of the auditor's procedures:

---

[60] *See* paragraphs 23-24 of Auditing Standard No. 12.

[61] *See* paragraph 79 of Auditing Standard No. 5 and paragraph 5 of AU sec. 325.

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*;

- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*;

- AU sec. 317, *Illegal Acts by Clients*;

- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements;*

- AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*; and

- AU sec. 711, *Filings Under Federal Securities Statutes*.

The other amendments to PCAOB Standards, included as part of the original proposed standard, were primarily related to changes in references to the original proposed standard and other conforming changes. There were no significant comments on these other amendments, and they were substantively retained as originally proposed.

APPENDIX 5

Comparison of the Objectives and Requirements of the Proposed Auditing Standard, **Communications with Audit Committees***, to the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants*

Introduction

This appendix discusses certain significant differences between the objectives and requirements of the accompanying proposed auditing standard, *Communications with Audit Committees,* and the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and analogous standards of the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants.

The comparable IAASB standards are International Standard on Auditing ("ISA") 210, *Agreeing the Terms of Audit Engagements*, and ISA 260, *Communication with Those Charged with Governance*. The comparable ASB standards are the issued Statement on Auditing Standards ("SAS") 122, *Statement on Auditing Standards: Clarification and Recodification,*[1/] AU-C Section 210, *Terms of Engagement*, and AU-C Section 260, *The Auditor's Communication with Those Charged with Governance*.[2/] The analysis does not

---

[1/] In October 2011, the ASB issued SAS No. 122, which contains the Preface to Codification of Statements on Auditing Standards, *Principles Underlying an Audit Conducted in Accordance with Generally Accepted Auditing Standards*, and 39 clarified SASs. SAS 122 identifies the section within the AICPA codification with "AU-C" section numbers. *See* http://www.aicpa.org/InterestAreas/FRC/AuditAttest/Pages/DescriptionofClarifiedSASs.aspx.

[2/] Other standards by the IAASB and the ASB were considered in this comparison to the extent they include comparable requirements, including ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, ISA 450, *Evaluation of Misstatements Identified During the Audit*, ISA 570, *Going Concern,* ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),* ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,* AU-C Section 240, *Consideration of Fraud in a* cover the application and explanatory material in the IAASB standards or ASB standards.[3/]

This appendix is provided for informational purposes only. It is not a substitute for the proposed auditing standard itself, which is presented in Appendix 1 of this release.

This analysis may not represent the views of the IAASB or ASB regarding the interpretation of their standards.

Objectives

PCAOB

The proposed auditing standard replaces AU sec. 310, *Appointment of the Independent Auditor*, and AU sec. 380, *Communication With Audit Committees*. Given the responsibility of many audit committees for the appointment and retention of the auditor, the proposed auditing standard combines the requirements from the Board's standards, AU secs. 310 and 380, into one auditing standard.

The proposed auditing standard includes four objectives for the auditor, which reflect both the appointment and retention of the auditor as well as the overall communication responsibilities. The objectives of the auditor are to:

Financial Statement Audit, AU-C Section 450, *Evaluation of Misstatements Identified During the Audit,* AU-C Section 600, *Using the Work Others – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),* Proposed SAS, *The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern* (Redrafted), and SAS 118, *Other Information in Documents Containing Audited Financial Statements*.

[3/] Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,* indicates that the Application and Other Explanatory Material section of the ISAs "does not in itself impose a requirement," but "is relevant to the proper application of the requirements of an ISA." Paragraph A63 of AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards,* states that although application and other explanatory material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

IAASB and ASB

ISA 210 and AU-C Section 210 both include an objective to establish whether the preconditions for an audit are present. The proposed auditing standard does not include this objective, because some of the related requirements in the ISA and SAS are not applicable to audits performed under PCAOB standards, such as determining whether the financial reporting framework is acceptable. For audits performed under PCAOB standards, 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.

Both ISA 260 and AU-C Section 260 include an objective for the auditor to promote effective two-way communication between the auditor and those charged with governance. The proposed auditing standard does not include a similar objective because the standard does not include a requirement to promote effective two-way communication.

Appointment and Retention

Significant Issues Discussed with Management In Connection with the Auditor's Appointment or Retention

PCAOB

The proposed auditing standard 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 significant discussions regarding the application of accounting principles and auditing standards.

IAASB and ASB

ISA 210 and AU-C Section 210 do not include a similar requirement.

Establish an Understanding of the Terms of the Audit

PCAOB

The proposed auditing standard requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the objective of the audit, the responsibilities of the auditor, and the responsibilities of management, and recording the understanding of the terms in an engagement letter. The proposed auditing standard also requires the auditor to provide the engagement letter to the audit committee annually. The proposed standard requires the auditor to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Additionally, the proposed auditing standard requires the auditor to decline to accept, continue, or perform the engagement if the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee.

IAASB and ASB

ISA 210 and AU-C Section 210 require the auditor to agree on the terms of the audit engagement with management and, where appropriate, those charged with governance.

ISA 210 and AU-C Section 210 require the engagement letter to be in writing, although there is no requirement that the engagement letter be given to the audit committee or that it be signed by the audit committee, or its chair on behalf of the audit committee, or otherwise be acknowledged by the audit committee. Additionally, ISA 210 states that for recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. Accordingly, ISA 210 permits the auditor to not send a new audit engagement letter or other written agreement each period.

AU-C Section 210 requires the auditor to assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented.

Both ISA 210 and AU-C Section 210 also establish requirements for the auditor to determine whether the preconditions for an audit exist. The proposed auditing standard does not include similar requirements as these requirements were either not applicable to audits performed under PCAOB standards or were addressed through the requirements in the proposed auditing standard for establishing an understanding of the terms of the audit engagement with the audit committee.

ISA 210 includes requirements regarding financial reporting standards supplemented by law or regulation as well as requirements regarding the financial reporting framework. AU-C Section 210 does not include similar requirements. The proposed auditing standard also does not include similar requirements as they are not relevant to the audits performed under PCAOB standards.

ISA 210 and AU-C Section 210 also include requirements regarding limitation of scope prior to audit engagement acceptance, other factors affecting audit engagement acceptance, and acceptance of a change in the terms of the audit engagement. The proposed auditing standard does not include such requirements as they are not applicable to audits performed under PCAOB standards.

AU-C Section 210 also includes requirements regarding initial audits and re-audits. The proposed auditing standard does not include similar requirements, although similar requirements are included in the Board's standard, AU sec. 315, *Communications Between Predecessor and Successor Auditors*.

Additionally, ISA 260 and AU-C Section 260 include a requirement for the auditor to communicate with those charged with governance the form, timing, and expected general content of communications. The proposed auditing standard does not include this requirement; however, the proposed auditing standard does not preclude the auditor from communicating these matters to the audit committee.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

PCAOB

The proposed auditing standard requires the auditor to inquire of the audit committee about whether it is aware of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters. Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* includes a requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks.[4/] The requirement in the proposed auditing standard complements the requirement in Auditing Standard No. 12.

IAASB and ASB

ISA 260 and the AU-C Section 260 do not contain a similar requirement for the auditor to inquire of matters that might be relevant to the audit, including but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters. However, ISA 240 requires the auditor to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity. AU-C Section 240 contains a similar requirement as ISA 240.

Overall Audit Strategy and Timing of the Audit

PCAOB

The proposed auditing standard requires the auditor to communicate to the audit committee an overview of the overall audit strategy, including a discussion of the significant risks identified during the auditor's risk assessment procedures, and the timing of the audit. As part of communicating the overall audit strategy, the proposed auditing standard requires the auditor to communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;

[4/] Paragraph 54 of Auditing Standard No. 12.

b. The extent to which the auditor plans to use the work of the company's internal audit function in an audit of financial statements;

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;

d. The names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

e) The basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit will be performed by other auditors.

In addition, the auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

IAASB and ASB

Similar to the proposed auditing standard, ISA 260 and AU-C Section 260 require the auditor to communicate an overview of the planned scope and timing of the audit. However, ISA 260 and AU-C Section 260 do not require the auditor to communicate significant changes to the planned scope and timing of the audit. Further, ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about specialized skill or knowledge need to apply audit procedures, using the work of internal auditors, or using the work of other company personnel or third parties working under the direction of management.

ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about the names, locations, planned roles, and responsibilities, including the scope of audit procedures of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures. However, ISA 600 and AU-C Section 600, include requirements for the auditor to communicate certain matters to those charged with governance including: an overview of the type of work to be performed on the financial information of the components; an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components; instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work; any limitation on the group audit; and fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or other where the fraud resulted in a material misstatement of the group financial statements. In addition, AU-C Section 600 also includes a requirement for the auditor to communicate the basis for the decision to make references to the audit of a component auditor in the auditor's report on the group financial statements.

Results of the Audit

Accounting Policies, Practices, and Estimates

PCAOB

The proposed auditing standard acknowledges that if management communicates matters related to accounting policies, practices, and estimates to the audit committee, the auditor does not need to communicate these matters at the same level of detail as management as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor is required to communicate any omitted or inadequately described matters to the audit committee.

These matters include:

a. Significant accounting policies and practices, including: (1) management's initial selection of, and changes in significant accounting policies, or the application of such policies in the current period; (2) the methods management used to account for significant unusual transactions; and (3) the effect of significant accounting policies on financial statements or disclosures in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

b. All critical accounting policies and practices, including: (1) the reasons certain policies and practices are considered critical, and (2) how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

c. Critical accounting estimates, including: (1) a description of the process management used to develop critical accounting estimates; (2) management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and (3) any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.

IAASB

ISA 260 requires the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. AU-C Section 260 also provides that, when applicable, the auditor should determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of the estimate.

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

PCAOB

The proposed auditing standard requires the auditor to communicate the following matters to the audit committee:

a. Qualitative aspects of significant accounting policies and practices. The results of the auditor's evaluation of and conclusions about the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements. The proposed auditing standard also requires the auditor to communicate when the auditor's evaluation of estimates indicates possible bias on the part of the company's management.

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates.

d. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth.

e. Matters for which the auditor consulted. Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor.

h. Material written communications. Other material written communications between the auditor and management.

IAASB

ISA 260 requires the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity. ISA 260 also requires the auditor to communicate to those charged with governance written representations the auditor is requesting.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable the auditor should:

a. Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity, and

b. Determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of the estimates.

AU-C Section 260 also requires the auditor to communicate to those charged with governance written representations the auditor is requesting.

Significant Unusual Transactions

PCAOB

The proposed auditing standard requires the auditor to communicate to the audit committee significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature. Such communication should include the auditor's understanding of the business rationale for such transactions.

IAASB and ASB

The ISAs or the AU-Cs do not include a similar requirement.

Other Information in Documents Containing Audited Financial Statements

PCAOB

When other information is presented in documents containing audited financial statements, the proposed auditing standard requires the auditor to communicate to the audit committee his or her responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.

AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires that if the auditor identifies a material inconsistency in the other information presented in documents containing audited financial statements, that is not revised by management to eliminate the material inconsistency, the auditor should communicate the material inconsistency to the audit committee. The auditor should also consider other actions, such as revising the audit report to include an explanatory paragraph describing the material inconsistency, withholding the use of the report in the document, and withdrawing from the engagement. The auditor should also communicate a material misstatement of fact to the audit committee, if the material misstatement of fact is not corrected.

IAASB

ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,* requires that if the auditor identifies a material inconsistency in the other information in documents containing audited financial statements, and revision of the other information is necessary and management refuses to make the revision then the auditor shall communicate this matter to those charged with governance and (a) include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; or (b) withhold the auditor's report; or (c) withdraw from the engagement, where withdrawal is possible under applicable law or regulation. ISA 720 also requires the auditor to notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action if there is a material misstatement of fact in the other information which management refuses to correct.

ASB

SAS 118 contains similar requirements to those in the proposed auditing standard.

Management Consultation with Other Accountants

PCAOB

The proposed auditing standard requires that when the auditor is aware that management consulted with other accountants about significant auditing or accounting matters, the auditor is required to communicate his or her views about such matters that were the subject of such consultation.

IAASB

The ISA 260 does not include a similar requirement.

ASB

AU-C Section 260 includes a similar requirement as the proposed auditing standard.

Going Concern

PCAOB

The proposed auditing standard includes a requirement for the auditor to communicate to the audit committee, when applicable, certain matters regarding the auditor's evaluation of the company's ability to continue as a going concern. These matters include (a) conditions and events the auditor identified that, when considered in the aggregate, indicate there could be a substantial doubt about the company's ability to continue as a going concern for a reasonable period of time; (b) if the auditor's doubt is mitigated, the information that mitigated the auditor's doubt, including, if applicable, a discussion of management's plans; (c) if the auditor concludes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the effects, if any, on the financial statements and the adequacy of the related disclosures and the effects on the auditor's report.

IAASB

ISA 570, *Going Concern*, requires the auditor to communicate events or conditions identified that may cast doubt on the entity's ability to continue as a going concern. This communication includes whether the events or conditions constitute a material uncertainty; whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and the adequacy of related disclosures in the financial statements.

ASB

The proposed SAS, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (Redrafted), requires the auditor to communicate with those charged with governance the nature of the conditions or events identified, the possible effects on the financial statements and the adequacy of related disclosures in the financial statements, and the effects on the auditor's report. Such communication is required if, after considering identified conditions and events in the aggregate and after considering management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains.

Uncorrected and Corrected Misstatements

PCAOB

The proposed auditing standard requires the auditor to provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that the auditor presented to management. The proposed auditing standard also requires the auditor to discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors considered. Additionally, the proposed auditing standard requires the auditor to communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could cause future period financial statements to be materially misstated. The auditor also should communicate to the audit committee those corrected misstatements that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

IAASB and ASB

ISA 450 and AU-C Section 260 include requirements for the auditor to communicate uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. The auditor's communication should identify the material uncorrected misstatements individually. Additionally, under ISA 450 and the AU-C Section 260, the auditor is required to communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

ISA 450 and AU-C Section 450 require the auditor to request that uncorrected misstatements be corrected. The proposed auditing standard does not require the auditor to make this request, because under SEC rules the financial statements are required to reflect all material correcting adjustments identified by the auditor.

ISA 450 does not include a requirement for the auditor to communicate corrected misstatements to those charged with governance. AU-C Section 260 requires the auditor to communicate material, corrected misstatements that were brought to the attention of management as a result of audit procedures.

Disagreements with Management

PCAOB

The proposed auditing standard includes a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. The proposed auditing standard further notes that disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved prior to the issuance of the auditor's report.

IAASB

The ISAs do not include a similar requirement.

ASB

AU-C Section 260 requires the auditor to communicate disagreements with management, if any.

Other Matters

PCAOB

The proposed auditing standard includes a requirement for 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. This communication includes complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.

IAASB and ASB

ISA 260 and AU-C Section 260 include a similar requirement for the auditor to communicate other matters to those charged with governance that, in the auditor's professional judgment, are significant and relevant to the oversight of the financial reporting process.

Form and Documentation of Communications

PCAOB

The proposed auditing standard requires the auditor to communicate the matters to the audit committee either orally or in writing, unless otherwise specified in the proposed auditing standard. The proposed auditing standard also requires the auditor to document the communications in the workpapers whether such communications took place orally or in writing. Additionally, the proposed auditing standard requires the auditor to include a copy of or a summary of management's communication provided to the audit committee in the audit documentation if management communicated accounting policies, practices, and estimates to the audit committee.

IAASB

ISA 260 requires the auditor to communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate. Written communication need not include all matters that arose during the course of the audit.

ASB

AU-C Section 260 requires the auditor to communicate in writing with those charged with governance significant findings or issues from the audit if, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved.

Timing

PCAOB

The proposed auditing standard requires the communications required by the proposed auditing standard to be made in a timely manner and prior to the issuance of the auditor's report.[5/]

IAASB and ASB

ISA 260 and AU-C Section 260 require that the auditor should communicate with those charged with governance on a timely basis.

[5/] The proposed auditing standard includes the following exception for registered investment companies: consistent with Rule 2-07 of Regulation S-X, in the case of a registered investment company, if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update, in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

PCAOB
Public Company Accounting Oversight Board

Exhibit 2(a)(F)

Alphabetical List of Comments on the Rules Proposed in PCAOB Release No. 2011-008

1	Aerospace Industries Association; Susan K. Tonner, Assistant Vice President, Acquisition Policy
2	BDO USA, LLP
3	Dennis R. Beresford, Ernst & Young Executive Professor of Accounting; University of Georgia
4	California Public Employees' Retirement System (CalPERS); Anne Simpson, Senior Portfolio Manager, Investment Office, Head of Corporate Governance
5	California Society of Certified Public Accountants; Howard Sibelman, Chair, Accounting Principles and Auditing Standards Committee
6	Canadian Public Accountability Board (CPAB); Brian Hunt, FCA, Chief Executive Officer
7	Capital Research and Management Company; Brian D. Bullard, Senior Vice President - Fund Business Management Group; Brian C. Janssen, Vice President - Fund Business Management Group
8	Center for Audit Quality; Cynthia M. Fornelli, Executive Director
9	J. Michael Cook
10	Crowe Horwath LLP
11	Deloitte & Touche LLP

12	Eli Lilly and Company; Arnold C. Hanish, Vice President Finance, and Chief Accounting Officer
13	Ernst & Young LLP
14	Federation of European Accountants; Philip Johnson, President
15	Florida Institute of Certified Public Accountants (FICPA); Robert Bedwell, CPA, Chair; Steven Bierbrunner, CPA, Member; Richard Edsall, CPA, Member; Accounting Principles and Auditing Standards Committee
16	Grant Thornton LLP
17	Hermes Equity Ownership Services Limited; Manuel Isaza, Senior Associate
18	Institut der Wirtschaftsprüfer; Klaus-Peter Feld, Executive Director; Gillian Waldbauer, Technical Manager
19	Institute of Management Accountants; Allan Cohen, Chair, Financial Reporting Committee
20	International Corporate Governance Network (ICGN); Janine M. Guillot, Co-Chair, Accounting and Auditing Practices Committee; Elizabeth Murrall, Co-Chair, Accounting and Auditing Practices Committee; Christianna Wood, Chairman, Board of Governors
21	KPMG LLP
22	Mark Bailey & Company, Ltd.
23	Mazars; Jean-Luc Barlet, Group Chief Compliance Officer
24	McGladrey & Pullen, LLP
25	Moss Adams LLP
26	New York State Society of Certified Public Accountants; Richard E. Piluso, President
27	Jack C Parsons
28	Piercy Bowler Taylor & Kern; Howard B. Levy, Principal and Director of Technical Services
29	PricewaterhouseCoopers LLP

30	Suzanne Hamlet Shatto
31	Society of Corporate Secretaries & Governance Professionals; Robert B. Lamm, Chair, Securities Law Committee
32	State Board of Administration of Florida; Ashbel C. Williams, Executive Director & CIO
33	Texas Society of Certified Public Accountants (TSCPA); Kathryn W. Kapka, CPA, CIA, CGAP, Chair, Professional Standards Committee
34	The Institute of Chartered Accountants in Australia; Yasser El-Ansary CA, General Manager - Leadership and Quality
35	The Institute of Chartered Accountants in England and Wales (ICAEW); Katharine E Bagshaw FCA
35	The Institute of Internal Auditors; Richard F. Chambers, CIA, CGAP, CCSA, CRMA, President and Chief Executive Officer
37	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness; Tom Quaadman, Vice President
38	United States Government Accountability Office (GAO); James R. Dalkin, Director, Financial Management and Assurance
39	WeiserMazars, LLP

AEROSPACE INDUSTRIES ASSOCIATION

February 24, 2012

Office of the Secretary
Public Company Accounting Oversight Board
166 K Street, NW
Washington, D.C. 20006-2803

Subject: Docket 030: Proposed Auditing Standard Related to Communications with Audit Committees

Dear Board Members and Staff of the PCAOB:

Thank you for providing the Aerospace Industries Association ("AIA") with the opportunity to share our view on the re-proposed auditing standard on Communications with Audit Committees ("the Proposed Standard"), issued by the Public Company Accounting Oversight Board ("the Board") on December 20, 2011. AIA represents the nation's major manufacturers of commercial, military and business products such as aircraft, helicopters, aircraft engines, missiles, spacecraft, and related components and equipment.

We are supportive of the Board's efforts to enhance the relevance and quality of communications between auditors and audit committees. We agree with the Board that an audit committee that is well-informed about a company's accounting and disclosure matters can better carry out its oversight responsibilities. While we generally support the enhancements to communications between the audit committee and outside auditor as set forth in the Proposed Standard, we offer the following suggestions for your consideration.

Given that inspections, whether they be PCAOB or internal quality reviews, often include reviewing the accounting policies of the company and their application, as well as treatment of items such as unusual transactions, we believe that audit committees would benefit from auditors informing them at least annually of any engagement specific findings from PCAOB and internal quality review inspections. Further, we believe that it would be beneficial for the auditors to provide the audit committee with the results of overall specific peer and internal quality reviews for the engagement. This would be a useful gauge for the audit committee to assess the execution of the firm's overall audit methodology.

As a result, we believe this communication should be added as a requirement to the Proposed Standard. Although the Proposed Standard acknowledges that the audit committee is not precluded from requesting additional information, experience levels among public company audit committees differ. As a result, this communication should be required to be shared with audit committees to avoid inexperienced audit committees from not asking for and obtaining this information. In addition, we believe auditors should be required to discuss with the audit committee how their audit team maintains not just independence, but also objectivity and professional skepticism. In our view these changes would strengthen audit quality and further reduce audit failures.

We suggest that Appendix A paragraph 12 *Accounting Policies, Practices, and Estimates,* as well as Appendix A paragraph 14 *Significant Unusual Transaction*s be modified to make it clear that the primary obligation for reporting these matters rests with management and that the auditors' role is to discuss anything with the audit committee that management has not fully communicated.

We recommend that the phrase "that individually or in the aggregate could be significant to the company's financial statements or the auditor's report" currently used in Appendix A paragraph 21 be added to Appendix A paragraph 19. We think this clarification would avoid the communication of clearly immaterial items. We suggest that although an auditor can provide these communications in writing, it should be a requirement to present for discussion orally at the audit committee meeting any of the more significant items.

Thank you for taking the time to consider our response.

Sincerely,

Susan K. Tonner

Susan K. Tonner
Assistant Vice President, Acquisition Policy

Tel: 212-885-8000
Fax: 212-697-1299
www.bdo.com

100 Park Avenue
New York, NY10017

February 29, 2012

Via E-mail: comments@pcaobus.org

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

Re: Request for Public Comment: PCAOB Release No. 2011-008, Rulemaking Docket Matter No. 030, *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*

Dear Members and Staff of the Public Company Accounting Oversight Board (PCAOB):

BDO USA, LLP welcomes this opportunity to comment on the PCAOB's Proposed Auditing Standard, *Communications with Audit Committees* (proposed standard), which would supersede the PCAOB's interim standards AU sec. 380, *Communication with Audit Committees,* and AU sec. 310, *Appointment of the Independent Auditor,* and related amendments to PCAOB standards. Overall, we support the issuance of the proposed standard, which we believe strengthens the functioning of the audit committee by encouraging more robust discussions between the auditor and the audit committee.

Following our overall comments are specific items that we ask the PCAOB to consider to either provide additional clarification or to better align with the PCAOB's stated objectives for the proposed standard.

Overall Comments

We reiterate our support of the PCAOB's efforts to enhance the relevance and quality of the communications between the audit committee and the auditor. Effective two-way communication that involves active participation by both the audit committee and the auditor underlie and support both the audit committee's oversight responsibility for the integrity of a company's financial statements and the financial reporting process, as well as the auditor's responsibility to obtain reasonable assurance about whether the financial statements are free from material misstatement. We believe that issuance of this proposed standard will better enable both the audit committee and the auditor to fulfill these responsibilities through the PCAOB's requirements designed to promote more robust and relevant discussions.

Specific Comments

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

Paragraph 4 of the proposed standard requires the auditor to discuss with the audit committee significant issues discussed with management in connection with the auditor's appointment or retention, including significant discussions regarding the application of accounting principles and auditing standards. In addition to this discussion, we recommend that the proposed standard include guidance around more robust fee discussions with the audit committee at the appointment or retention stage, in the context of aligning fees with the committee's expectations regarding audit scope and quality. In addition, such discussions would reflect the intent of the current SEC requirements relating to the audit committee's oversight responsibilities to engage auditors and approve compensation for the audit services they perform.

Establishing an Understanding of the Terms of the Audit - Acknowledgment/Agreement of Engagement Letter

With regard to the audit engagement letter, we recommend including the guidance contained on page A4-6 (Appendix 4) within paragraph 6 of the proposed standard to clarify that acknowledgment of and agreement to the terms of the annual engagement letter may be made by the audit committee to the auditor either orally or in writing or may be demonstrated through other means such as through the minutes of the audit committee meeting.

Overall Audit Strategy and Timing of the Audit – Involvement of Others

We agree with the overall communication of the audit strategy by the auditor to the audit committee, including involvement of other participants in the audit engagement. Paragraph 10d of the proposed standard requires communication of "the names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit." We suggest the PCAOB consider inclusion of a guideline or threshold for such communications that recognizes that not all parties may be considered significant participants to the audit based upon the procedures being performed by them; thus, such communication may not be meaningful to the audit committee. This guideline might be tied to a minimum percentage threshold, similar to the threshold for disclosing other participants in the audit that we suggested in our comment letter on the PCAOB's proposed standard on *Improving the Transparency of Audits,* dated January 9, 2012.

Additionally, we suggest that a second screen involving auditor judgment as to whether procedures being performed by others address significant risks, even if they would fall below the threshold established in the first screen. By way of example, consider an auditor of a financial institution who engages a third party expert to perform a valuation and assist in determining potential other-than-temporary impairment of a material, hard-to-value security. The third party spends an insignificant amount of time relative to the total audit hours in assisting the auditor; however, considering the significant impact on the auditor's procedures and conclusion related to the valuation of and accounting for the security, he/she believes the audit committee would find the involvement of the valuation expert relevant to their understanding of the audit approach to this area. As another example, consider the use of a network member firm that performs audit procedures associated with a goodwill impairment analysis associated with a recent and material foreign acquisition. The auditor would likely conclude that the risk associated with such an analysis, along with the audit procedures performed underlying the analysis, would be information that the audit committee would likely be interested in, regardless of the time spent or who actually performed the work. We believe that including these or similar examples in the proposed standard would assist the auditor in determining the types of communications that would be relevant to the audit committee in situations where the involvement of others is below the established threshold.

We also suggest that the proposed standard include, within paragraph 10d, guidance for more robust discussions with the audit committee when network member firms, or other firms, are utilized to audit foreign components. Depending upon the nature and size of the foreign components, we believe it may be relevant to audit committees to more fully understand certain considerations and implications in auditing such locations (e.g., working paper access issues, independence rules, local regulatory oversight matters, whether the foreign firm is registered with the PCAOB, etc.).

Consultations

We agree with the PCAOB's direction to focus communications regarding consultations with others outside of the engagement team on matters that are defined as difficult or contentious or that the auditor reasonably determined are relevant to the auditor committee's oversight of the financial reporting process. Pages A4-27 and 28 (Appendix 4) contain pertinent guidance on such matters that we recommend the PCAOB include within paragraph 13e of the proposed standard to promote consistency in application of this new requirement.

With regard to the auditor's determination of relevance of matters to communicate, we believe it would be useful, as a means to encourage effective two-way communication, to emphasize that the auditor is encouraged to discuss with the audit committee its expectations as to the nature and extent of detail of consulted matters that should be communicated.

Furthermore, we believe that it is important for the auditor to understand the PCAOB's focus on the matters on which the auditor consulted and not on the parties involved in the consultation. On page A4-28 (Appendix 4), the PCAOB indicates that these consultations are not intended to exclude discussions with the engagement quality reviewer. To avoid any misunderstanding about whether relevant consultations with the engagement quality reviewer are required to be communicated to the audit committee, especially since such consultations were explicitly excluded in the previously proposed standard, we recommend including this clarification within paragraph 13e of the proposed standard to emphasize that consultations with the engagement quality reviewer involving difficult or contentious matters that are relevant to the audit committee should be communicated by the auditor.

Uncorrected and Corrected Misstatements

We agree with providing the audit committee information regarding uncorrected and corrected misstatements but recommend that clarification to paragraph 19 be added to emphasize that communication of corrected misstatements relates to both "accounts and disclosures," to be consistent with the language included in paragraph 18.

Timing

Paragraph 25 of the proposed standard indicates that all audit committee communications should be made in a timely manner and prior to the issuance of the auditor's report. We agree with this proposed requirement. The proposed standard further scopes in consideration of other timing requirements as specified by PCAOB rules or the rules and regulations of the Securities and Exchange Commission. To that point, we recommend that the PCAOB provide clarification, perhaps in a footnote, to address situations involving the subsequent issuance of a consent related to the auditor's report (e.g., related to a 1933 Act filing) and the extent that updating communications would be required. For example, Question 26 of the SEC's Office of the Chief Accountant: Application of the January 2003 Rules on Auditor Independence Frequently Asked Questions[1] provides guidance as to the type of information that the auditor would be required to communicate:

Question 26

Q: Would the requirement to communicate with audit committees apply to situations where the auditor is providing a consent (e.g., related to a 1933 Act filing)? If so, what information should be communicated to the audit committee?

A: Yes. In that situation, the audit report is deemed to be filed. As a result, the auditor would be required to communicate the relevant information to the audit committee. Since the auditor would have communicated the relevant information when the audit report was originally filed, this communication at the time of the consent may properly be restricted to updating the audit committee. However, if in the process of applying audit procedures required by AU §711, matters come to the auditor's attention that would or could have affected the financial statements or the auditor's report that was previously filed, all relevant information should be communicated to the audit committee.

Proposed Amendments to PCAOB Standards - Interim Financial Information

Page A4-48 (Appendix 4) emphasizes that the amendments proposed to AU sec. 722, *Interim Financial Information*, do not change the scope of existing required communications which

[1] Refer to: http://www.sec.gov/info/accountants/ocafaqaudind080703.htm

limit communications to the audit committee in an interim review to the effect of significant events, transactions and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. Nor does the proposed standard require the auditor to repeat communications that were made as part of the annual audit. We recommend also including this discussion within the proposed standard.

We further recommend that the amendments to AU sec. 722 become effective for interim periods occurring after the first annual period in which the proposed standard becomes effective. Otherwise, all of the incremental communications required by the proposed standard would be required for the first interim period in the year of adoption, significantly increasing the amount of communications typically involved related to interim reviews. Also, because that first interim period may not be interpreted to be "part of the annual audit," it seems the same may apply to the second and third interim periods in the year of adoption.

Audits of Brokers and Dealers

In response to the PCAOB's questions related to audits of brokers and dealers, we agree that the proposed standard should be applicable to all audits of brokers and dealers. We further agree with the PCAOB that the audit committee communication requirements under the PCAOB's interim standard, AU sec. 380, should be applicable to all audits of brokers and dealers prior to the effective date of the proposed standard if the Securities and Exchange Commission's proposed rule requiring audits of brokers and dealers in accordance with PCAOB standards becomes effective prior to the effective date of the proposed standard.

******

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Chris Smith, National Accounting & Auditing Professional Practice Leader at 310-557-8549 (chsmith@bdo.com) and Susan Lister, National Director of Auditing at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting
J. M. Tull School of Accounting
University of Georgia
Athens, Georgia 30602-6252
706 542-3502

January 10, 2012

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Rulemaking Docket Matter No. 030

Members of the PCAOB:

This letter contains my comments on the re-proposed auditing standard relating to "Communications with Audit Committees." These comments are from my perspective of serving as the Chairman of two large public company audit committees at present and four others in the past. I submitted a letter (dated April 23, 2010) on the earlier proposal and while I am, of course, disappointed that the Board did not adopt all of my recommendations, I appreciate that they were given consideration per the discussion in Appendix 4. However, I do have a few remaining important concerns with the revised exposure draft that I hope the Board will carefully consider in its final deliberations.

I was disappointed that only three or so of the relatively small number of comment letters on the earlier exposure draft came from audit committee members, including mine. After all, three of the four objectives of this communication process as stated in the new draft deal with what the audit committee should want from the auditor. I greatly appreciate that the PCAOB did reach out to audit committee members through a subsequent roundtable meeting (with other participants) and by extending the comment deadline, but input from audit committee members was still quite limited. The relative lack of involvement by audit committee members on this project vs. the great interest from them on the audit firm rotation project may lead you to conclude that audit committee members are either supportive or ambivalent about the communication project. I think, however, for the audit firm rotation project audit committee members saw their responsibility or even integrity being more directly attacked by the PCAOB and, thus, were more motivated to write. On the other hand, I believe they just haven't fully awakened to the consequences of this project.

I do appreciate the Board's re-exposing the document for further input. However, given the relatively short comment period occurring during the year-end closing period for most corporations, it's likely that this won't be a high priority response item. I urge the Board to be sure it receives a reasonable amount of input in some form from audit committee members before making final decisions.

Overall objectives of the release

As noted in my earlier letter, excellent communications between independent auditors and a company's audit committee are a critically important contributor to high quality corporate financial reporting, even more so as a result of the Sarbanes-Oxley Act of 2002. Thus, I fully support updating the interim auditing standards that deal with this topic. However, I also noted in my earlier letter that there are already a fairly large number of required communications from auditors to audit committees and this proposal would add others. A danger is that auditors will perhaps focus too much on meeting these extensive requirements to the detriment of truly effective communications with audit committees – an increase in number or detail doesn't necessarily mean better. For example, I have observed that in some audit committee meetings it's necessary for the Chairman to closely monitor activities of the audit engagement team who, left unchecked, may spend large amounts of precious meeting time reading some of those required communications to committee members.

Given the lengthy list of required communications, I remain concerned that the revised document may result in "checklist behavior" or an exercise in compliance rather than communication. With so many references to auditing standards that may well be reviewed by the PCAOB through the inspection process, the standard simply may not reach an appropriate balance between what auditors think audit committees should receive vs. what the members of those committees actually need to receive from auditors.

Having expressed the above concerns, I acknowledge that there probably isn't much the PCAOB can do to address them in a final standard. It's hard to make a case for deleting any of the specific requirements (except as noted below). And the overall tone of the release is generally positive. The issue is whether a new standard will actually result in improved communications or simply more compliance activity by the accounting firms and after the fact challenges by PCAOB inspection teams. If the former, than this will be a real plus for audit committees. If the latter, we will have taken a step backwards.

Confusing the Roles of the Auditor and Management

I am somewhat concerned that the revised proposal does not acknowledge the proper roles of the auditor and management in certain key respects. In such a lengthy document (considering all of the appendices, etc.), it is easy to lose focus on the big picture and I probably didn't do a very good job of analyzing the earlier release in thinking about the roles of management and the auditor. However, I've now done this in the chart that appears as the attachment to this letter. This chart notes my analysis that while most of the proposed requirements in the exposure draft are auditor initiated matters, there are some that represent management reporting responsibilities. For the latter, the traditional auditor responsibility would be to "attest" or to communicate to the audit committee that management has reported appropriately rather than initiating the reporting. However, the proposal instead would require that the auditor must initiate this reporting in at least some cases.

For items grouped under paragraphs 4, 5-7, and 8-11 in the attachment, I think it is fair to describe them as being related to the nature of the audit and matters that are appropriately communicated by the auditor to the audit committee. And items grouped under paragraphs 13, 15, 17, 18-19, 20, 21, and 22, can fairly be related to the results of the audit and are also appropriately communicated by the auditor to the audit committee.

However, paragraphs 12 and 14, in particular, cover what I would characterize as matters that the PCAOB believes should be reported by the auditor to the audit committee when they aren't reported directly by management (and the auditors have to be at least somewhat involved as described further below). I have some separate comments about paragraph 14 in the following section but first a few comments about paragraph 12.

The information covered in paragraph 12 generally would be made available to audit committees by management through a company's financial statements and SEC filings as well as other presentations during committee meetings. And the paragraph is worded such that the auditor's responsibility is to communicate that information already developed by management and not to initiate the development of such information. However, by placing the reporting responsibility squarely on the shoulders of the auditor rather than on management where it belongs, the PCAOB has reversed the normal relationship. Perhaps the problem here is that AU 380 needs reconsideration but it is clearly inappropriate for auditors to have the primary responsibility for communicating management information.

The note to paragraph 12 indicates that the auditor might not have to communicate these matters "at the same level of detail as management" given certain conditions. However, page 23 of Appendix 4 makes clear that the auditor must "participate in management's discussion." Further, the auditor must identify for the audit committee those accounting policies and practices that the auditor considers critical – is this intended to be a different listing than what management presents to the audit committee?

As an audit committee chairman I rely on the CFO, CAO, Controller, etc. to provide this information and it's also important for the auditor to be present during those discussions to speak up if they feel anything is left out. However, I don't think this communication needs to be a joint presentation by the CFO and engagement partner, for example, where it would then become more like the two of them telling me what they have designed as the company's policies and practices. I think this proposal steps over the independence line and requires the auditor to act more like a member of the management team, which is unacceptable.

In summary, I strongly believe that the final standard should be reworded such that the matters in question are described solely as management's reporting responsibilities and the auditor's role as informing the audit committee only when the information is materially misreported.

Significant unusual transactions

The re-proposal introduces a new requirement for the auditor to communicate significant transactions that are "outside of the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature." The rational for this new requirement as stated in paragraph IX of Appendix 4 is that "Some commenters suggested (it) …" That is not very compelling, and I hope that the Board will now be open minded about comments to the contrary.

Audit committee members certainly want to be well informed about the key issues involved in a company's financial statements. Thus, on the surface, receiving information about "significant unusual transactions" would seem to help audit committee members better understand those financial statements and related materials in SEC filings. However, if a new rule would become effective there would be the inevitable questions about such matters as:

> What does significant mean? Does it have the same meaning as material? Should it apply to segments or only to consolidated amounts?
>
> How should "unusual" be determined? For example, would large real estate loan related losses in recent years be considered "unusual" for financial institutions? (Recall the debate over whether the costs related to terrorists attacking the World Trade Center in 2001 should have been considered "extraordinary.")

Your response may well be "let judgment deal with these issues." However, practice generally demands responses through FASB Emerging Issues Task Force attention, accounting firm guidance, etc. Thus, accounting firms and corporations will almost certainly demand more guidance before this could be effectively applied. And the PCAOB inspection process will be challenging accounting firms for their compliance with this new rule after the fact.

As an audit committee member I fully expect that management will inform me about the types of matters that would no doubt fall under what the PCAOB has in mind in paragraph 14. Similar to my comments in the preceding section, I would expect the auditor to inform me only if management has failed to do so. Further, paragraph 14 and the related explanations in the Appendix are worded such that the auditor apparently <u>must</u> communicate these significant unusual transactions regardless of whether management has already done so. That seems to add further insult to the normal management/audit committee reporting relationship.

I strongly urge that paragraph 14 be deleted from a final standard.

<u>Other Comments</u>

I continue to believe that communications with audit committees ought to be in writing, notwithstanding the arguments in the revised exposure draft. Writing a memo for the file to satisfy a communication requirement simply doesn't ensure an adequate understanding by audit committee members.

I agree with the commenters who said that the engagement letter also should include the responsibilities of the audit committee. While you note that "those responsibilities are governed by other rules," it doesn't make sense to have such an obvious omission from the engagement letter.

Please let me know if you have any questions about my comments.

Sincerely,

Dennis R Beresford

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting

Analysis of Requirements Between Auditor and Management Responsibility

Paragraph Number and Description	Auditor Initiated	Company Initiated
4 – Issues discussed before appointment	X	
5-7 – Engagement letter	X	
8-11 – Audit strategy	X	
12 – Accounting policies, practices, and estimates		X
13 – Evaluation of the quality of financial reporting	X	
14 – Significant unusual transactions		X
15 – Other information in documents containing audited financial statements	X	
16 – Management consultation with other accountants about significant auditing or accounting matters		X
17 – Going concern considerations	X	
18-19 – Uncorrected and corrected misstatements	X	
20 – Departures from the standard auditor's report	X	
21 – Disagreements with management	X	
22 – Difficulties encountered in performing the audit	X	

California Public Employees' Retirement System
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
TTY: (916) 795-3240
(916) 795-3400 phone • (916) 795-2842 fax
www.calpers.ca.gov

February 28, 2012 Via E-Mail: comments@pcaobus.org

James R. Doty, Chairman
Public Company Accounting
Oversight Board (PCAOB)
1666 K Street N.W.
Washington, DC 2006-2083

Re**: PCAOB Release No. 2011-008, Docket Matter No. 030** "Proposed Auditing Standard related to Communications with Audit committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380"

Dear Chairman Doty:

I am writing on behalf of the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the United States with approximately $236.6 billion in global assets and equity holdings in more than 9,000 publicly traded companies. CalPERS provides retirement benefits to more than 1.6 million public workers, retirees, and their families and beneficiaries.

Reproposal – Audit Standard related to Communications with Audit committee

Thank you for the opportunity to provide comment to the Public Company Accounting Oversight Board (PCAOB) on the reproposed auditing standard, *Communications with Audit committees* and related amendments that will replace interim standards AU sec. 380 and AU sec. 310, *Appointment of the Independent Auditor*. We continue to support the need for a comprehensive and robust standard since submitting a comment in 2010 and agree with the need to repropose the standard based on:

1. Better alignment with the eight new risk assessment standards issued since the original proposal;
2. Providing the ability of brokers and dealers, their boards, and their auditors the ability to comment since the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the registration and inspection of audit firms of brokers and dealers; and
3. The new requirement that auditors communicate to audit committees significant unusual transactions that are out of the normal business for the company or that otherwise appear to be unusual, ensuring communication by the auditor their understanding of the business rationale for such transactions.

Objectives

We strongly support the four objectives outlined in the reproposal of the auditor's communications with the audit committee which includes:

1. The auditor's responsibilities in establishing an understanding of the terms of the audit engagement with the audit committee;
2. Obtaining information from the audit committee that is relevant to the audit;
3. Communicating the overall audit strategy and timing; and
4. Timely observations arising from the audit that are significant to the financial reporting process.

We agree that the new proposed standards should be applicable to all audits of brokers and dealers and in the interim that AU sec. 380 should apply to audits of brokers and dealers required under section 982 the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Overall, CalPERS is pleased to see that the reproposal provides a number of specific matters that must be discussed with the audit committee, including the audit strategy and structure and timing of the audit; the auditor's assessment of risk areas, including fraud risks; the auditor's use of external experts and other auditors; the discussion of difficult and contentious issues that arise in the course of the audit; significant unusual transactions; significant accounting policies, judgments and estimates; and going concern evaluation and issues of other matters.

Auditor and Audit Committee Roles

The need for this standard is underscored by the important role that audit committees play in protecting the interests of investors and in overseeing the integrity of the company's financial reporting process. CalPERS as a significant long-term institutional investor, believes both the roles of auditors and audit committees are critical to the confidence, efficiency and integrity of the capital markets. The financial interests of CalPERS beneficiaries are most effectively served in an environment where investors can confidently utilize financial statements to evaluate risks and rewards.

CalPERS does not agree with the following significant changes in the reproposal. These include:

1. No longer requiring that auditors evaluate the two-way communications process between the auditor and the audit committee;
2. Omitting the requirement that auditors discuss with the audit committee the quality, clarity and completeness of the company's financial statements and related disclosures; and
3. Restructuring requirements on the communication between the auditor and audit committee on management's critical accounting estimates.

Observations and Recommendations:

With this in mind, we would like to offer the following observations and recommendations on the reproposal of this standard.

- Clearly outline the roles of the auditor and audit committee, ensuring the underlying objective of transparency, and integrity of the financial reporting process. CalPERS Global Principles of Accountable Corporate Governance state "the auditor should articulate to the audit committee, risks and other matters arising from the audit that are significant to the oversight of the financial reporting process, including situations where the auditor is aware of disputes or concerns raised regarding accounting or auditing matters. The audit committee should consider providing to investors a summary document of its discussions with auditors to enhance investor confidence in the audit process."

- Investors are particularly interested in any auditor communications and information that may be material to the integrity of the financial reports and possibly to the share price of the issuer's stock, including:

  1. Key business, operational and audit risks believed to exist and considered;
  2. Assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low or high end of the range of possible outcomes;
  3. Appropriateness of the accounting policies adopted by the company;
  4. Changes to accounting policies that have a significant impact on the financial statements;
  5. Methods and judgments made in valuing assets and liabilities;
  6. Unusual transactions;
  7. Accounting applications and practices that are uncommon to the industry;
  8. Identification of any matters in the annual report that the auditors believe are incorrect or inconsistent, with the information contained in the financial statements or obtained in the course of their audit;
  9. Audit issues and their resolution which the audit partner documents in a final audit memo to the Audit committee;
  10. Evaluation of whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time (which should be defined);
  11. Quality and effectiveness of the governance structure and risk management;
  12. A view on how the entity compares to its peers in the effectiveness of its internal controls and financial reporting practices; and
  13. Completeness and reasonableness of the audit committee report.

- The standard should include requirements for the auditor to communicate, or to evaluate whether management has adequately communicated:

  1. How management subsequently monitors critical accounting estimates;
  2. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;
  3. A discussion of any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements and the information that supports or challenges such changes; and
  4. When critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various sections within the range would affect the company's financial statements.

- The guidelines should foster a two-way meaningful exchange between auditors and audit committees which are documented to avoid misunderstandings. We do not believe documentation will constrain robust, frank and effective discussions and it is important that communications not solely be oral.

- Audit committees also need to also do a better job at providing effective disclosures to investors. CalPERS principles outline this responsibility as including:

    1. Assessment of the independence and objectivity of the external auditor to assure the auditors and their staff have no financial, business, employment or family and other personal relationships with the company;
    2. Assessment of the appropriateness of total fees charged by the auditors;
    3. Assessment of non-audit services and fees charged including limitations or restrictions tied to the provision of non-audit services;
    4. Explanation of why non-audit services were provided by the auditor rather than by another party and how the auditor's independence has been safeguarded;
    5. Rationale for recommending the appointment, reappointment or removal of the external auditor including information on tendering frequency, tenure and any contractual obligations that restrict the choice of external auditors;
    6. Auditor rotation period;
    7. Assessment of issues which resulted in auditor resignation.

The financial crisis has resulted in concerns that auditors and audit committees may not be receiving adequate information from management, including better two-way communication between the auditor and the audit committee. We therefore welcome the PCAOB's attention to this important subject.

Thank you for considering our comments. If you have any questions, please do not hesitate to contact me at (916) 795-9672 or my colleague, Mary Hartman Morris at (916) 795-4129.

Sincerely,

ANNE SIMPSON
Senior Portfolio Manager
Investment Office
Head of Corporate Governance

cc: Board Members – PCAOB
J. Gordon Seymour, General Counsel and Secretary – PCAOB
Joe Dear, Chief Investment Officer – CalPERS
Janine Guillot, Chief Operating Investment Officer – CalPERS
Bill McGrew, Portfolio Manager – CalPERS
Mary Hartman Morris, Investment Officer - CalPERS

CalCPA

1800 Gateway Drive, Ste 200
San Mateo CA 94404-4072
(800) 922-5272
www.calcpa.org

Via email: comments@pcaobus.org

February 14, 2012

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES; RELATED AMENDMENTS TO PCAOB STANDARDS; AND TRANSITIONAL AMENDMENTS
PCAOB Release No. 2011-008
December 20, 2011
PCAOB Rulemaking Docket Matter No. 030

The Accounting Principles and Auditing Standards Committee ("the Committee" or "We") of the California Society of Certified Public Accountants ("CalCPA") is grateful for the opportunity to comment on the proposed auditing standard referenced above. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 35,000 members. The Committee is comprised of 43 members, of whom 56 percent are from local or regional firms, 21 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 9 percent are in academia and 2 percent are in an international firm.

1. Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

The Committee believes the new proposed standard is appropriately aligned with the performance requirements in the risk assessment standards.

2. The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?

The Committee does not believe there are additional matters that should be communicated to the audit committee.

3. The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

a. Is the requirement in the standard clear?

The Committee believes the requirement in the proposed standard is sufficiently clear.

b. As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

The Committee believes the communication should be evidenced by the audit committee, either in writing through direct signature or acknowledged in the official minutes of the audit committee, or through electronic communication. It is sufficiently important that it should not be solely oral.

4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

As stated in the Committee's response to the initial exposure draft of this topic, management should have the primary responsibility to communicate these matters to the company's board of directors, and the audit committee should initially get the information on significant unusual transactions in this manner.

Appendix 1, paragraph 12. a. (2) requires the auditor to communicate methods used by management to account for significant unusual transactions and paragraph 14. requires other communication related to these same transactions,

Paragraph 12. b. requires the auditor to communicate data on critical accounting policies and practices, and

Paragraph 12. b. also points out that the critical accounting policies and practices relate to events in the current year.

Paragraph 12. c. requires the auditor to communicate data on critical accounting estimates.

Paragraph 12. (in the note at the end) acknowledges that management might communicate matters related to critical accounting policies, practices and estimates, and how that might affect the auditor's communication to the audit committee.

The Committee believes that all of the foregoing communications should be made by management to the board of directors, which includes members of the audit committee, although this is a corporate governance matter and this proposal is not the vehicle in which to mandate such communications. The acknowledgement that management might communicate matters related to critical accounting policies, practices and estimates should be extended to significant unusual transactions, and that this would affect the auditor's communication to the audit committee. The auditor can then be charged with reviewing management's communications to determine they are complete and supplementing them as may be necessary.

Further, the Committee fails to see the distinction between accounting policies and practices related to "significant unusual transactions" and "critical accounting policies and practices" and suggests the disclosure requirement for these and the communications in paragraph 14 be combined and be stated only once.

5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

The Committee believes the proposed requirements are reasonable.

6. Are the amendments to other PCAOB standards appropriate? If not, why?

The Committee assumes this question addresses the mechanics of reflecting the proposed changes in the PCAOB standards. The Committee has no exception to how this was done.

However, the following amendments are not appropriate and should not be made. References are all to Appendix 1

> Paragraph 10 d. Other independent accounting "firms" should not include affiliates of the accounting firm. The disclosure could be lengthy, and would not be meaningful. These have long been regarded as part of the principal auditor, and it is common knowledge that affiliates outside the country of the principal auditor are separate entities. While we understand problems have been reported with affiliates in some countries, the proposed disclosures, as they relate to affiliated firms, will do nothing to communicate information concerning potential problems with a foreign affiliate. The audit committee will know the countries where the auditor is performing procedures, and that should be sufficient.

> Paragraph 13. a. appears to require communication about the qualitative aspects of ALL significant policies and practices, rather than just the ones with which the auditor took exception. The Committee does not know how this would be operative, since if the modification is really significant it should require an exception in the auditor's report; since

such an exception is not permitted under SEC certification requirements; management would make the proposed modification.

Paragraph 13. e. and Paragraph 10. a. requires communication of the nature and extent of specialized skill or knowledge needed for the audit, as further explained in Appendix 4, paragraph VI.A. Paragraph 13.e. states a different requirement for communication of consulting outside the "engagement team." The scope of the definition of the engagement team can be very broad, and include personnel in regional and national offices. We suggest the communication requirement in 13.e. be amended to reflect the communication in paragraph 10.a.

Paragraph 13. g. appears to require communication of all alternative accounting treatments permissible and the accounting treatment preferred by the auditor. The Committee believes the auditor's role is to determine the acceptability of management's accounting and disclosure, and the auditor may not have formally established a preference for any alternatives, **or have discussed such preferences with management. The auditor is under no current professional responsibility to explore all conceivable alternatives for which the auditor might develop a preference**. The Committee recommends this required communication be clarified to apply to only those alternatives that have been discussed with management, consistent with the language in SEC Reg. S-X, Rule 2-07.

7. The Board requests comments regarding the audits of brokers and dealers on the following matters:

a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?

The Committee supports applying the proposed standard to brokers and dealers because of the benefits the communication is designed to provide. However, the Committee is concerned that smaller brokers and dealers may not have designated anyone to oversee the accounting and financial reporting processes of the company and audits of its financial statements, or that the person so designated may not have the status and authority in the company to conduct meaningful communication with the auditor on any but routine matters. This concomitant lack of independence of the company's personnel subverts any pretension of the independence that an audit committee would normally have.

b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

As stated in the Committee's response to 7 a., in principle, we support applying the proposed standard to brokers and dealers because of the benefits the communication is designed to provide. However, the Committee is not certain, as we stated in our response to 7 a. that the communication would always be meaningful. We recommend the PCAOB evaluate the appropriate internal governance standards for smaller brokers and dealers through the PCAOB's inspection plan for brokers and dealers, and subsequently determine if the proposed standard ought to be applied to them.

c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

The Committee does not have any specific recommendations on this matter.

The Committee would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

Howard Sibel

Howard Sibelman, Chair
Accounting Principles and auditing Standards Committee
California Society of Certified Public Accountants

CPAB
CCRC

CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

150 York Street, Suite 200, Box 90, Toronto, Ontario M5H 3S5
Tel 416.913.8260 Fax 416.850.9235 www.cpab–ccrc.ca

March 5, 2012

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

Dear Sir:

Request for Comment: Proposed Auditing Standard Related to Communications with Audit Committees
PCAOB Rulemaking Docket Matter No. 30

The Canadian Public Accountability Board (CPAB) is pleased to comment on the Public Company Accounting Oversight Board (PCAOB) Release No. 2011-008 entitled *Proposed Auditing Standard Related to Communications with Audit Committees* (the "Proposed Standard"). CPAB supports the PCAOB's efforts to enhance the relevance and quality of communications between the auditor and the audit committee, thereby improving audit quality and transparency.

CPAB is Canada's independent audit regulator and is responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing that contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

Audit committees have a critical role to play in achieving audit quality, and integrity of financial reporting. Accordingly, audit committees need to receive high quality, relevant and timely communication from the auditor in order to effectively evaluate the quality of the audit. The Proposed Standard strengthens existing auditor communication requirements and will improve the consistency with which significant matters are communicated to audit committees.

Overall Audit Strategy and Timing of the Audit

We support the proposed new requirements to enhance the auditor's communication of the overall audit strategy. It is important for the audit committee to understand the extent of the involvement in the audit of other independent public accounting firms or persons not employed by the auditor, including the scope of the audit procedures completed by them. The requirements of paragraph 10 of the Proposed Standard will assist in ensuring that the audit committee fully understands the involvement of the principal auditor who is reporting to them.

We agree it is important to communicate with the audit committee significant changes to the planned audit strategy or the significant risks initially identified, and we support the inclusion of this requirement in the Proposed Standard. This information could impact the audit committee's oversight of the financial reporting process and so they should have this information to make their own assessment of the impact.

Significant Unusual Transactions

We support the proposed new requirement for the auditor to communicate to the audit committee any significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual, and to communicate the auditor's understanding for the business rationale for such transactions. Our inspection findings have shown that this is an area needing improvement, and the proposed new requirement codifies current best practices.

In conclusion, we support the PCOAB's efforts to improve auditor communication with audit committees. We appreciate the opportunity to respond to the Proposed Standard, and would be pleased to discuss any of the above comments with you at your request.

Yours very truly,

Brian Hunt, FCA
Chief Executive Officer

Capital Research and Management®

Capital Research and Management Company
333 South Hope Street
Los Angeles, California 90071-1406

Phone (213) 486 9200
Fax (213) 486 9455

VIA ELECTRONIC DELIVERY

February 29, 2012

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

Re: Request for Public Comment: Proposed Auditing Standard Related to Communications with Audit Committees, PCAOB Rulemaking Docket Matter No. 30

Dear Office of the Secretary:

Capital Research and Management Company ("Capital") serves as investment adviser to the American Funds, one of the oldest and largest mutual fund families in the nation. We appreciate the opportunity to provide comments on the Proposed Auditing Standard related to Communications with Audit Committees ("Proposed Standard"). These comments are informed by our interactions with the audit committees and independent auditors of the American Funds. These comments reflect our own views and not necessarily those of Capital, or other Capital associates.

We support the Public Company Accounting Oversight Board's continued efforts to enhance the relevance and quality of the communications between the independent auditor and the audit committee. We believe fuller and more relevant communications between the independent auditor and the audit committee will enable the audit committee to more effectively fulfill its oversight responsibilities regarding the financial reporting process, and allow the auditor to perform a more informed and effective audit. At audit committee meetings for the American Funds, the Funds' independent auditors provide the audit committees with an understanding of the overall audit strategy and an evaluation of the inherent risks identified as part of the audit. Routinely discussed items include significant/critical accounting policies, practices and estimates, including significant unusual transactions, CRMC's internal control reports (known as SOC 1 reports under the SSAE 16 guidance) and the Funds' financial statements themselves. In addition, members of the committees coordinate with Capital associates and the independent auditors to facilitate focused discussions on internal control topics and current events, such as new accounting and regulatory pronouncements, relevant to the oversight of the financial statements.

The foregoing paragraph includes examples of information currently communicated between our audit committees and independent auditors, and we believe the Proposed Standard codifies these and other best practices into standard required communications. In closing, we support the Boards goal of improving audit committee communications and believe the requirements in the Proposed Standard provide a framework that will promote effective and consistent communications between the audit committee and independent auditor.

* * * * *

Please feel free to contact any of us should you have any questions or wish to discuss our thoughts on the Proposed Standard.

Sincerely,

Brian D. Bullard
Senior Vice President – Fund Business Management Group –
Capital Research and Management Company
(949) 975-3708

Brian C. Janssen
Vice President – Fund Business Management Group –
Capital Research and Management Company
(949) 975-6753

CENTER FOR AUDIT QUALITY

Serving Investors, Public Company Auditors & the Markets

February 29, 2012

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

Re: Request for Public Comment*: Proposed Auditing Standard Related to Communications with Audit Committees, Related Amendments to PCAOB Standards, and Transitional Amendments to AU sec. 380*, PCAOB Rulemaking Docket Matter No. 30

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA).

The CAQ appreciates the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB or the Board) on its release, Proposed Auditing Standard Related to Communications with Audit Committees, Related Amendments to PCAOB Standards, and Transitional Amendments to AU sec. 380 (Proposed Standard). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Supporting and Enhancing Audit Committee Communications

The audit committee serves an essential role in the corporate governance framework by protecting investors through its oversight of a company's financial reporting process. As noted in the CAQ's recent comment letter on the Board's *Concept Release on Auditor Independence and Audit Firm Rotation*, we believe that the role of the audit committee should continue to be supported and strengthened. The CAQ acknowledges the importance of effective two-way communications between the auditor and the audit committee and is supportive of efforts to enhance these communications with the objective of further assisting audit committees in fulfilling their fiduciary responsibilities on behalf of investors.

Overall, we are supportive of the Proposed Standard and its objective to enhance the relevance and effectiveness of the communications between the auditor and the audit committee. We have, however, identified certain areas in the Proposed Standard where we believe further clarification or modification would help to achieve better alignment with the stated objectives of the Proposed Standard. We are pleased to offer for the Board's consideration our observations on these areas as well as our thoughts on some of the specific questions posed by the Board.

Applicability to the Audits of Brokers and Dealers

The Proposed Standard requests comment on whether it should apply to the audits of all brokers and dealers and on whether the Board's interim standard, AU sec. 380, should apply to such audits prior to the effective date of the Proposed Standard. The CAQ believes that the Proposed Standard should be applicable to all audits of brokers and dealers conducted in accordance with PCAOB standards. We also support the application of the Board's interim standard, AU sec. 380, to all audits of brokers and dealers prior to the effective date of the Proposed Standard, if the Securities and Exchange Commission's (SEC) proposed rule requiring such audits to be performed in accordance with PCAOB standards[1] becomes effective prior to the effective date of the Proposed Standard.

The Proposed Standard also requests comment on whether there are any communication requirements specific to the audits of brokers and dealers that should be added to the new proposed standard. As additional communication requirements exist for audits of brokers and dealers under SEC Rule 17a-5, and under the Board's proposed attestation standards, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers, and Review Engagements Regarding Exemption Reports for Brokers and Dealers*, we recommend that Appendix B of the Proposed Standard ultimately be updated to reference the PCAOB rules and standards that would require these additional communications for brokers and dealers when such rules and standards become effective.

Involvement of Others in the Audit

Paragraph 10d of the Proposed Standard requires the auditor to communicate to the audit committee the "names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit." The CAQ supports providing additional information to the audit committee to enhance its understanding of the auditor's role and responsibilities and the audit process, including information about the involvement of others to support the audit effort. We note, however, that the proposed requirement for the auditor to communicate to the audit committee regarding the involvement of participants that are not considered key participants in the audit could result in a disproportionate amount of the overall communication to the audit committee being devoted to this requirement, thereby potentially shifting the emphasis away from other more important matters. We believe that establishing a threshold for this communication would be more consistent with the Board's intent to encourage effective two-way communications between the auditor and the audit committee regarding important matters related to the audit.

One method of establishing the threshold would be to utilize a minimum percentage that is consistent with that ultimately used in the Board's transparency proposal[2] (if adopted) for disclosing in the audit report the involvement of other firms or persons. In the context of communicating with the audit committee regarding significant risks as required by the Proposed Standard, this minimum percentage could be coupled with a

---

[1] See SEC Release No. 34-64676; File No. S7-23-11, *Broker Dealer Reports*
[2] See PCAOB Release No. 2011-007, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*

requirement to communicate with the audit committee regarding other participants who performed audit procedures to address one or more assertion(s) for which significant risks have been identified, even if such involvement fell below the minimum percentage. We believe this approach would be consistent with the objectives of the Proposed Standard and will help focus these additional audit committee communications on the other firms or participants that have a more meaningful involvement in the audit.

Consultations

Paragraph 13 of the Proposed Standard requires the auditor to communicate to the audit committee, "matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process." The Board has provided a discussion of "difficult or contentious matters" on page A4-28 in Appendix 4 to provide additional guidance to the auditor regarding what types of consultations would be required to be communicated to the audit committee. We recommend that this discussion be included within the final standard to assist the auditor in determining what consultations are required to be communicated to the audit committee.

Uncorrected and Corrected Misstatements

We note that the first sentence of paragraph 18 requires the auditor to provide the audit committee with the "schedule of uncorrected misstatements related to accounts and disclosures," while paragraph 19 requires the auditor to communicate "corrected misstatements" without specifying that the corrected misstatements also relate to both accounts and disclosures. We suggest that clarifying language be added to paragraph 19 to better align it with paragraph 18 and to more clearly indicate that the communication requirement for corrected misstatements includes misstatements related to both accounts and disclosures.

Amendments to PCAOB Standards

The required communications to audit committees under the proposed amendments to AU sec. 722, *Interim Financial Information* (AU sec. 722), generally are limited to the effect of significant events, transactions, and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. We recommend that the Board include clarification in the Proposed Standard to indicate that, as noted on page A4-46 in Appendix 4, the auditor is not required to repeat communications that were made as part of the annual audit.

In addition, implementation of the proposed amendments to AU sec. 722 prior to the time of the auditor's required annual communications under the Proposed Standard likely would result in expanded communication requirements related to the auditor's review of interim information. Accordingly, we recommend that the proposed amendments to AU sec. 722 only become effective for interim periods following the annual period in which the Proposed Standard becomes effective.

Engagement Letter

As noted on page A4-6 in Appendix 4, the Board would allow the audit committee to acknowledge the engagement letter orally or in writing. We suggest that clarifying language be added to paragraph 6 of the Proposed Standard to reflect this option.

Timing of Communications

We agree that it is essential for the auditor to communicate with the audit committee on a timely basis and we appreciate the Board's acknowledgement of instances where it is most efficient to communicate to the audit committee through the audit committee chair. We also support the requirement for the auditor to subsequently communicate to the audit committee those matters initially communicated to the audit committee chair. In order to recognize that not all members of the audit committee must be present in order to achieve a quorum, and under such circumstances a full audit committee may not be present (and is not required to be present) when the auditor provides the required communications, we recommend that the word "full" be removed from the note to paragraph 25 of the Proposed Standard.

****

In conclusion, the CAQ supports the Board's efforts to encourage effective, two-way communication between the auditor and the audit committee. We appreciate the opportunity to comment on the Proposed Standard and welcome the opportunity to respond to any questions regarding the views expressed in this letter.

Sincerely,

Cynthia M. Fornelli

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

PCAOB
James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Daniel L. Goelzer, Board Member
Jay D. Hanson, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC
Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
James L. Kroeker, Chief Accountant
Brian T. Croteau, Deputy Chief Accountant
J. W. Mike Starr, Deputy Chief Accountant

J. Michael Cook
980 Lake Avenue
Greenwich, CT 06831
203-552-9215

February 20, 2012

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

RE: Request for Public Comment on Proposed Auditing Standard Related to Communications with Audit Committees (PCAOB Release No. 2011-008, December 20, 2011)

Board Members:

I appreciate this opportunity to comment on the Public Company Accounting Oversight Board's (the Board) proposed Auditing Standard Related to Communications with Audit Committees. This proposed standard has benefitted significantly from input from the September 2010 Roundtable, the reopening of the initial comment period and will benefit further from input received on this reproposal. I commend the Board and staff for their comprehensive approach to this very important subject.

The comments and suggestions that follow are principally from my experience and perspective as an audit committee chair and member.

At this stage, my only significant comment concerns what I believe to be the best practice approach for audit committee communications. The proposed standard often refers to two-way communications between auditors and audit committees. I strongly favor an emphasis on robust three-way communication between management, auditors and audit committees. In my experience this is almost always the way these communications take place. I can't recall the last time I participated in a significant discussion of an important financial reporting matter related to accounting, disclosure, controls, etc., when all three parties were not present and actively participating together.

I am aware and acknowledge that the Board has no authority to set standards for either management or audit committees and therefore has needed to set forth the matters it believes must be communicated through a standard written for auditors. However, I believe the document should recognize management as the primary source of such communications with audit committees, with auditors participating directly in such communications. The auditor's responsibility to engage in a direct two-way communication with the audit committee would be by exception, taking place only if the three-way process fails to appropriately include all important matters.

If the auditor concludes that direct two-way communication with the audit committee is necessary, due to a failure or unwillingness of management to communicate effectively, the auditor should be required, in addition to communicating the subject matter in lieu of management, to discuss the circumstances with the audit committee so that the committee can fully understand why the expected three-way communication process has failed to occur. Presumably the audit committee would then have a full discussion of the matter with management as well.

I assume that a final standard will be issued sometime later this year. If so, although the standard's effective date will have to be for audit years after 2012, I recommend that the Board encourage early application of the standard to the extent feasible and practicable for 2012 audits in process. Many of the proposed requirements are standard practice today but to the extent that they are new for a particular company, their adoption should be encouraged for 2012 year-end communications, without imposing any retroactive requirements. Important improvements should not wait a year to be implemented.

I would be happy to answer any questions the Board or staff may have concerning my comments and suggestions.

Sincerely,

J. Michael Cook

cc: James R. Doty
Chairman, PCAOB

cc: Lewis H. Ferguson
Board Member, PCAOB

cc: Jeanette M. Franzel
Board Member, PCAOB

cc: Jay D. Hanson
Board Member, PCAOB

cc: Steven B. Harris
Board Member, PCAOB

Crowe Horwath LLP
Independent Member Crowe Horwath International

One Mid America Plaza, Suite 700
Post Office Box 3697
Oak Brook, Illinois 60522-3697
Tel 630.574.7878
Fax 630.574.1608
www.crowehorwath.com

February 27, 2012

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

RE: **PCAOB Rulemaking Docket Matter No. 030, *Proposed Auditing Standard Related to Communications with Audit Committees Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380,* PCAOB Release No. 2011-008**

Dear Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) *"Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380"* (Proposed Standard).

We share the goal of improving communication between the auditors and the audit committee. We believe it is critically important that the audit committee and the auditors have strong two-way communications that will enhance the audit and enhance the oversight responsibilities of the audit committee. This communication should be tailored to the client, to the audit committee's expressed needs and should be free flowing throughout the audit and not prescriptive nor boiler plate. Audit committees play an important role in protecting the interest of the investors. Audit committees should receive important information from the auditors that assist them in carrying out their roles and responsibilities and the audit committee should share important information with the auditors that enhances the audit process. We believe there are several items within the proposed standard that do not achieve the above objectives, and we have described those in the following comments.

Paragraph 10 indicates that the auditor should communicate the overall audit strategy with the audit committee. However, in paragraph 10d, the auditor should communicate *"the names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform procedures in the current period audit"*. We do not believe the description in 10d is consistent with objective of communication of the overview of the overall audit strategy. The requirement in 10d is very detailed and prescriptive and we do not believe it is important to the audit committee to be presented in that manner. We understand the need to communicate the overall strategy and as part of that strategy a firm may utilize other audit firms or individuals not employed by the principal auditor in the process. We believe such communication should be related to communication of other firms participating in a significant part of the audit or other firms that may be auditing significant risk even though their overall participation may not be significant. This would apply to individuals as well. As noted in paragraph 13e and repeated here, this should be left to judgment of the auditor and the audit committee as to what is relevant to the audit committee's oversight of the audit process.

Paragraph 18 of the Proposed Standard specifically notes that the auditor should provide the audit committee with the schedule of *"uncorrected misstatements related to accounts and disclosures"*. However, in paragraph 19, *"the auditor should communicate to the audit committee those corrected misstatements that may...."* The description in paragraph 19 (corrected misstatements) does not explicitly indicate *"related to accounts and* *disclosures"*. We believe for consistency and for appropriate communication to the audit committee, paragraph 19 should describe misstatements in the same manner as uncorrected misstatements were in paragraph 18.

Paragraph 25 addresses the timing of audit committee communications. However, the "Note" under paragraph 25 indicates that *"An auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit. The auditor, however, should communicate such matters to the full audit committee prior to the issuance of the auditor's report"*. We believe the requirements to communicate to the full audit committee is an unnecessary burden and may cause unforeseen consequences (e.g. report delays) therefore, we encourage the PCAOB to eliminate the requirement for "full" and simply indicate that communication should be made to the audit committee. A quorum would appear to be sufficient and would reduce the chance of unforeseen consequences.

The Proposed Standard requests comment on whether it should apply to the audits of all brokers and dealers and on whether the Board's interim standard, AU sec 380, should apply to such audits prior to the effective date of the Proposed Standard. We support the application of AU sec 380 to all audits of brokers and dealers prior to the effective date of the Proposed Standard if the SEC's proposed rule becomes effective earlier.

* * * * * * * * * * * * *

Crowe Horwath LLP supports the Board's efforts to improve its auditing standards and communication with the audit committee. We hope that our comments and observations will assist the Board in its consideration of the matters in the Proposed Standard.

Cordially,

Crowe Horwath LLP

Crowe Horwath LLP

Deloitte.

Deloitte & Touche LLP
1633 Broadway
New York, New York 10019-6754
USA

www.deloitte.com

February 28, 2012

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

Re: *Proposed Auditing Standard: Communications with Audit Committees*
PCAOB Rulemaking Docket Matter No. 030

Deloitte & Touche LLP ("D&T") is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Auditing Standard: Communications with Audit Committees*, PCAOB Release No. 2011-008; PCAOB Rulemaking Docket Matter No. 030 (December 20, 2011).

AUDIT FIRM COMMUNICATIONS

We support efforts to encourage and promote effective communication between auditors and audit committees. In responding to the Board's request for comments on the proposed standard, we offer the following observations:

1. **Current requirements and practices.** A variety of requirements currently exist in PCAOB standards, the rules of the Securities and Exchange Commission ("SEC"), and listing exchanges with respect to audit committees and auditor communications with audit committees. We believe the incremental required communications in the proposed standard codify and build upon certain best practices that currently take place and will enhance audit quality.

2. **Consultations.** We believe discussing significant accounting and auditing consultations with the audit committee in a timely manner is important, and we support this aspect of the proposed standard. During the course of an audit numerous consultations may take place with specialists, national office partners, and others. We encourage the Board to consider clarifying what it considers to be a consultation under the proposed standard for purposes of reporting to the audit committee. In addition, numerous discussions take place with engagement quality reviewers. As a result, we also recommend the Board clarify that engagement team discussions with the engagement quality reviewer in connection with requirements under PCAOB Auditing Standard No. 7 are not considered to be consultations. This could be achieved by reinserting the note that was in the original proposal which explained that discussions with the engagement quality reviewer would not be included within the requirement.

3. **Non-issuer broker dealer audits.** We would also encourage the Board to consider the desirability and practicability of the proposed communication requirements with respect to non-issuer broker dealer audits.

4. **Management communications.** We agree with the Board that management is likely to discuss certain matters enumerated in the proposed standard with the audit committee, and we support the

Board's acknowledgment of this with respect to accounting policies, practices, and estimates by adding a note which permits the auditor to avoid duplicating management communications. The Board should provide similar guidance with respect to communications regarding significant unusual transactions (including the business rationale for such transactions), management consultations with other accountants, and going concern matters, as such topics may also be discussed with the audit committee by management.

5. **Critical accounting policies and practices.** Based on the PCAOB release it appears the PCAOB is intending for the auditor to communicate its assessment of the critical accounting policies and practices that are disclosed within the footnotes to the financial statements.[1] However, this is not clear. For instance, the language in the proposed standard could be interpreted to require the auditor to assess the discussion of critical accounting policies and practices located in management's discussion and analysis. In addition, generally accepted accounting principles do not require an issuer to disclose "critical accounting policies and practices" as such. As a result, the auditor will be in the position of assessing disclosures that management is not necessarily required to provide. We recommend the PCAOB clearly state within the final standard that the disclosures being referred to are those within the notes to the financial statements and that the assessment should be made in the context of the financial statements taken as a whole. In addition, there needs to be a requirement for management to provide disclosures regarding "critical accounting policies and practices" prior to the auditor being able to assess them as part of the audit.

RELATED CONSIDERATIONS

As discussed in our December 8, 2011 letter to the Board on its August 16, 2011 *Concept Release on Auditor Independence and Audit Firm Rotation,* we believe best practices with respect to audit committee communications could be more universally put into place. The following are two topics related to audit committee communications that we believe would be relevant to future projects in this area:

1. **Audit firm communicates with the audit committee prior to earnings release.** Timely discussion of critical accounting estimates[2] with the audit committee improves overall understanding of such matters.

2. **Audit firm discusses inspection results with the audit committee.** Audit committees value information on inspections and remediation efforts because such information provides insights relevant to their oversight generally and in particular to their auditor reappointment decisions. It would be useful for the PCAOB and the audit profession to review the protocols relating to the disclosure of inspection results to facilitate discussions on this subject between audit firms and audit committees.

---

[1] Refer to paragraph 13 b of the proposed standard and page A4-17 of the release.

[2] The term critical accounting estimates is used in connection with this recommendation in order to conform it to the terminology adopted in the PCAOB's proposal. In our December 8, 2011 letter we referred to "significant accounting and auditing judgments" and "sensitive transactions and judgments;" we believe these concepts have since been captured in the Board's definition of critical accounting estimates as described in the proposal.

In addition, as discussed in our October 20, 2010 letter to the Board in connection with the Board's original proposal on audit committee communications and the related roundtable, we believe the PCAOB should partner with other interested parties (including the SEC, the National Association of Corporate Directors, the listing exchanges, and others) to develop best practices, training, and practice aids for audit committees. Such efforts would be consistent with the PCAOB's 2011-2015 Strategic Plan *Improving the Relevance and Quality of the Audit for the Protection and Benefit of Investors* to contribute to the quality of corporate governance.

* * *

D&T appreciates this opportunity to provide our perspectives on this important topic. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential impacts. We encourage the PCAOB to engage in active and transparent dialogue with commenters as the proposed standard is evaluated and changes are considered. If you have any questions or would like to discuss these issues further, please contact Robert Kueppers at 212-492-4241 or William Platt at 203-761-3755.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Member
Daniel L. Goelzer, PCAOB Member
Jay D. Hanson, PCAOB Member
Steven B. Harris, PCAOB Member
Martin Baumann, PCAOB Chief Auditor and Director of Professional Standards

Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Daniel M. Gallagher, SEC Commissioner
Troy A. Paredes, SEC Commissioner
Elisse B. Walter, SEC Commissioner
James L. Kroeker, SEC Chief Accountant
Brian T. Croteau, SEC Deputy Chief Accountant

Eli Lilly and Company
Lilly Corporate Center
Indianapolis, IN 46285
U.S.A.

February 29, 2012

Office of the Secretary
PCAOB
1666 K Street N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking docket matter No.30: Proposed Auditing Standard Related to Communications with Audit Committees

Dear Board Members:

Eli Lilly and Company ("Lilly") appreciates the opportunity to comment to the Public Company Accounting Oversight Board ("PCAOB") on the PCAOB Release No. 2011-008, Proposed Auditing Standard Related to Communications with Audit Committees (the "Proposed Standard"). Lilly is a large, multinational pharmaceutical company, with presence in over 50 country jurisdictions, and creates and delivers innovative medicines that enable people to live longer, healthier, and more active lives.

Lilly supports the Proposed Standard to enhance the relevance and quality of communications between the auditor and audit committee. We commend the PCAOB for considering comments and feedback received in response to the initial proposal on audit committee communications issued in July 2010. It is clear that several areas of concern in the initial proposal were addressed in the Proposed Standard, including not requiring duplicative communications if the matters have already been adequately communicated by management, removing the communication requirements regarding critical accounting estimate ranges, and removing the evaluation of the communication process. These revisions to the Proposed Standard from the initial proposal improve the effectiveness of the communication to ensure the communications focus on the most important matters.

While we generally agree that the Proposed Standard improves the effectiveness of the communications between auditors and audit committees, we have some concerns about the level of detail required in the Proposed Standard as certain requirements may be more granular than is necessary or wanted by the audit committee and may take focus away from more important matters. It is important to understand that there is a significant amount of information to cover with the audit committee, and it is critical to focus the communications on the most significant matters. If more detail is provided than needed, it is possible that the truly important matters will get lost among all of the other communications. We believe there still should be the concept of materiality and professional judgment within the communications to the audit committee so the discussions can be focused on the issues that are most important. We are providing the following comments to address each of our concerns:

Uncorrected and Corrected Misstatements
We agree with the Proposed Standard's requirements to communicate uncorrected and corrected misstatements identified by the auditor during their audit procedures. Our understanding is the Proposed Standard requires the same level of detail provided to management to be provided to the audit committee. We are concerned with the level of detailed required. While an aggregation of all uncorrected misstatements does not seem appropriate, we believe the use of materiality and professional judgment should be a consideration in determining the extent of communications around uncorrected

misstatements. The Proposed Standard indicates that aggregating at any level may be misleading. However, we believe that providing the audit committee too much detail may not provide the appropriate focus of the discussion related to these corrections or unadjusted differences (i.e. that audit committee may get lost in the details or may spend too much time on items that are immaterial). We believe that if the audit committee and auditors agree on a level in advance, it would not appear to be misleading. In addition, there could always be discretion by the auditor to communicate uncorrected or corrected misstatements based upon professional judgment if there were qualitative factors or systemic issues that warranted the audit committee's attention. For example, it is typical for auditors and the audit committee to agree upon a threshold that deminimus amounts be aggregated for communication of uncorrected misstatements. Except where there are qualitative factors, such as controls issues, systemic issues, fraud, etc, we do not believe communication of these deminimus amounts at an individual level would be an efficient or appropriate use of time. We suggest the PCAOB incorporate the concept of materiality and professional judgment within this communication.

Consultation with Other Accountants

We support the revised language in the Proposed Standard to include Other Accountants. However, we suggest that the term Other Accountants be defined as other accounting firms that can render an audit opinion, and not other accountants that can provide technical accounting advice. It appears the risk that is being addressed relates to any consultations made by management with other accountants about auditing or accounting matters equivalent of "opinion shopping". This risk only relates to other accounting firms that have the ability to render an audit opinion and not other accountants who are consultants that have specialized practices that provide accounting advice. In today's accounting environment, accounting matters are complex and highly technical and in many cases require management to consult with experts to determine the proper accounting treatment. It is important to consider that it is not appropriate to consult with the external auditor on these accounting matters, and thus, other experts are often required. In our view, it should not be necessary to communicate these types of consultations to the audit committee as these types of consultations are not related to the risk that is being addressed. However, a broad interpretation of this provision may lead one to conclude these types of communications are within the definition of "other accountants". To avoid unnecessary communications to the audit committee, we suggest the PCAOB clarify the definition of Other Accountants to specify that the term relates to other accounting firms that have the ability to render an audit opinion.

Disagreements with Management

We agree that any unresolved disagreements with management should be communicated to the audit committee; however, we are concerned with the requirement regarding communication of disagreements with management that have been satisfactorily resolved. First is it unclear as to what constitute a disagreement that is ultimately resolved. As many accounting matters are complex, highly technical and judgmental, there could be times throughout the audit process where there are disagreements or discussions as to the appropriate accounting. This is a normal course of the audit process. However, most, if not all, of these disagreements or discussions are resolved satisfactorily with no lingering issues by either the auditor or management. If the disagreement is satisfactorily resolved and there are no issues, the audit committee would question why this matter is coming to their attention. In addition, this requirement may add pressure to the communications between management and the auditor. If there is nothing for the audit committee to act upon and there are no qualitative factors that the auditor feels would warrant the audit committee's attention, we believe this communication would be superfluous. Of course, if the auditor feels there is a qualitative issue that requires the audit committee's attention, the auditor has the professional judgment to bring it to their attention. We suggest the PCAOB revise the requirement to communicate disagreements with management, unless satisfactorily resolved, or if satisfactorily resolved that the auditor feels require the audit committee's attention from a qualitative perspective.

Conclusion
Again, Lilly supports the PCAOB's efforts to enhance the relevance and quality of communications between the audit committee and auditors and believes the Proposed Standard is an improvement from the initial proposal. However, we believe it is important to focus the audit committee's attention on the most important matters and avoid having significant issues get lost among all of the detail. Our general concern relates to the general magnitude of the communication requirements and whether certain of the requirements are considered valuable to audit committees. We ask that the PCAOB consider our suggestions to refine the communications to the audit committee further to ensure the appropriate level of information is being communicated.

We appreciate the opportunity to express our views and concerns regarding the Proposed Standard. If you have any questions regarding our response, or would like to discuss our comments further, please call me at (317) 276-2024.

Sincerely,

ELI LILLY AND COMPANY

/s/Arnold C. Hanish

Arnold C. Hanish
Vice President, Finance and
Chief Accounting Officer

Ernst & Young LLP
Five Times Square
New York, New York 10036-6530

Tel: + 1 212 773 3000
Fax: + 1 212 773 6350
www.ey.com

29 February 2012

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 30
Proposed Auditing Standard related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Section 380

Dear Mr. Seymour:

Ernst & Young LLP is pleased to submit comments on the Public Company Accounting Oversight Board's (PCAOB or Board) above referenced proposal (the Proposed Standard) related to communications with audit committees.

We recently submitted comments on another PCAOB rule proposal, PCAOB Rulemaking Docket Matter No. 37, Concept Release on Auditor Independence and Audit Firm Rotation. There, we noted, "In recent years, we have seen significant changes in audit committee engagement and performance and the rigor with which the audit process and auditor relationship is overseen and evaluated. Audit committees are asking the auditor probing questions, meeting with the audit firm's subject-matter experts and senior leadership, and challenging management on the appropriateness of its accounting and disclosure, all of which positively affect the tone and results of the audit." We are committed to robust and regular communication with audit committees or those charged with governance and in helping these bodies execute their important responsibilities. We believe the Proposed Standard will improve our practices in this area and help enhance audit quality and transparency.

We also appreciate the Board's responsiveness to comments submitted by EY and other parties in relation to the Board's initial proposal. The current proposal contains a number of significant improvements over the initial draft. For example, we support the Board's decision to remove the requirement that the auditor evaluate the effectiveness of the two-way communication between the auditor and the audit committee. Likewise, we believe the standard was improved by allowing the auditor to consider the communications made by management when determining the extent of the auditor's own communications with the audit committee. We also agree with the Board's decision to allow communications to be either written or oral. We believe this will allow auditors to communicate matters to audit committees in the way that they believe is most effective and adapt those communications based on the specific circumstances of the entity, the matters to be discussed and the interests of the audit committee. On the whole, we believe the Proposed Standard would enhance the auditor's existing focus on providing timely, meaningful information to audit committees.

We do, however, have a handful of suggestions we think will further improve the final standard, which we discuss below.

Definition of certain terms and use of judgment in general

Several terms used in the Proposed Standard require the application of considerable judgment by the auditor. Two are particularly subjective in nature. First, the Proposed Standard requires communications to audit committees on "matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process." Second, the Proposed Standard requires the auditor to communicate to the audit committee "significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature."

As for the "difficult or contentious" phrase, Appendix 4 to the release accompanying the Proposed Standard provides a helpful discussion of the phrase's meaning (App. 4, at A4-28). For example, the Appendix states that a "contentious issue might be a matter that not only requires significant consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management." We suggest this additional discussion of the meaning of this phrase be placed within the Proposed Standard itself.

As for the requirement regarding "significant transactions" that are "unusual" in nature, this communication would require the use of considerable judgment; what might appear "unusual" in hindsight to a non-auditor might not have been considered "unusual" to the auditor at the time he or she is completing the audit engagement. We think it would be helpful if the final standard made clear that (1) certain of the terms used in the standard, in particular the word "unusual," are not terms found generally or defined in the accounting literature and, accordingly, the auditor should use his or her best judgment in applying these terms to the relevant facts and in determining what communication may be required and (2) in this regard, the auditor's judgment should be controlling. Additionally, we assume that the Board will consider their proposed amendments regarding significant, unusual transactions prior to finalizing any communication requirements related to these types of transactions in order to fully align the communications and performance requirements.

Applicability to brokers and dealers

The release accompanying the Proposed Standard notes that these required communications would become applicable to the audits of brokers and dealers after the Securities and Exchange Commission (SEC) adopts rules requiring the use of PCAOB standards for such audits and the rules become effective. Because some broker and dealers do not have boards of directors or audit committees, the Board has modified the definition of "audit committee" to add "for the audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to a company, those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company."

Under this standard, some communications would become circular – that is, they would be made to the same individuals who provided the original information to the auditors. In many instances, the person designated to "oversee the accounting and financial reporting processes" of a non-issuer broker or dealer, and the audits of the financial statements of such an entity, would be the chief financial officer (CFO). Providing a copy of the letter of representations or communicating management's selection of significant accounting policies to the CFO who signed that letter and approves such policies – along with other similar activities – would be a compliance exercise that would add no value to the audit process. Accordingly, we suggest the final standard be aligned with the definition of an audit committee in ISA 260 and AICPA AU Section 260. That definition refers to "the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity." Under that definition, the communication would likely be made to the Chief Executive Officer or another officer of the broker or dealer.

In addition, in some cases non-issuer brokers and dealers may be subsidiaries of issuers. There may be instances where providing communications regarding the audit of a subsidiary non-issuer broker or dealer to the parent's audit committee may not be that important. However, we also recognize there may be other cases where reporting such matters to the parent's audit committee may be a relevant and valuable communication. Given the potential for there to be more than one corporate governance body for entities that encompass broker or dealer subsidiaries, we recommend revisiting the Proposed Standard to allow the auditor to determine the most appropriate body to which the required communications should be directed.

Finally, the Board requested comment on whether there are additional matters related to the audits of brokers and dealers that should be considered for specific audit committee communications. We believe that the Board should consider adding in the final standard communication requirements relating to the additional attestation reporting required for brokers and dealers as outlined in SEC Rule 17a-5. For example, there are provisions in SEC Rule 17a-5 that require filing certain supplementary information with the financial statements on which the independent auditor is required to opine. Additionally, the independent auditor is required to issue a report on internal control. When the SEC's proposal to update the existing requirements of SEC Rule 17a-5 is finalized, auditors will be required to either (1) issue an examination report regarding the entity's assertions of compliance with specified rules and related internal controls, or (2) issue a review report that addresses the assertion that the broker or dealer is exempt from Rule 15c3-3. We encourage the PCAOB to consider whether these additional reporting requirements warrant specific audit committee communications given their importance to the audits of brokers and dealers.

Going concern

We understand the PCAOB's interest in improving communications relating to the auditor's assessment of an issuer's ability to continue as a going concern, and we have supported suggestions that the PCAOB reconsider its standards in this area. Our comment here is to urge that communication in this area be consistent with the auditor's current responsibilities.

Specifically, the Proposed Standard includes a requirement for the auditor to make certain communications regarding his or her evaluation of the company's ability to continue as a going concern. This includes communicating the conditions or events identified by the auditor that indicate there "could be" substantial doubt about the entity's ability to continue as a going concern and, if the auditor's doubt is mitigated, the information that mitigated such doubt. Under AU 341, however, the auditor first considers whether, as a result of audit procedures performed related to various audit objectives (that is, the auditor is not required to design procedures solely to identify such events and conditions), the auditor believes there "could be" doubt regarding the entity's ability to continue as a going concern. The auditor is not required to obtain information regarding management's plans and conclude upon the likelihood that those plans can be implemented unless he or she believes "there is" substantial doubt regarding the entity's ability to continue as a going concern. This is further clarified in AU 341.7, which states that the auditor is required to consider management's plans only upon believing "there is" substantial doubt (a step beyond "could be"). Additionally, AU 341.17 establishes the following documentation requirements:

> "As stated in paragraph .03 of this section, the auditor considers whether the results of the auditing procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he or she follows the guidance in paragraphs .07 through .16. In connection with that guidance, the auditor should document all of the following..."

Thus, documentation is required only after the auditor has concluded that he or she believes "there is" a substantial doubt about the entity's ability to continue as a going concern and not when he or she has considered there "could be" substantial doubt. We do not believe the communication requirements should exceed the AU 341 performance and documentation standards. We suggest the auditor be required to communicate to the audit committee circumstances where (1) the auditor believes "there is" substantial doubt regarding an entity's ability to continue as a going concern, as described in AU 341.7, and (2) if that substantial doubt is somehow mitigated by management's plans, to communicate the information that mitigated such substantial doubt.

In this regard, AU 341.6 provides examples of items an auditor considers in assessing whether there could be doubt about an entity's ability to continue as a going concern, which include recurring operating losses, negative cash flows from operating activities, default on loan agreements, negative legal proceedings, labor issues, etc. We believe these are items that the audit committee would be familiar with (as a result of its financial reporting oversight role, the financial information provided to the audit committee, and through its discussions with management). As a result, we have doubts that the proposal for a separate communication on such matters from the auditors will be particularly helpful or would accomplish the goal of providing the audit committee with an "early warning."

If the Board decides not to take our suggestion on modifying the going concern communications trigger from "could be" to "there is," we suggest the Board nonetheless provide some guidance on how the "could be" communications requirement might be applied. As noted, AU 341.06 gives examples of conditions and events that the auditor might consider, and it includes a wide range of possible events, including "labor difficulties," or "uneconomic long-term commitments," or "uninsured or underinsured catastrophe such as a drought, earthquake, or flood." As discussed above, auditors might consider all of these "could be" events but are not required to document such considerations (or communicate their considerations) under current performance standards. It would be unfortunate if, under the Board's final standard, auditors felt compelled to communicate to the audit committee their consideration of *any* "could be" event under the broad baskets of conditions outlined in AU341.06. We assume this is not the Board's intention and that by imposing a "could be" reporting requirement, the Board would expect an auditor to exercise his or her judgment as to what events might reasonably apply to the audit client's particular risks and operations. However this intention is not clear and we believe it would be helpful if the final standard were to state this.

Finally, we understand the 2012 standard setting agenda of the PCAOB's Office of the Chief Auditor incorporates "evaluating potential revisions to the going concern auditing standard." We suggest that any changes to the audit committee communication requirements in this area be deferred pending clarification of the Board's broader standard setting efforts on going concern.

Procedures performed by other firms or persons

Paragraph 10(d) of the Proposed Standard requires that the auditor communicate the "names, locations, planned roles, and responsibilities" of other firms, including member firms in the network or persons that performed audit procedures for the current period. We support providing additional information to audit committees regarding other firms or persons involved in the audit process. However, the Proposed Standard, as written, would appear to require the auditor to communicate every instance where another firm, including member firms in a network, or person has performed work on behalf of the auditor, even if the involvement is quite limited (for example, where a member firm in the network participated in an inventory observation). We are concerned that providing this granular level of information for all participants may result in a lengthy list of other participating firms that would be of little, if any, value to the audit committee and may take focus away from more important matters, including the nature and extent of work performed by other auditors that have a significant role in the audit.

The extensive level of detail that could be required for audits of large, multinational issuers is not consistent with other required communications in this paragraph, which are more focused on areas that are critical or significant (for example, the communication of specialized skills or knowledge in procedures to be performed related to significant risks). We believe that establishing a threshold to communicate meaningful involvement of other firms or persons would more effectively achieve the Board's intent of improving communication with audit committees so that the audit committee could focus on two-way communications regarding locations that are of significance to the audit and use that opportunity to ask questions of the auditor regarding the involvement of those other audit firms. As described in our comment letter to the PCAOB dated 9 January 2012 regarding Improving the Transparency of Audits, we believe an appropriate minimum threshold for disclosure within the audit report of other participants is 10% of total audit hours. We believe the threshold for communicating to the audit committee should be the same. Aligning the threshold with the transparency proposal also would provide consistency throughout the standards, if adopted, and would lead to more consistent application of the standard in practice.

Other matters

Engagement letter

The Proposed Standard requires providing the engagement letter to the audit committee on an annual basis and determining that the audit committee has "acknowledged and agreed to the terms of the engagement." Appendix 4 states that the acknowledgement of such terms can be either written or oral (App. 4, at A4-6). We suggest that the final standard itself contain this statement.

New accounting pronouncements

The Proposed Standard requires auditors to communicate "situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting." The phrase "identified a concern" is undefined and is likely to be difficult to address in practice. We suggest that required communications in this area be tied to management's disclosure of recently issued accounting pronouncements, as required by Staff Accounting Bulletin 74. That is, auditors should communicate their assessment of whether the disclosures are in conformity with the applicable financial reporting framework and the bases of amounts set forth (as described in paragraph 13(d) of the Proposed Standard). Thus, we believe the required communication related to new accounting pronouncements should be: "The results of the auditor's evaluation of management's disclosure of the impact that recently issued accounting standards will have on the financial position and results of operations of the entity when such standards are adopted in a future period." Communicating the auditor's assessment of management's disclosures required under Staff Accounting Bulletin 74 would be helpful to audit committees and can be implemented in practice.

Use of "boilerplate"

The release accompanying the Proposed Standard states that communications should be "tailored to the circumstances" and that the auditor should avoid using "boilerplate" or "standardized" discussions. We agree that meaningless "boilerplate" communications are not helpful to an audit committee, but there are many types of communications that a firm can make in a consistent fashion and still be meaningful and directed to an entity's specific circumstances. In other words, we do not think that a firm's consistency of approach in communicating particular matters renders those communications mere "boilerplate," and we think it would be helpful if the PCAOB were to make this point clear in the final standard.

Minor edit to paragraph on timing

Paragraph 25 of the Proposed Standard states that audit committee communications should be made in a timely manner, depending on such factors as the significance of the matters to be communicated, "unless other timing requirements are specified by PCAOB rules or standards or the rules or regulations of the Securities and Exchange Commission." We suggest the standard include a reference to "the federal securities statutes" as well as to SEC rules and regulations; this is because Section 10A of the Securities Exchange, which imposes certain communications requirements on auditors, is a statute rather than an SEC rule or regulation.

* * * * *

In conclusion, we support the Board's effort to improve communications to audit committees. We believe that our suggested modifications are consistent with the Board's objectives and will help to strengthen the final standard.

We would be pleased to discuss our comments with members of the Board or its Staff.

Sincerely,

Ernst + Young LLP

Federation of European Accountants
Fédération des Experts comptables Européens

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington DC 20006-2803
USA

15 February 2012

Ref.: AUD/PRJ/HBL/LAN/SHA

Dear Sir or Madam,

Re: FEE Comments on PCAOB Rulemaking Docket Matter No. 030 on Proposed Auditing Standard related to Communications with Audit Committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380

FEE (the Federation of European Accountants) is pleased to provide you with its comments on the PCAOB Rulemaking Docket Matter No. 030 on Proposed Auditing Standard related to Communications with Audit Committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380.

FEE commends the PCAOB for giving its stakeholders the opportunity to consider the new proposed requirements in relation to auditor's communication with audit committees. As mentioned in relation to the first exposure of this PCAOB standard, FEE welcomes the initiative to set a standard for auditors' communication with audit committees. A fruitful two-way dialogue with the entity's audit committee is an important part of the work of an auditor of public interest entities, and any initiative to strengthen this cooperation is beneficial to both parties. The re-exposed standard introduces enhancements that better enable the audit committee to carry out its monitoring role based on the information received from the auditor.

As the PCAOB may already be aware of, current discussions in Europe also focus on strengthening the role of audit committees. As part of this objective, it is proposed to enhance the communication between the auditor and the audit committee by introducing an additional internal report that the statutory auditor is to submit to the audit committee[1]. The content of this report focuses on the audit and the uncertainties discovered by the auditor, as well as other matters. As audit committees of multinational companies may also be multinational, FEE encourages the PCAOB to work closely with its counterparts in other jurisdictions, for instance the European Commission as well as the IAASB, who are also considering this area.

The PCAOB appears to be updating its various auditing standards at different pace and on different topics. In order to get a coherent set of standards, the PCAOB is encouraged to develop an overall strategy for its standard setting activities. Such a strategy would allow auditors and other stakeholders to contribute to the prioritisation of these activities. Furthermore, it will facilitate consistency between the different standards.

[1] European Commission proposal for regulation on audit of public interest entities, article 23
http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

Our general comments on the issues raised in the PCAOB proposed standard that are relevant from a European or international perspective are set out below and can be summarised as follows:

1. A number of the previous concerns expressed by FEE have been acknowledged and addressed as suggested. With certain exceptions, which are discussed below, we support the changes to the standard now proposed.

2. In general, FEE believes that alignment in auditing standards worldwide, to the maximum degree possible, is beneficial for capital market participants with cross-border interests and global activities. The new proposed standard introduces a closer alignment with the equivalent ISAs issued by the IAASB, for instance in relation to the emphasis on two-way communication. However, FEE remains of the view that an even closer alignment could further enhance the communication between the two parties.

3. Although the new proposed standard introduces improvements compared to the first exposure draft, FEE believes that further improvements can be introduced in the following areas:

    a. The adequacy of the two-way communication should be included in the objective to the standard as proposed in the original exposure draft. This will even further foster the need for the auditor to ensure that there is effective two-way communication.
    b. Information about the entity regarding accounting policies and estimates should be provided by the company itself and not by the auditor. The reporting responsibilities in paragraph 12 will lead to descriptive boilerplate information that will be duplicative of information already submitted by management. Removing paragraph 12 from the requirements will make the information submitted to the audit committee more concise and efficient.
    c. The information required in paragraph 13 should be reported to the audit committee where relevant so that it can help them discharge their monitoring responsibilities. However, it could be reduced in length, as it still appears prescriptive. Instead, more flexibility in the information to be reported would be beneficial to the audit committee.

International alignment – Question 1

International alignment of auditing standards enhances the quality of audits based on globally accepted auditing standards at national level, including the acceptance of audit reports beyond home jurisdictions. In addition, aligning requirements worldwide regarding communication with audit committees facilitates the participation of non-national members in audit committees which is a corporate governance consideration that multinational companies face. In this context, FEE welcomes the comparison between the proposed standard and the ISAs included in Appendix 5. Currently, this appendix is mainly descriptive with references to the requirements in each set of standards. Appendix 5 could benefit from having specific explanations of differences as well as arguments from the PCAOB for retaining the differences. This would facilitate the application of the PCAOB audit standards by auditors of multinational companies that normally operate in an ISA environment. FEE would encourage the PCAOB to publish Appendix 5 together with the final standard, including the relevant amendments.

The use of professional judgement in audits is indispensable. It enables the auditor to make informed decisions about the appropriate course of action during the audit. The requirements related to the communication with audit committees in the proposed standard continue to appear prescriptive and rules-based, although some flexibility has been introduced. Therefore, the risk of limiting the auditor's ability to exercise professional judgement in deciding on the most appropriate and efficient way of communicating with the audit committee remains to exist.

Although the proposed standard remains essentially rules- rather than principles-based, quite a lot of guidance and explanation relating to the application of particular requirements is provided in material accompanying the draft standard (in particular in Appendix 4). In many instances, such guidance would be helpful if included in the standard itself in order to ensure consistent application of the standard. Examples include:

a. The definition of the audit committee which is adapted from the original standard (page A4-1-2). This would facilitate comparisons with the term "audit committee" in non-US jurisdictions.
b. Guidance regarding the timing of required communications (page A4-10).
c. The form and documentation of communications and the timing thereof (page A4-42- 44).

Appendix 4 is quite extensive and could benefit from having more concise conclusions that clearly set out the reasons for the decision to amend a specific provision. With these amendments to Appendix 4, FEE recommends that it is published as a "Basis for Conclusions". Such Basis for Conclusions is found very useful in practice which is also recognised by other standard setters, such as the IASB and the IAASB.

Two-way communication – Question 2

One of the main comments made by FEE in response to the original 2010 exposure draft, focused on the need for clear two-way communication consistent with the approach set out in ISA 260[2]. This approach is generally preferable as it highlights the clear need for effective cooperation with the audit committee in order for the auditor to deliver high quality work. This is further emphasised in the recent proposals from the European Commission which also aim to strengthen two-way communication between the two parties.

FEE acknowledges and fully supports the addition of a new subset to the proposed objective in paragraph 3 b to "*Obtain information from the audit committee relevant to the audit*" as well as additional references in the Introduction to two-way communication throughout the audit instead of merely at the end of the audit.

However, the requirements of the standard could still be made clearer toward helping the auditor to achieve this aspect of the objective, for instance in relation to:

a. The use of the phrase "communicate to the audit committee" throughout the standard leads to interpreting it as one-way communication. Although the auditor is to communicate to in some cases (for instance in paragraph 9 regarding the audit strategy), we find it more appropriate to use "communicate with the audit committee" in the instances where a two-way discussion is desired. Therefore, to use the example of paragraph 9, the submission of the information regarding the audit strategy ought to lead to an open and frank two-way discussion at an early stage of the audit. For instance, communication about significant risks identified by the audit committee will lead to a more effective performance of the audit.

b. The standard concentrates on matters that the auditor is to communicate (one-way) to the audit committee. For instance, paragraph 8 requires the auditor to inquire of the audit committee whether it is aware of matters that might be relevant to the audit in relation to two specific areas (violations of laws or regulations and complaints or concerns regarding financial reporting matters). The reference to certain other matters in section V and VI of Appendix 4 of

[2] ISA 260 Communication with Those Charged with Governance

the Release (which is comparable to ISA 260 paragraph 4(b)) does take note of other areas and these other examples would be equally useful within the text of (or in the footnote to) the standard.

c. The objective in the original proposal in paragraph 3(d) included the evaluation of the adequacy of the two-way communication, accompanied by requirements in paragraphs 26-28.

This particular point is not taken forward in the re-exposed standard as the PCAOB considers it duplicative of requirements in other PCAOB standards. Although this may be the case, FEE believes that the requirement to carry out such evaluation of the adequacy of the communication is an essential part of the quality review of the two-way communication from the viewpoint of the auditor. Furthermore, this difference is currently not highlighted in Appendix 5 which FEE believes it should have been as it is a substantive difference between the ISAs and the PCAOB standard.

In summary, FEE does not support the proposed deletion, as the auditor should make an assessment of whether improvements to the communication can be introduced to enhance the effectiveness of the audit.

Disclosures of composition of engagement team and experts – Question 2

The requirement in paragraph 9 of the standard to disclose details of the composition of the engagement team and others participating in the audit has been expanded compared to the original proposal. FEE believes that such information could be relevant to disclose to the audit committee, although the appropriate balance between useful information and boilerplate disclosures needs to be found. However, as mentioned in our response to the PCAOB Release no. 2011-007[3], FEE did not support proposals for the auditor to disclose such detailed information in the audit report.

Therefore, FEE supports the proposal in paragraph 9 (d), but would recommend that the scope for disclosure is reduced to only significant work performed by another external auditor or a person involved in the audit, and is not supplemented by details, such as the percentage of hours. Furthermore, clarification of how the requirement relates to the definition of engagement team is needed to ensure that the disclosures are consistent from one company to another.

Communication regarding significant and critical accounting matters – Question 5

FEE appreciates that the extent of the information to be reported to the audit committee has been reduced compared to the original proposal, as this introduces some flexibility and allows the auditor to use professional judgement in assessing the relevant information to be provided.

However, FEE remains of the view that information about the entity regarding accounting policies and estimates should be provided by the company itself and not by the auditor. The reporting responsibilities in paragraph 12 will lead to descriptive boilerplate information that will be duplicative of information already submitted by management. Therefore, removing paragraph 12 from the requirements will make the information submitted to the audit committee more concise and relevant. This will be beneficial to the monitoring task of the audit committee.

[3] PCAOB Release no. 2011-007 on "Improving Transparency of Audits", FEE Comment Letter, 7 December 2011

The information required in paragraph 13 regarding the assessments made by the auditor is the useful part for the audit committee in the discharge of its monitoring responsibilities. However, it could be reduced in length, as it still appears prescriptive. Instead, more flexibility in the reporting will be beneficial to the auditors and to the audit committee.

The PCAOB is proposing to use the term "*could be substantial doubt...*" in paragraph 17a in relation to going concern evaluations. In contrast, section 10A of the US Securities Exchange Act requires the auditor to perform "… *an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern….*" The proposed PCAOB wording might set a too low threshold. In this context, we suggest the SEC term of "*…is substantial doubt...*" is used, or alternatively, that further clarification of what "*could*" is intended to mean is included.

For further information on this FEE[4] letter, please contact Lotte Andersen at +32 2 285 40 80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,

Philip Johnson
President

---

[4] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.
FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

Avenue d'Auderghem 22-28, B-1040 Brussels
Tel: +32 (0)2 285 40 85
Fax : +32 (0)2 231 11 12
secretariat@fee.be
www.fee.be
Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (850) 224-2727 • FAX (850) 222-8190

February 23, 2012

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Exposure Draft – *Proposed Auditing Standard Related to Communications with Audit Committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380*

Dear Sirs:

The Accounting Principles and Auditing Standards Committee (the "Committee") of the Florida Institute of Certified Public Accountants ("FICPA") has reviewed and discussed the subject exposure draft. The Committee has the following responses to the questions set forth in Section VI of the Exposure Draft:

1. The Committee agrees that the communication requirements in the new proposed standard are appropriately aligned with the performance requirements in the risk assessment standards.

2. The Committee did not note any specific additional matters based on existing auditor performance obligations that should be communicated to the audit committee. However, certain members of the Committee requested that additional guidance be provided in the proposed standard regarding this issue.

3. Regarding the requirement to have the engagement letter executed by the appropriate party or parties on behalf of the company:

    a) The Committee agrees that the requirement in the standard is clear.

    b) The Committee believes that the acknowledgement by the audit committee should be in written form rather than an oral acknowledgement, as allowed by the proposed standard, and also believes that audit committees, in general, would be more comfortable with a written acknowledgement. The Committee noted that the engagement letter should be reviewed and discussed by the audit committee, as logistically practical, and that the audit committee chair should sign on behalf of the audit committee.

4. The Committee agrees that the requirement for the auditor to communicate significant unusual transactions to the audit committee is appropriate and noted that this corresponds with the requirements of Statement on Auditing Standards No. 114.

5. The Committee agrees that there are circumstances when the auditor is aware that management has consulted with other accountants regarding significant accounting or auditing matters and the auditor has identified a concern regarding these matters. The Committee believes that the requirement for the auditor to communicate to the audit committee his or her views regarding such matters is appropriate.

6. The Committee agrees that the amendments to the other PCAOB standards are appropriate.

7. Regarding the audits of brokers and dealers:

a) The Committee agrees that, if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective, the communication requirements under interim standard AU Sec. 380 should be applicable to these brokers and dealers. However, the Committee believes that these communication requirements should applicable to all brokers and dealers only if all of them are to be audited in accordance with PCAOB standards.

b) Similar to the response to Question 7a above, the Committee believes that the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers only if all of them are to be audited in accordance with PCAOB standards.

c) The Committee does not believe that there are any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard or, alternatively, that there are any communication requirements contained in the new proposed standard that should not be applicable to these audits.

The Committee appreciates this opportunity to comment on the subject exposure draft. Members of the Committee are available to discuss any questions regarding this response.

Respectfully submitted,

Robert Bedwell, Chair
FICPA Accounting Principles and Auditing Standards Committee

Committee members coordinating this response:

Robert Bedwell, CPA
Steven Bierbrunner, CPA
Richard Edsall, CPA

Grant Thornton

February 29, 2012

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

Audit – Tax – Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200
F 312 565 4719
www.GrantThornton.com

Re: PCAOB Rulemaking Docket Matter No. 30, *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*, and we respectfully submit our comments and recommendations thereon. In consideration of the responsibilities instilled upon the audit committee by the Sarbanes-Oxley Act of 2002, the increasing complexity of financial accounting standards, the significant changes in recent industry and market conditions, and the call from investors for high quality financial reporting, audit committees are becoming more accountable and their oversight responsibilities more demanding. We believe that empowering audit committees with the necessary information and training to effectively perform their responsibilities is a critical component of maintaining and enhancing investor protection.

Although audit committees need to obtain and evaluate information from a variety of sources to meet their objectives, the communications between the audit committee and the auditor are essential for audit committees to oversee the financial reporting process and the auditor's work and for auditors to perform an effective audit. Accordingly, we support the Board's initiative to clarify and strengthen these two-way communications based on the relative importance of the matters to be communicated throughout the audit, including encouraging more open, constructive dialogue and less formal, standardized reports. Overall, we believe that the proposed auditor considerations and requirements are appropriately aligned with the risk assessment standards; however, we suggest that the standard include considerations around the scalability of the communications to reflect circumstances such as the entity's governance structure and the audit committee's knowledge and familiarity with the entity and its auditor.

Significant issues discussed with management as to auditor's appointment

Paragraph 4 of the proposed standard 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 significant discussions regarding the application of accounting principles and auditing standards. Because the audit committee is now responsible for the appointment, compensation, and oversight of the auditor, this requirement may seem contradictory to that responsibility. Appendix 4 of the PCAOB's release indicates that the requirement was retained "…because the audit committee might ask management for its views concerning the appointment or retention of the auditor based on the interaction between the auditor and management." It goes on to indicate that "…management's views might be influenced by the auditor's evaluations and conclusions regarding the application of accounting principles or auditing standards."

To appropriately reflect these views, the audit committee would need to make certain inquiries of both management and the auditor, which would assist the audit committee in making an informed judgment. That said, we believe that a more appropriate requirement would be for the auditor to discuss with the audit committee significant issues related to the entity's accounting and financial reporting practices or management's integrity that were considered by the auditor during its client acceptance or retention process that have not already been communicated via the other requirements in the proposed standard. This approach would emphasize the audit committee's role as the decision-maker in accepting or retaining the auditor.

Establish an understanding of the terms of the audit

We agree with superseding AU sec. 310, *Appointment of the Independent Auditor*, and including requirements, within the proposed standard, related to the auditor's responsibility to establish an understanding of the terms of the audit engagement with the audit committee. In addition, we generally agree with the requirements in the proposed standard to provide the engagement letter to the audit committee annually, have the engagement letter executed by the appropriate parties on behalf of the entity, and determine that the audit committee has acknowledged and agreed to the audit engagement terms. We note, however, that the Board's interpretations of these requirements are included within Appendix 4 of the release, which may be lost upon finalizing the proposed standard. As with previous proposals, we request the Board to include relevant interpretations related to the application of the requirements within the standard itself or modify the requirements themselves to be clearer. It is possible that some firms may not interpret the Board's requirements in the same fashion without this additional discussion, particularly the nuance between *providing* and *preparing* the engagement letter annually and the *written* or *oral* audit committee acknowledgment.

The Board requested specific comments as to whether the audit committee's acknowledgement should be in written form or whether oral acknowledgment is sufficient. In light of the audit committee's responsibilities instilled upon it by the Sarbanes Oxley Act of 2002, we prefer a written acknowledgment, whether it is included within the engagement letter itself or within the minutes of the audit committee's meeting. An oral acknowledgement seems to weaken the spirit of the law and the audit committee's related responsibilities. Further, in circumstances in which the engagement letter is executed by the audit committee, we believe that the auditor should determine that management has also acknowledged and agreed to the terms of the audit engagement, in particular management's responsibilities and the auditor's related expectations.

Obtaining information relevant to the audit

Paragraph 8 of the proposed standard includes a rather broad requirement for the auditor to inquire of the audit committee whether it is aware of matters that might be relevant to the audit; it also provides and references certain matters that are to be included within these inquiries. We generally agree with the requirement and the Board's intent not to limit the nature of the auditor's inquiries of the audit committee, but we also believe that the requirement could be further clarified by providing some context regarding matters relevant to the audit from an audit committee perspective. In this regard, it may be helpful to provide audit committees with some guidance as to what this inquiry entails and what is expected to be communicated to the auditor. It may also be appropriate to include, as part of these inquiries, the audit committee's awareness of significant company events and transactions or significant changes in company conditions or activities. Such inquiry would assist the auditor in confirming their understanding of the entity and its environment. This would be incremental to the inquiries required by the risk assessment standards.

Accounting policies, practices, and estimates

We support the changes the Board made from the previous proposal to clarify the nature and extent of the communication requirements related to accounting policies, practices, and estimates, including the clarifications made with regard to management's communications of these matters. However, we believe that the auditor's communications should be flexible to take into account the audit committee's knowledge of and familiarity with the entity and its auditor, including whether the audit is an initial or continuing engagement. Although the additional discussion in Appendix 4 recognizes that the discussion could vary from year-to-year, the proposed standard, as written, seems more prescriptive. We recommend that the Board include an additional note within the proposed standard that will more clearly allow the auditor to vary the communications based on engagement circumstances.

Significant unusual transactions

The Board requested specific comments with regard to the communication requirements related to significant unusual transactions. We believe that it is appropriate to discuss such transactions with the audit committee. However, management should have the primary responsibility for communicating such transactions, including their business rationale, to the audit committee. As such, we believe that the note at the end of paragraph 12, which would allow the auditor to communicate information that was omitted by management or inadequately described by management to the audit committee, should also apply to this communication.

Audits of brokers and dealers

We understand and agree with the transitional amendments to AU sec. 380, *Communication With Audit Committees*, particularly eliminating the last sentence in paragraph .01 and footnote 2, which could be interpreted that the standard does not apply to audits of brokers and dealers. We also agree with aligning the effective date of these amendment with the effective date of the

U.S. Securities and Exchange Commission's (SEC) amendments related to audits of brokers and dealers, if such amendments become effective prior to the proposed standard.

Further, we concur that the proposed standard should apply to audits of brokers and dealers and do not believe that there are any additional requirements that would need to be included from a financial statement audit perspective. Any additional communication requirements related to other services, such as the proposed examination or review engagement, should be included within those standards. We do, however, ask that the Board consider the following matters to make the communication requirements more scalable to audits of non-issuer brokers and dealers:

- The Board appropriately recognizes various governance structures that are permitted by regulation and may exist for brokers and dealers. In particular, the additional discussion in Appendix 4 indicates that "…in an owner-managed entity, the designated person would be the owner." It further indicates that in a limited partnership, "…the designated person may be the managing or general partner responsible for preparation of the financial statements." We believe that if those charged with governance and management are the same individuals, some of the communications would not apply. Thus, it would be appropriate for the final standard to provide additional clarification in this regard, thereby allowing the auditor to adapt the communications based on the governance structure.

- Non-issuer brokers and dealers are currently not subject to the SEC's independence requirements related to audit committee communications regarding critical accounting policies and practices and critical estimates (Rule 2-07 of Regulation S-X), nor do brokers and dealers disclose such matters in a Management's Discussion and Analysis. However, the proposed standard incorporates similar communication requirements that would be applicable in audits of brokers and dealers. We recognize that the proposed standard defines these terms; yet, management of brokers and dealers are not required to differentiate between matters that are significant versus those that are critical within the financial statements. Since separate disclosures are not provided, the auditor may be unable to effectively make the separate assessment required by paragraph 13b. As such, we believe that this is an area in which the requirements for issuers and non-issuers may need to differ or require more clarification. Refer to our specific comments on paragraphs 13b-c below.

Potential additional communication requirements

We believe that, in connection with the Board's transparency initiatives and its initiatives to enhance auditor independence, objectivity, and professional skepticism, the Board may consider additional communication requirements related to the acceptance and retention of the auditor. These communications could include matters related to the firm's internal quality-control procedures and inspection issues raised during the most recent PCAOB inspection. We support consideration of these communications to further enhance the audit committee's oversight. In this regard, we encourage the PCAOB, in conjunction with the SEC, to further strengthen these responsibilities by providing guidance to audit committees to assist them in effectively performing their role and also looking at potential avenues to monitor audit committee involvement when reporting issues arise.

Amendments to PCAOB standards

We propose that the Board consider the effective date in regard to the amendments to AU sec. 722, *Interim Financial Information*, to permit sufficient time for implementation of the new requirements.

Other comments

The following offers more specific comments related to certain paragraphs and Appendix C for the Board's consideration.

Paragraph	Comment
1, 3	The proposed standard imposes certain responsibilities on the auditor to *obtain* information relevant to the audit from the audit committee. We agree with this notion, but suggest that the proposed standard refer to the auditor's responsibilities to *request* such information, as the auditor cannot control what the audit committee provides. A scope limitation would then be imposed if the audit committee did not provide the requested information.
10d	Until such time the Board amends AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, it may be more appropriate to align the audit committee communication requirements in this paragraph with the requirements therein. For instance, the principal auditor could communicate the names and locations of other auditors, the components upon which they will perform audit procedures for purposes of the principal auditor's audit, and whether the principal auditor will assume responsibility or make reference to the work of the other auditor. If the Board decides to maintain the requirement as proposed, we suggest clarifying what is intended by the reference to the *scope of audit procedures* in consideration of the note to paragraph 9.
13b-c	These paragraphs require the auditor to communicate to the audit committee the auditor's assessment of management's disclosures related to critical accounting policies and practices, along with any significant modifications to the disclosures proposed by the auditor, and the basis for the auditor's conclusions regarding the reasonableness of critical accounting estimates. For issuers, we believe that this would include matters included or disclosed in the financial statements, as well as those in Management's Discussion and Analysis. Accordingly, a reference to the requirements of Rule 2-07 of Regulation S-X seems warranted, as PCAOB standards are more limited with regard to the auditor's responsibilities for other information included in Management's Discussion and Analysis.
13d	We understand the purpose of this communication as it relates to the auditor's evaluation of whether the financial statements achieve fair presentation. However, the requirement, as written, could be considered duplicative in regards to the communications of corrected and uncorrected misstatements and departures from the standard auditor's report, both of which would apply if the financial statements did not conform with the applicable financial reporting framework. As such, it is not fully clear what the auditor is expected to communicate and at what threshold. It is our view that the auditor could communicate significant matters resulting from the auditor's evaluation, such as modifications that were necessary to the overall presentation, structure, and content, including disclosures, so that the financial statements would not be misleading.
13e, 13h	These communications, which pertain to consultations and material written communications, are included under the broad category of communications related to the auditor's evaluation of the quality of the company's financial reporting. We suggest that the Board reconsider the placement of these communication requirements within the proposed standard. With respect to communicating consultation matters, we believe that it would be helpful to include a note within the final standard that further clarifies the Board's intent regarding the matters to be communicated, such as the paragraph describing the differences between a difficult and a contentious issue within the additional discussion in Appendix 4.

Paragraph	Comment
15	This paragraph essentially retains an existing requirement for the auditor to communicate the auditor's responsibilities related to other information, any related procedures performed, and the results thereof. Typically, except when material inconsistencies or misstatements of fact are identified, the communication is rather boilerplate because the auditor describes those responsibilities and procedures as set forth by professional standards. In reading the Board's additional discussion in Appendix 4, it appears that the Board intends the auditor to describe all of the procedures the auditor performed on the information. We believe that this is a nuance that will likely be missed and also that any description of additional procedures could inappropriately convey a level of assurance that is not being expressed. Accordingly, we recommend that the final standard require the auditor to communicate the auditor's responsibilities related to other information and any identified material inconsistencies or misstatements fact, including the auditor's response to such matters. We believe that such communication would be more relevant to the audit committee.
16	The Board requested specific comments as to the appropriateness of the requirement for the auditor to communicate significant auditing or accounting matters that were the subject of management consultations with other accountants about which the auditor has concern. We agree with the revised requirement, as we believe that it allows for appropriate auditor judgment based on the significance of the matters and the auditor's concerns about such matters.
25	To communicate matters in a timely manner, the note to this paragraph allows the auditor to communicate only to the audit committee chair. However, it also indicates that the auditor should communicate such matters to the *full* audit committee *prior to the issuance of the auditor's report*. As currently worded, the proposal does not address all situations in which the auditor may need to only communicate to the audit committee chair to meet the requirements in the proposed standard. For example, the auditor would be required to provide to the audit committee the representation letter and the uncorrected misstatements attached thereto as well as the wording of the auditor's report when the report is modified or otherwise includes explanatory language. However, the date of the auditor's report aligns with the date of the management representation letter, which, in most case, also aligns with the date of issuance of the auditor's report. In this case, providing these matters to the audit committee chair and allowing him or her to distribute the information to other audit committee members should be sufficient. The communications with the audit committee prior to the issuance of the auditor's report could include draft copies, in addition to the related discussion.
Appendix C	Appendix C to the proposed standard describes the matters that are to be included in the audit engagement letter. Although we do not have significant reservations related to these matters, we do have some recommendations for the Board. In some respects, Appendix C seems to provide specific language to be included in the engagement letter as it relates to the auditor's responsibility. Although we recognize that this may not be the intent, due to various situations that may arise, including compliance with multiple standards, it may be best to simply identify the matters that should be included. In addition, the matters related to the communication of significant deficiencies and material weaknesses seem overly prescriptive in light of the auditor's other communication responsibilities.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

Grant Thornton LLP

Hermes Equity Ownership Services

Hermes Equity
Ownership Services Limited
1 Portsoken Street
London E1 8HZ
United Kingdom

Tel: +44 (0)20 7702 0888
Fax: +44 (0)20 7702 9452

www.hermes.co.uk

February 28th, 2012

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

RE: PCAOB Release No. 2011-008:
Proposed auditing standard related to communications with audit committees; related amendments to PCAOB standards; and transitional amendments to AU Sec. 380

Dear Board Members:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's proposals regarding auditing standard related to communications with audit committees; related amendments to PCAOB standards; and transitional amendments to AU Sec. 380, dated December 20, 2011.

By way of background, Hermes is a leading asset manager in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from across the world, all of which invest in companies whose audits are subject to PCAOB oversight. In all, EOS advises clients with regard to assets worth more than $140 billion.

We welcome the proposed changes by the PCAOB as these not only endeavour to enhance the quality of information exchanged between auditors and audit committees, but most importantly because they foster appropriate behavioural and cultural changes for both parties. These newly proposed standards increase the accountability of auditors to audit committees and vice versa, which in turn ought to result in the audit committees' improved oversight of the production of accurate and transparent financial reports. We welcome the PCAOB's ongoing focus on the interactions between the parties active in the corporate financial reporting process, because we firmly believe that by enhancing these interactions the level of oversight and challenge arising from the audit process can be enhanced. Audit quality will thus advance, the quality of the numbers reported to investors will improve, and most importantly market confidence in those numbers will increase.

We are particularly encouraged by the PCAOB's new proposed requirement for the auditors to inform the audit committee of significant unusual transactions and of the auditors' interpretation of how these impact the company's normal course of business. We believe that this contributes to address the ever-controversial issue of identifying and reporting 'material events/transactions' whose impact on financial reports is often

HERMES

underestimated and sometimes overlooked. We would regard noting such transactions as a central part of audit scepticism and we believe that auditors and audit committees will only be performing effectively their respective roles if they have direct dialogue about those issues which are a matter of audit scepticism. When such issues are brought to the surface of dialogue between these two parties, the need for and value of scepticism will be more apparent to all.

We also find that the proposed standard to align communication requirements with risk assessment standards encourages auditors and audit committees to engage in dialogue that transcends the mere production of financial reports; it encourages both sides to better understand the processes behind the production of such reports and to incorporate information that is material to the company. The better understanding of these processes together with more material information should help to cut down the use of irrelevant standardized, boiler-plate reporting and contribute to more effective risk mapping for both auditors and audit committees.

In closing, we applaud the PCAOB's proposed enhancements to the communication requirements between auditors and audit committees, given their overall aim to provide greater transparency of information and additional emphasis on identification of risks and material information. By seeking to emphasise the need for auditor scepticism and enhance dialogue which will improve the behaviours in and around the audit, we are confident that these improved standards will directly contribute to greater accountability to shareholders by their board representatives as well as by their auditors.

Yours faithfully,

Manuel Isaza
Senior Associate

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

Mr. Martin F. Baumann
Associate Chief Auditor
Public Company Accounting Oversight Board
c/o Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803
USA

By E-mail: comments@pcaob.org

February 29, 2012

Dear Mr. Baumann

Re.: PCAOB Rulemaking Docket Matter No. 030
PCAOB Release No. 2011- 008, December 20, 2011
Proposed Auditing Standard Related to Communications with Audit Committees;
Related Amendments to PCAOB Standards;
And Transitional Amendments to AU SEC. 380

The IDW commented in a letter dated May 28, 2010 on the previous draft relating to Rulemaking Docket Matter No. 030. We appreciate that a number of changes have been made which address concerns we had raised previously. We would like to thank you for the opportunity to comment on the PCAOB's Proposed Auditing Standard Related to Communications with Audit Committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU SEC: 380 (hereinafter collectively referred to as the "proposed standard") released December 20, 2011.

In this letter, we have not responded to individual questions raised, but comment instead on those areas with which we have concerns. We submit our comments as follows:

Alignment with Auditing Standards Promulgated by the IAASB

As we have previously commented in a number of letters to the PCAOB, we welcome the updating of the PCAOB's interim standards, and particularly wel-

IDW

INSTITUT DER WIRTSCHAFTSPRÜFER

come the efforts made to align the proposed standards with the ISAs as a measure towards the international convergence of auditing standards needed for international capital markets. In this context, we would like to refer to our previous letters in which we addressed this issue more fully, as we have chosen not to repeat our comments. We nevertheless confirm our previously stated views.

Indeed, our main areas of concern in respect of this proposed standard revolve around the issue of compatibility with the respective IAASB standards dealing with communications between an auditor and those charged with governance, which we discuss in more detail below.

Fostering Effective Two-Way Communication

We support the addition of a new subset to the proposed objective in para. 3 b: "Obtain information from the audit committee relevant to the audit". However, we are concerned that the rest of the standard is not sufficiently geared toward the auditor achieving this aspect of the objective.

Paragraph 8 aside, the standard concentrates on matters the auditor is to communicate (one-way) to the audit committee, since paragraph 8 alone requires the auditor inquire of the audit committee whether it is aware of matters that might be relevant to the audit. Of further concern is that paragraph 8 itself places emphasis – albeit specifically without limitation thereto – on 2 specific areas (violations of laws or regulations and complaints or concerns re financial reporting matters), which could distract from a potentially wide range of other matters that ought to be discussed. We appreciate the fact that in sections V and VI of Appendix 4 of the Release, the PCAOB does refer to certain other such matters (compare also ISA 260.4(b)). However, we believe that specific mention of these other matters would be equally useful within the text of paragraph 8.

In addition, we do not understand why, although the PCAOB has entitled the Standard "Communications with Audit Committees" implying that communication may be a two-way act, the PCAOB has chosen not to use the term "communicate with" in a single paragraph of the draft Standard. We are aware that paragraph 1 explains that "communicate to," as used in the standard is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit. Nevertheless, for the reasons discussed more fully in our previous letter, we remain concerned that the use of the phrase "communicate to the audit committee" throughout the standard is not optimal, as it might not foster appropriate two-way communication in practice. In many instances the communication of information required by this Standard may well be one-way by nature, but not in all cases. We believe it would be more appropriate to use "communicate with the audit committee" where a two-way discussion would be appropriate in ensuring the auditor will obtain information on particular matters or aspects relevant to the audit.

For example, as we had also explained in our previous letter, paragraph 9 (discussion of significant risks) ought to lead to an open and frank two-way discussion, as it is conceivable – particularly if such communication occurs at a relatively early stage of the audit – that the auditor may obtain further information concerning significant risks (both in relation to risks already identified by the auditor and potentially other risks not yet identified) from the audit committee of which the auditor was previously unaware. We appreciate that as part of risk assessment procedures, PCAOB AS 12-54 also foresees the auditor obtaining information from the audit committee, but are nevertheless concerned that in limiting paragraph 9 of this draft standard to a communication to the audit committee of the significant risks identified during the auditor's risk assessment procedures only, information on potential additional risks, i.e., due to new information becoming available or subsequent developments may not be forthcoming from the latter. In our view, if it is to be effective, communication of risk assessment should not be limited to initial inquiries and a subsequent one-sided reporting of the auditor's own risk assessment.

Assessment of the Adequacy of the Two-Way Communication

As we had pointed out in our previous letter, we support fostering a constructive working relationship between auditors and those charged with governance, including audit committees, as effective communication may potentially help enhance the quality of the audit.

We, therefore, do not support the PCAOB's decision to delete without substitution the part of the objective and corresponding requirement regarding the auditor's assessment of the adequacy of the two-way communication and effects of inadequate two-way communication on both the auditor's assessment of risk and the auditor's ability to obtain appropriate audit evidence.

Whilst we appreciate that the auditor's consideration of the company's control environment is covered by PCAOB AS 12, we do not believe this is the only aspect that the requirement and objective originally proposed needs to cover. For example, if the auditor's attempts to communicate with the audit committee were to meet with a lack of cooperation on the part of the audit committee (or, in extreme cases, a refusal to respond to inquires the auditor makes pursuant to paragraph 8 or pursuant to other PCAOB ASs), the auditor may evaluate this part of the desired communication as inadequate on the basis of suspecting information may be being withheld. (Compare ISA 260.A43 last sentence: "There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements"). We therefore believe that the auditor does need to make an assessment in this context, albeit, as other commenters have pointed out, not on the understanding the audit committee obtained, but based on whether the auditor perceives the two-way communication as having been adequate for the purposes of the audit.

Including Guidance within the Standard to Foster Consistent Application

The PCAOB has included useful guidance and explanation relating to the application of particular requirements in material accompanying the draft standard (in particular in Appendix 4). For example, material regarding the timing of required communications (page A4-10), the definition of the audit committee (page A4-3 last two sentences in Subsection I "Definition of Audit Committee") which is helpful in clarifying what the term "the audit committee" is to mean in practice in non-US jurisdictions that may have other legal forms etc., and the discussion on form and documentation of communications and the timing thereof (see page A4-42- 44). In many instances, we believe that such guidance – possibly in the form of a Note – would be helpful both to auditors and to the PCAOB in ensuring consistent application of the standard.

Role of Management vs. Role of the Auditor

Paragraph 12 requires the auditor communicate to the audit committee specific information concerning accounting policies, practices and estimates. In our opinion management should provide this information. Since paragraph 13 requires the auditor to communicate the auditor's own evaluation of the quality of the company's financial reporting including qualitative aspects of significant accounting policies and practices and conclusions regarding critical accounting estimates, this seems to us to cover this area appropriately.

Furthermore, in comparison to the previous draft, certain new aspects have been added, which cause us concern:

- 12 a (3) the PCAOB is proposing the term "diversity in practice" be added to the end of this sentence – auditors may not be in a position to provide accurate information on areas for which there is diversity in practice, e.g., for new situations no one may yet know what is used in practice by other entities – it also raises the question as to whether this is meant to be a US-only diversity or a diversity at a world wide level? (NOTE: this additional wording also goes beyond the wording of AU sec. 380.07).
- 12 b the inclusion of "anticipated future events" is problematical. Despite commenters having noted that the auditor cannot predict the future, the PCAOB rejected recommendations to delete this. We do not see the justification for rejecting these comments.

Danger of Information Overload to the Audit Committee

We noted in our previous letter that specific information required to be communicated by the then proposed standard exceeds but does not necessarily appear to equate with that specified in Section 204 of the Sarbanes-Oxley Act of 2002 (SOX) for an auditor to report to the audit committee. We had also argued in that letter that there is a danger that auditors and audit committees may become overly focused on adhering to the required informational exchange as set forth in the then proposed standard and "fail to see the woods for the trees". As a result important information – irrespective of which party is communicating it – may be overshadowed such that its significance is not readily apparent to the recipient. Such over prescription may also be detrimental to an effective two-way exchange of information, since if a matter is not listed in the requirements of the standard it may not be communicated at all. Whilst we appreciate that the PCAOB has subsequently used the thresholds "significant" or "critical" in a number of instances, our concerns in this area have not been fully addressed.

For example, in this context, we would like to note that although the IDW did not comment on the PCAOB Release no. 2011-007 relating to auditor reporting, we would not support proposals for the auditor to disclose detailed information on audit work performed by other participants in the audit externally. In our opinion the usefulness of this (retrospective) information to the public is questionable. However, the audit committee might well be in a position to assess and discuss implications for the audit (prior to appointment). In this context, we support the disclosure of <u>significant</u> work performed by another external auditor to the audit committee, but not so as to overload with the details of every other firm or person irrespective of the significance of their participation in audit procedures. We

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

therefore suggest paragraph 10 d. should be amended to include the term "significant" between "perform" and "audit procedures".

A further example is discussed in Appendix 4 section XIII. Despite "several" comments received the Board did not change the requirement to report the schedule of uncorrected misstatements. In line with our comments above concerning the desirability of closer alignment with the ISAs, we believe that ISA 450.12 solves the problem of overloading the audit committee with the communication of all misstatements in a more appropriate way. In addition, ISA 450.8 requires the auditor at least request management correct all misstatements as "good practice" as explained in ISA 450.A9 – it is not clear why the PCAOB differs in its approach, notwithstanding management's actual legal responsibilities. It is not entirely clear to us why the PCAOB rejected calls for change in this instance.

We hope that our comments are useful for the Board's further deliberations. Should you have any questions about our comments, we would be pleased to be of assistance.

Yours very truly,

Gillian G. Waldbauer.

Klaus-Peter Feld
Executive Director

Gillian Waldbauer
Technical Manager

ima

The Association of
Accountants and
Financial Professionals
in Business

February 29, 2012

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Rulemaking Docket No. 030

Dear Members of the Board:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is pleased to comment on the PCAOB's proposed auditing standard relating to *Communications with Audit Committees.*

The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies, representatives from the largest accounting firms, valuation experts, accounting consultants, academics, and analysts.[1] The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

While we believe that the proposal largely represents a codification and expansion of existing PCAOB requirements, we recommend greater clarity as to precisely which requirements are new. We believe that it would be very helpful if the PCAOB included in the final standard an easy-to-read table summarizing the new requirements from carryover and expanded requirements. We believe that the additional requirements are communications covering:

- a written engagement letter to the audit committee,
- an overview of audit strategy and timing,
- reasons that critical policies and practices are critical, information about changes in such policies and practices, concerns regarding related disclosures and the basis for auditor's conclusions regarding reasonableness of critical policies and practices,
- certain matters for which the auditor consulted outside of the engagement team,
- auditor concerns regarding new accounting pronouncements,
- details of significant unusual transactions, including business rationale,
- going-concern matters and,
- any departure from the standard auditor's report.

[1] Additional information about the IMA Financial Reporting Committee can be found at www.imafrc.org.

10 Paragon Drive
Suite 1
Montvale, NJ 07645
www.imanet.org

FRC members find that these new requirements cover matters that are customarily discussed in audit committee meetings. We do not object to any of the carryover, expanded or additional communication requirements and believe that the items in the proposal should be discussed with audit committees. We are fully supportive of the PCAOB objective of effective two-way communication between the auditors and audit committees. We do, however, have several concerns regarding the proposal.

First, we have an overriding concern that the proposal adds to a growing list of check-the-box type requirements governing the dialog between auditors and audit committees. The experience of FRC members (which includes preparers, auditors and audit committee members) is that a robust dialog currently exists between the auditors and audit committees and includes most of the new or expanded requirements. It is our experience that audit committee meetings are currently lengthy and time compressed. We are concerned that the proposal could increase compliance type communication, some of which is redundant of information communicated by management in the presence of the auditors, rather than ensuring that meaningful dialogue takes place. We suggest that the auditors be encouraged to issue written communications to the audit committee covering the required matters in advance of meetings, allowing meeting discussions to focus on the vital areas and address any questions or concerns. Revising the proposal in this manner is consistent with the PCAOB's objective of promoting robust two-way dialog.

Second, we believe that the proposal and certain existing requirements may not appropriately distinguish the roles of the auditor and management. We believe that the auditor should be the primary communicant for activity that is attest related and that management should be the primary communicant for activity that is management led. Accordingly, we believe that the communication regarding accounting policies, practices and estimates (paragraph 12), significant unusual transactions (paragraph 14) and management consultation with other accountants (paragraph 16) is absolutely the responsibility of management. While we believe that management should take the lead in discussing their conclusions, we recognize that the auditor's views on these matters are also important to the audit committee. That is, the auditor's comments on management led issues should not be restricted to a "agree" or "disagree".

It is our experience that management discusses the matters in paragraphs 12, 14 and 16 with the audit committee as a matter of course and management would certainly be queried by audit committees in the absence of management initiated discussion regarding these matters. It is also our experience that, as a matter of course, auditors are asked by management (and if not by management, by audit committees) to add their comments and perspective during these discussions. We believe that the PCAOB standard should be limited to requiring that the auditor ensure that such discussion takes place between management and the audit committee. If the PCAOB is concerned about the all-inclusiveness of management's discussions with the audit committee then the standard could include language that requires the auditor to comment in the written communication with audit committees on the sufficiency of management's communication on these matters and that they are not aware of anything else requiring the audit committee's attention.

Finally, while we believe that accounting issues related to significant unusual and difficult and contentious transactions should be discussed with the audit committee, we believe that without specific definitions in the standard for the terms "significant and unusual", as well as "difficult and contentious", inconsistencies in interpretations especially in light of subsequent PCAOB inspection may result.

We would be pleased to respond to any questions you have about our comments. You can reach me at (212) 664-1733.

Sincerely,

Allan Cohen
Chair, Financial Reporting Committee
Institute of Management Accountants

ICGN
International Corporate Governance Network

J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Members of the Public Company Accounting
Oversight Board (PCAOB)
1666 K Street, NW
Washington, D.C. 2006-2803 USA

By email: comments@pcaobus.org

29 February 2012

Dear Mr. Seymour and Board Members

Re: Consultation input on PCAOB Rulemaking Docket 030
PCAOB Release No. 2011-008, December 20, 2011.
Proposed Auditing Standard Related to Communications with Audit Committees

Thank you for the opportunity to comment on the Re-proposed Auditing Standard, *Communications with Audit Committees,* issued by the Public Company Accounting Oversight Board (PCAOB). We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of U.S. $18 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through ICGN Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the ICGN Accounting and Auditing Practices Committee (AAPC or the Committee) is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. In doing so, the Committee, through collective comment and engagement, strives to help to ensure the quality and integrity of financial reporting around the world. More information about the Committee can be found via:
http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

The ICGN wishes to express our support for the PCAOB's comprehensive and fundamental review of auditor communications with the audit committee and we are pleased to provide general comments as well as comments on some of the specific issues raised in the document. In particular, we are encouraged by the fact that the PCAOB is consulting stakeholders, especially investors, shareowners and the wider investor community, to better understand an auditor's communications with the audit committee and to seek suggestions for possible improvements to the proposed standard. We would also like to emphasise that investors are primarily interested in - and should be provided with - information regarding all current and foreseeable material issues, rather than a focus on a myriad of details on non-material factors.

We would like to express our continuing commitment to the concept of best practice that contributes to the efficiency and effectiveness of capital markets, including credible, high quality financial reports which serve the needs of investors and other users of financial information. Investors need to have confidence in financial statements in using them to evaluate and make investment decisions, and hold management to account. The integrity and quality of financial reports is supported and strengthened by a robust external independent audit and an active vigilant audit committee.

Clarity of Roles

A key audit committee role is to uphold audit quality and to protect the interests of investors. Robust and open communications between the external auditor and the audit committee supports and promotes this confidence.

The ICGN believes the audit committee of the board has an important role in ensuring the integrity of financial reporting and ensuring quality oversight of financial reporting on behalf of shareowners. Communications that serve to enhance their role are important and helpful to shareowners. The auditor, on the other hand, issues the audit report for the benefit of shareowners and the capital markets, not only for the benefit of the audit committee. It is in the course of undertaking the audit, the auditor may glean information useful to the audit committee as well as to shareowners and future investors.

We also believe it is most important that the specific roles of the auditor, the audit committee and management are clearly outlined within the standard, so there can be no confusion in this respect. No one party should encroach on the legitimate role of the others.

Content

We are particularly interested in any auditor communications and information that may be material to the market price of the company shares. In particular, this could include:

- Key business, operational and audit risks which the auditor believes exist, and which the auditor has considered when conducting the audit;
- The auditor's perspective on what are the key assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low, most likely, or high end of the range of possible outcomes;
- The appropriateness of the accounting policies adopted;
- Changes to accounting policies that have a significant impact;
- The methods and judgments made in valuing assets and liabilities;
- Any unusual transactions;
- Accounting applications and practices that are uncommon to the industry;
- Identification of any matters in the Annual Report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit;

- Key audit issues and their resolution which the audit partner documents in a final summary audit memo;
- Quality and effectiveness of the governance structure and risk management (including internal controls);
- Evaluation of whether there is a substantial doubt about the company's ability to continue as a going concern for a reasonable period of time; and
- A view on how the entity compares to its peers in the effectiveness of its internal controls and financial reporting practices.

Communication

We would like to see robust communications between the auditor and the audit committee that are not formulaic nor adopt a 'checklist approach'. Further the ICGN would like to avoid a compliance approach to these communications. Minor matters should not be included unless they are indicative of higher level issues and risks. The dialogue should be a two way meaningful exchange on important matters and not clouded by minutiae. However we also believe that a record of the exchange should be kept in order to avoid misunderstandings. Ultimately, the ICGN would like to see a robust, substantive exchange between the parties, aimed at helping to ensure effective communications in promoting transparent and reliable information in the conduct of the audit.

Scope

Whilst it seems that the new standard does not impose any new requirements on auditors, it does helpfully clarify the nature and style of the communications between the auditor and the audit committee. The ICGN is pleased to see references to a number of specific matters, not necessarily placed here in order of importance, which should be discussed with the audit committee, including:

- The audit strategy and structure and timing of the audit;
- Auditor liability;
- The auditor's assessment of risk areas, including fraud risks;
- The auditor's use of external experts and other auditors;
- Difficult and contentious issues that arise in the course of the audit;
- Significant unusual transactions
- Significant accounting policies, judgments and estimates; and
- Going concern evaluation and issues and other matters.

To ensure high quality audits, we also believe audit committees should not agree to limit the liability of outside auditors and ensure this is clearly expressed in its communications with the external auditor and shareowners.

However we would not want the above list to be the only matters considered in the communications envisaged. We believe both the auditor and the audit committee should be free to raise any matter each deems important. This then would lead to the full and frank discussions the investor community is seeking in the relationship. The list should therefore be viewed as a non-exclusive guide to some topics that may be canvassed. We would like to see included in the standard mention of the auditor's view of the quality, clarity and completeness of the financial statements.

A particular focus of the exchange should be any risks faced by the entity, whether they are financial or business risks. Particularly helpful to the work of the audit committee would be the auditor's view of the internal controls of the entity.

The better audit committees may already have these kinds of communications in place. However recent experience in the financial crisis has shown that there is sufficient concern in many entities that audit committees may not be receiving adequate information from management on company financial reporting and the work of the auditor. This is compounded by ineffective communications between the auditor and the audit committee. Therefore we support the standard and its attempt to make these communications more robust, which we see will strengthen the audit committee's oversight function.

To summarize, the areas of specific comment we would wish to bring to your attention are as follows:

- The proposal mentions 'significant unusual transactions'. In order for auditors to discuss these with the members of an audit committee, the ICGN believes that both 'significant' and 'unusual' need to be defined or at the very least clarified.
- The ICGN believes that the communications between the auditor and the audit committee should not be constrained by written reports. However a good and relatively detailed record of the discussions should be kept in order to avoid later misunderstandings.
- Given that the standard is expected to be applicable in the United States (US) and that there are many companies that come under US jurisdiction as well as another jurisdiction, some evaluation of the extraterritorial effects of the standard may be useful.

If you would like to discuss any of these points, please do not hesitate to contact Carl Rosen, our Executive Director, at +44 207 612 7098 or carl.rosen@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,

Christianna Wood
Chairman of the ICGN Board of Governors

Janine M. Guillot
Co-Chair, ICGN Accounting and Auditing Practices Committee

Elizabeth Murrall
Co-Chair, ICGN Accounting and Auditing Practices Committee

Cc

ICGN Board Members
ICGN A&A Practices Committee

KPMG LLP
757 Third Avenue
New York, NY 10017

Telephone 212 909 5600
Fax 212 909 5699
Internet www.us.kpmg.com

February 29, 2012

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

PCAOB Rulemaking Docket Matter No. 030
Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380

Dear Mr. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2011-008, "*Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*" (the Release or the revised proposed standard).

We also appreciate the Board addressing many of our comments provided on the Board's March 2010 proposed standard, *Communication with Audit Committees* (the original proposed standard) within the revised proposed standard. We are supportive of the revised proposed standard and offer the following comments for the Board's consideration to either enhance the communication of important information or clarify the auditor's responsibilities in the development of a final standard.

Overview

We support the Board's overall objectives reflected in the revised proposed standard to enhance the relevance and effectiveness of communications between the auditor and the audit committee and emphasize the importance of these two-way communications. More specifically, we support the four objectives[1] for the auditor's communications with the audit committee as described within the revised proposed standard and believe that the communication requirements appropriately align with the auditor's performance requirements in the risk assessment standards.

[1] Refer to paragraph 3 of the revised proposed standard.

We believe a well-informed audit committee is better equipped to effectively perform its role of overseeing both a company's financial reporting process and its independent registered auditor, and accordingly, we support the continued strengthening of existing requirements for auditor communications with the audit committee. As described within several of our recently issued comment letters on other PCAOB proposals, we strongly support enhancing our communications with and the role of the audit committee. For example, in our December 13, 2011 comment letter response[2] to the Board's *Concept Release on Auditor Independence and Audit Firm Rotation,* we note that audit committees are essential to effective corporate governance and are best placed to make decisions on what is in investors' best interests. That comment letter then provides some suggested enhancements to the process, aimed at increasing the information and resources available to audit committees, which could, in turn, increase their ability to monitor auditor performance and gauge audit quality. We recognize that some of those enhancements are included in the Release; while others require further consideration and development. In that regard, we look forward to continuing to work with the Board and other stakeholders on finding ways to enhance auditor communications and strengthen audit quality.

Obtaining Information and Communicating the Audit Strategy

Other participants in the audit not employed by the auditor. The revised proposed standard currently requires the communication of the names, locations, planned roles, and responsibilities, including the scope of audit procedures of other participants in the current period audit that are not employed by the auditor. We support this requirement, but suggest the Board consider applying a significance threshold in identifying those participants to include in this communication.

We believe that communicating this information only for those participants that perform audit procedures over a significant risk or are considered key participants in the audit, for example, would be more effective in assisting the audit committee with understanding matters that are most significant to the conduct of the multi-location audit. We recommend that the criteria for determining a key participant in the audit be consistent with the final amendments

---

[2] Refer to our December 13, 2011 comment letter response to the Board's Release No. 2011-006 that includes a Concept Release on Independence and Mandatory Audit Firm Rotation at http://pcaobus.org/Rules/Rulemaking/Docket037/337_KPMG.pdf.

associated with the Board's October 2011 Release, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*.

Results of the Audit

Matters for which the auditor consulted. The revised proposed standard would require the auditor to communicate to the audit committee those matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial process. The original proposed standard indicated that this communication would not include discussions with the engagement quality reviewer (EQR) conducting a review in accordance with Auditing Standard No. 7, *Engagement Quality Review* (AS7). However this exclusion was removed within the revised proposed standard. The Board indicated that, "the focus of the revised communication requirement is on matters on which the auditor consulted, not on the parties involved in the consultation."[3]

We appreciate the Board's focus on the significance of the matter subject to a consultation, however, we believe that it will be operationally difficult to differentiate a consultation undertaken by the lead audit partner from discussions with the EQR fulfilling its obligations under AS7. As a result, we are concerned that the audit committee will receive information relative to "consultations" that simply evidence that the EQR was appropriately engaged pursuant to the AS7 requirements.[4] While we support the Board's objective, we believe that the requirements of AS7 and the defined role of the EQR warrant the exclusion of the EQR's normal interactions with the lead audit partner and engagement team from this specific communication requirement.

Accordingly, we strongly recommend that interactions between the EQR and the engagement team required by AS7 be excluded from the consultation requirement for difficult or contentious matters under the revised proposed standard. Additionally, we find the discussion of "difficult or contentious matters" as described on page A4-28 of the Release to be helpful and therefore recommend that this discussion be included within the final standard.

---

[3] Refer to Section D of Appendix 4 of the Release.

[4] The EQR's responsibility includes evaluating the engagement team's assessment and audit response to all significant judgments, risks, findings and issues, and accordingly the provisions of AS7 likely would result in the EQR discussing all "difficult or contentious matters" identified in the course of the audit with the engagement team.

KPMG

Other Clarifications

Timing of communications. We agree that it is essential for the auditor to communicate with the audit committee on a timely basis and appreciate the Board's acknowledgement of instances where it is most efficient to communicate to the committee through the audit committee chair. We also support the requirement for the auditor to communicate to the audit committee those matters initially communicated to the audit committee chair. In order to recognize that not all members of the audit committee must be present in order to achieve a quorum, we recommend that the word "full" be removed from the note to paragraph 25 of the revised proposed standard.

Consideration of anticipated future events. Paragraph 12(b)(2) of the revised proposed standard requires the auditor to communicate how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical. Page A4-19 of the Release implies that this communication is consistent with existing SEC requirements under Rule 2-07 of Regulation S-X and provides some related implementation guidance. While we believe this communication requirement is incremental to the requirements within Rule 2-07, we believe it can implemented. However, we recommend that the Board provide further clarification and/or implementation guidance within the final standard.

Considerations related to Critical Accounting Estimates portion of management's discussion and analysis (MD&A). We support the revisions within the revised proposed standard to remove the requirement to communicate both how management subsequently monitors critical accounting estimates and information about critical accounting estimates when these estimates involve a range, as we believe these communications are management's responsibility. Appendix 4 Section B of the Release references SEC guidance that requires management to disclose within its Critical Accounting Estimates portion of MD&A, material implications of uncertainties associated with the methods, assumptions and estimates underlying the company's critical accounting measurements.[5] This section further describes the Board's rationale for removing these communication requirements in the revised proposed standard and highlights the auditor's responsibility for this information presented within

[5] Refer to Section 501.14 of Financial Reporting Codification, *Critical Accounting Estimates,* for a description of the MD&A disclosure requirements for critical accounting estimates.

MD&A under the provisions of AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.* We believe this reference to AU sec. 550 may imply an auditor performance requirement relative to the disclosures within a Critical Accounting Estimates portion of MD&A that exceeds the requirements of AU sec. 550 and suggest that the Board remove this reference or provide additional clarification within the final standard.

Amendments to PCAOB Standards

The required communications to audit committees under the proposed amendments to AU sec. 722, *Interim Financial Information*, generally are limited to the effect of significant events, transactions, and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. We recommend that the final standard clarify that the auditor is not required to repeat communications that were made as part of the annual audit.

Based on the proposed effective date included in the Release, it would appear that the amendments to AU sec. 722 would become effective prior to the initial implementation of the final standard (replacing AU sec. 380, *Communication with Audit Committees*) for fiscal years beginning after December 15, 2012. Given that the objective of a review of interim financial information differs significantly from that of an audit, we recommend that the proposed amendments to AU sec. 722 only become effective for periods following the first annual period in which the final standard is effective.

Broker-Dealer Considerations

We support the proposed standard being applicable to all audits of brokers and dealers. We also support the application of the Board's interim standard AU sec. 380 to all audits of brokers and dealers should the SEC adopt its proposal requiring such audits to be performed in accordance to PCAOB standards prior to the effective date of the revised proposed standard.

For those broker-dealers with governance structures that do not include a board of directors or audit committee, the revised proposed standard allows for the required discussions to occur with "those persons designated to oversee the accounting and financial reporting process of the company and audits of the financial statements of the company." In many instances, particularly at smaller non-issuer brokers and dealers, oversight of the accounting, financial reporting, and audit process is performed directly by the Chief Financial Officer. In order to achieve the objectives of the revised proposed standard, the individuals to whom these communications are made should include the Chief Executive Officer in addition to any other persons so designated. Accordingly, we suggest that this clarification be included in the final standard.

As additional communication requirements exist for brokers and dealers under Exchange Act Rule 17a-5, and under the Board's proposed attestation standards, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, and *Review Engagements Regarding Exemption Reports for Brokers and Dealers*, we recommend that Appendix B to the final standard be updated to reference these PCAOB standards relative to brokers and dealers.

Codification

As evidenced within Appendix B, a number of the PCAOB Rules and Standards, in addition to AU sec. 380, include communication requirements with audit committees. We believe that codifying these requirements into a single topic would significantly benefit the auditor and may improve the consistent application of each of the communication requirements.

* * * * * * *

KPMG

We appreciate the Board's careful consideration of our comments, and support the Board's efforts to enhance the role of the audit committee through improved auditor communications. We would be pleased to answer any questions regarding this comment letter.

Very truly yours,

KPMG LLP

Cc:

PCAOB	**SEC**
James R. Doty, Chairman	Mary L. Schapiro, Chairman
Lewis H. Ferguson, Member	Luis A. Aguilar, Commissioner
Daniel L. Goelzer, Member	Daniel M. Gallagher, Commissioner
Jeanette M. Franzel, Member	Troy A. Paredes, Commissioner
Jay D. Hanson, Member	Elisse B. Walter, Commissioner
Steven B. Harris, Member	James L. Kroeker, Chief Accountant
Martin F. Baumann, Chief Auditor and Director of Professional Standards	Brian Croteau, Deputy Chief Accountant

MARK BAILEY & COMPANY, LTD.
Certified Public Accountants & Management Consultants
1495 Ridgeview Dr., Ste 200 | Reno, NV 89519 | http://www.markbaileyco.com

February 22, 2012

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Transmitted by email to: comments@pcaobus.org

RE: PCAOB Rulemaking Docket Matter No. 030

We are pleased to respond in this letter to the Board's re-proposed standard entitled, *Communications with Audit Committees* that is contained as Appendix 1 to its Release No. 2011-008 (the Release) of December 20, 2011.

Some of the comments below are general in nature and some are specific to paragraphs in the proposed standard. We have also commented on some of the PCAOB's specific questions regarding the re-proposed standard. Please note that we have shortened audit committee to "AC" in the comments below.

Comments

1. This standard should better address the needs of smaller reporting companies. It is our experience that a majority of these companies have no AC's as they are not required by the exchanges they are listed on. Appendix A does address the definition of "audit committee" and acknowledges that an auditor may have to make these communications to a body other than an AC, like the full board. However, the full board most likely includes the same management that we are supposed to be reporting about or in other words we would be making required communications to those who are already intimately involved in the selection of accounting principles and drafting of financial statements, etc. Thus making these communications with them often seems silly and does not accomplish any of the objectives of the standard. Therefore, it seems there should be language added that the "required" communications can be tailored where necessary to meet the needs and to make sense for smaller reporting companies. In general this standard, as is typical for US standard setters, is very rules based and does not allow much room for auditor judgment.

2. In reading the proposed standard, we are most concerned with the requirements of paragraphs 9-11, regarding communicating to the AC an overview of our audit strategy. We're not sure what purpose this would serve other than to add more steps to our checklists, make audits more costly and take longer to perform. What does the AC gain from knowing the details of our audit strategy? We certainly don't want the AC to influence the independent auditor's audit procedures or to tell us not to focus attention in a certain area because they don't think there is a significant risk there. They could use such information to try and influence our audit (hopefully un-intentionally), but in the end any involvement by the Company, which includes the audit committee, on our selection of audit procedures, infringes on our independence. Management should be communicating to the AC their views of risk in regards to the financial statements,

(shouldn't this be part of the Company's risk assessment procedures), not the independent auditor. Furthermore, as an audit is a fluid process, where new risks may be identified as fieldwork begins; it seems again like an extra burden to have to communicate to the AC about changes in our strategy. Why don't we just make the AC chair a member of our audit team who receives all our planning documents and changes thereto? That must sound ridiculous when stated like that, but aren't we making them a part of our team by imparting such information to them. We think communication with the AC is important and should be taken seriously, but the requirements of paragraph 9-11, infringe on the concepts of auditor judgment and independence.

3. In general we're not opposed to the requirements of paragraph 10e, but information such as this is determined based on technical audit standards, that the average AC member won't be familiar with and frankly we can't imagine they would care about how that determination was made.

4. In regards to whether the communication should be required to be written, we believe oral communication is adequate and also gives the AC an opportunity to ask questions as the auditor goes through the results of the audit and the other required communications. The memo our firm adds to our audit documentation regarding this communication is more than sufficient and in most cases would resemble the same document we would send to the AC anyhow. It may be that a firm has an oral conversation that is followed-up by a formal letter, but it seems counterintuitive to have the auditor send a letter to the AC and think that this will improve two-way communication. Sending a letter with no oral conversation is pretty one-sided.

PCAOB Questions

Q1. Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why not?

A1. See comment 2 above.

Q2. The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing performance obligations?

A2. No, in fact we believe the existing audit committee communication standard is adequate and that most of the new items included in this proposed standard do not meet cost/benefit considerations.

Q3. The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement. (a) Is the requirement in the standards clear? (b) As stated, the new proposed standard allows the acknowledgement by the audit committee to be oral. Should the acknowledgement by the audit committee or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgement sufficient?

A3. (a) Yes, the requirement is clear. (b) In this case it seems acknowledgment in a written form should be required. The standard should just say the engagement letter should be signed by the AC chair, as based on the premise of this whole standard shouldn't it be an exception if it is someone other than the AC chair or a board member to sign the engagement letter?

Q4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

A4. This appears to be a redundant requirement. If there was any accounting application issue or other disagreement with management regarding significant unusual transactions wouldn't that come out when discussing the requirements already in paragraphs 12, 13, 18, 21 or 22? Shouldn't management have already informed the AC of such matters?

Q5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

A5. Yes, but only if the auditor disagrees with the accounting treatment ultimately applied to the matter at hand. In this case we believe the disagreement would be covered by other paragraphs of the proposed standard, so again it seems this requirement would be redundant. We're not sure what other concerns the auditor could have regarding matters where management has consulted with other accountants other than arriving at an incorrect accounting treatment.

Q6. Not considered for comment.

We would like to thank the PCAOB for the opportunity comment and believe that the comment process is a valuable part of the standard setting process, as long as the PCAOB takes seriously the comments made by those most affected by the proposed standard. Please let us know if you have any questions regarding our comments.

Very truly yours,

Mark Bailey & Company, Ltd.

Mark Bailey & Company, Ltd.

MAZARS

Paris La Defense, February 29, 2012

Public Company Accounting Oversight Board (PCAOB)
Office of the Secretary
1666 K Street, N.W.
Washington, DC 20006, USA
Attention: J. Gordon Seymour, Secretary, and the Members of the Board

Re: PCAOB Release No. 2011-008 - December 20, 2011 - PCAOB Rulemaking Docket Matter No. 30: Proposed Auditing Standard on Communications with Audit Committees, Related Amendments to PCAOB Auditing Standards and Transitional Amendments to AU sec. 380

Dear Sirs,

MAZARS is pleased to submit this letter in response to the request for comments from the PCAOB, on its Proposed Auditing Standard on Communications with Audit Committees.

MAZARS is a unique integrated partnership with a global reach. It operates as one integrated international partnership in 68 countries, with nearly 13,000 professionals, leaded by more than 700 partners, with 14 additional countries where MAZARS is present through correspondents and joint ventures (see MAZARS annual reports together with its IFRS joint-audited consolidated financial statements, published since 2005, on http://annualreport.mazars.com).

MAZARS is a founding member of 'Praxity', an alliance of firms operating in 82 countries with more than 28,000 professional, one of the world's largest alliance of independent accounting firms.

MAZARS is also a member of the International Federation of Accountants' (IFAC) Forum of Firms, thus fully supporting, since many years now, the initiatives of IFAC to promote high quality standards in the international practice of auditing.

In addition to the statements of its previous comment letter dated October 2010, MAZARS strongly supports the PCAOB work on improving and enhancing the communications between auditors and audit committees. We believe that an effective two-way communication between the audit committee and the auditors can substantially improve the financial reporting process as a whole.

PCAOB can also refer, on the Communications with Audit Committees, to the MAZARS Response to the European Commission (EC) Green Paper on Audit Policy: *Lessons from the Crisis*:
http://www.mazars.com/Home/News-Media/Latest-news2/Mazars-contribution-to-the-Green-Paper

We would be pleased to discuss our detailed comments submitted hereafter with you and remain at your disposal, should you require further clarification or additional information.

Yours sincerely,

Jean-Luc Barlet
MAZARS Group Chief Compliance Officer

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

Conclusion and general comments

MAZARS is an international, integrated and independent organization, specializing in audit, accountancy, tax, legal and advisory services.

MAZARS was founded with certain core values: Independence, Competence; Intellectual and Ethical Rigor and Integrity; Sense of Service and Responsibility; Continuity; Respect for Individuals and Diversity.

As stated above, MAZARS believe that an effective two-way communication between the audit committee and the auditors can substantially improve the financial reporting process as a whole.

MAZARS urges the PCAOB to properly delineate the responsibilities of auditors and audit committee (who does what and when) in this standard-setting project while avoiding redundancy with existing rules and regulations, and also keeping in mind the underlying cost-benefit consideration of such communications.

MAZARS thanks the PCAOB for its outreach efforts directed to the profession and public at large during this consultation process, and for taking into consideration the work of other standard setters (e.g., FASB, IASB, ASB, and IAASB).

Below are our specific comments on the re-proposed auditing standard relating to Communications with Audit Committees and Related Amendments to PCAOB Standards. Please note that MAZARS responded to the first proposal with its comment letter dated October 21, 2010[1].

Q. 1.: Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

Yes, based on our review of these proposed communication requirements in light of the PCAOB new risk assessment standards[2], it appears that these proposed communication requirements adequately aligned with the performance requirements in the new risk assessment standards.

Q. 2.: The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?

MAZARS believes that the new proposed communication requirements along with the already existing required communications with audit committees[3] are adequate and sufficient to provide audit committee with quality information that could improve the overall financial reporting process. Redundancy and confusion should be avoided at all costs.

---

[1] http://pcaobus.org/Rules/Rulemaking/Docket030/043_Mazars.pdf
[2] http://pcaobus.org/Standards/Auditing/Pages/default.aspx
[3] Appendix B of this proposal – Communications with Audit Committees Required by Other PCAOB http://pcaobus.org/Rules/Rulemaking/Docket030/Release_2011-008.pdf

Q. 3.: The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

a) Is the requirement in the standard clear?

Yes, this requirement is clearly stated.

b) As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

The audit committee has the responsibilities to hire, compensate, and oversee the work of the external audit engagement firm. The engagement letter materializes the understanding between both parties. The purpose of the engagement letter is to "crystallize" the objectives of the engagement, the responsibilities of the auditors, and the responsibilities of the audit client. As such, the acknowledgement by the audit committee, or its chair on behalf of the audit committee, should be required to be in a written form. To be enforceable in a court of law, this acknowledgement by the audit committee should be in writing.

Q. 4.: Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

Yes, MAZARS believes that the requirement for the auditor to communicate significant unusual transactions to the audit committee is appropriate. This is consistent and in line with SAPA 5[4] (Communicating with Audit Committees, page 10 of 12).

Q. 5.: Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

Yes, it is appropriate to require the auditors to communicate to the audit committee their views regarding significant accounting or auditing matters when the auditors are aware that management has consulted with other accountants about such matters and the auditors have identified a concern regarding these matters.

[4] Alert No. 5: Auditor Considerations Regarding Significant Unusual Transactions (April 7, 2010) - http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf

MAZARS

Q. 6.: Are the amendments to other PCAOB standards appropriate? If not, why?

The amendments to other PCAOB standards are appropriate.

Q. 7.: The Board requests comments regarding the audits of brokers and dealers on the following matters:

a) Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?

MAZARS is of the opinion that the communication requirements under the Board's interim standard, AU sec. 380, should not be applicable to audits of brokers and dealers earlier.

b) Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

MAZARS believes that the auditors' communications to audit committees included in the new proposed standard could generally be applicable to most of the audits of brokers and dealers. However, we believe that there should be a possibility of tweaking the proposed standards to the uniqueness and specificities of certain audits of brokers and dealers. These proposed auditing standards should not be an all-size fit all.

c) Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

Please refer to response 7 b) above.

We believe that overall and in general, the communication requirements as proposed in the new standards can basically cover the specific needs of the audit committee during audits of brokers and dealers. But, there should be room for unforeseen events.

McGladrey & Pullen, LLP
3600 American Blvd West
Third Floor
Bloomington, MN 55431
O 952.835.9930 F 952.921.7704
www.mcgladrey.com

McGladrey

February 24, 2012

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

RE: PCAOB Rulemaking Docket Matter No. 030

Dear Office of the Secretary:

McGladrey & Pullen, LLP appreciates the opportunity to comment on the PCAOB's *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*. We continue to support the PCAOB's efforts to further strengthen the communications between auditors and audit committees. We have the following comments, which we believe would help to clarify certain sections of the proposed standard and enhance its application in practice.

Establish an Understanding of the Terms of the Audit

Paragraph 5 requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee, including communicating to the audit committee the responsibilities of the auditor and the responsibilities of management. Although this requirement does not institute the responsibilities of the auditor or management, it does require the establishment of an understanding of such responsibilities. Likewise, the proposed standard should not institute the responsibilities of the audit committee. However, it should require the establishment of a mutual understanding of the audit committee's responsibilities. This is particularly relevant for audits of non-issuer brokers and dealers who do not have audit committees that are subject to the rules of the SEC or the stock exchange governance rules.

We believe the requirements in paragraph 5 should be expanded to include establishing an understanding of the audit committee's responsibilities related to the audit of the company's financial statements. Additionally, we believe that Appendix C, "Matters Included in the Audit Engagement Letter," should be revised to include matters such as the following:

d. Audit committee's responsibilities:
    1. The audit committee is responsible for overseeing the company's financial reporting.
    2. The audit committee is responsible for informing the auditor of matters that may be related to the audit, including for example, knowledge of known or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters.
    3. The audit committee is responsible for adequate communications with the auditor, including, but not limited to the following:
        i. Appropriate and timely actions taken in response to matters raised by the auditor;
        ii. Open communications with the auditor;
        iii. A willingness to meet with the auditor without management present; and
        iv. Probing issues raised by the auditor.

Paragraph 6 requires the auditor to have the engagement letter executed by the appropriate party or parties on behalf of the company. Further, if the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement. We suggest this requirement be strengthened to require acknowledgment by the audit committee in writing. This is especially important if the audit committee's responsibilities are outlined in the engagement letter.

Overall Audit Strategy and Timing of the Audit

Paragraph 10.d. requires the auditor to communicate to the audit committee the names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit. We believe it could be beneficial to provide the audit committee with additional relevant information related to the involvement of others who support the audit effort. We are concerned however that the proposed requirement for the auditor to communicate the involvement of others who are not considered key participants in the audit could detract from the meaningfulness of this aspect of the communication to the audit committee.

We suggest establishing a threshold for this communication, such as a minimum percentage that is consistent with that ultimately used in the PCAOB's transparency proposal (if adopted) for disclosing in the audit report the involvement of other firms or persons. With respect to metrics that might be used to indicate the extent of participation of each firm, we believe a threshold of 10 or 20 percent would provide audit committees the most meaningful information about participants in the audit. This is consistent with existing PCAOB rules that set a threshold for the level of audit work deemed significant enough to require PCAOB registration and inspection.

Accounting Policies, Practices, and Estimates

Paragraph 12.b.(2) requires the auditor to communicate to the audit committee how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical. We are unclear as to how an auditor should anticipate future events and determine whether they are relevant and/or likely to affect a company's current policies or practices. We believe management would be in a much better position to provide meaningful information to the audit committee about how current and anticipated future events or transactions might affect the determination of whether certain policies and practices are considered critical.

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

Paragraph 13.e. requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process. We recommend that the auditor, through the use of professional judgment, be allowed to determine which matters meet the criteria of "difficult" and "contentious" when determining which consultations need to be communicated to the audit committee. To assist the auditor in the exercise of professional judgment in this area, it would be helpful if the guidance explaining the terms "difficult" and "contentious" on page A4-28 of the proposal were included within the final standard.

Going Concern

Paragraph 17.a. of the PCAOB's proposed standard requires the auditor to communicate to the audit committee, when applicable, the conditions and events the auditor identified that, when considered in the aggregate, indicate that there *could* be substantial doubt about the company's ability to continue as a going concern for a reasonable period of time (emphasis added). Paragraph 17.b. requires that if the auditor's doubt is mitigated, the auditor should communicate to the audit committee the information that mitigated the auditor's doubt, including, if applicable, a discussion of management's plan. Paragraph 3(a) of AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, of the PCAOB's interim standards requires the auditor to consider whether the results of audit procedures performed identify conditions or events that indicate there could be substantial doubt about the entity's ability to continue as a going concern. However, the auditor is only required to obtain information regarding management's plans if he or she believes *there is* substantial doubt regarding the entity's ability to continue as a going concern. Therefore, the communication requirement in proposed paragraph 17.b. would require a level of detail to be provided to the audit committee that exceeds the auditor's current responsibility for performance and documentation.

We believe the trigger point for requiring auditor communication with the audit committee should be when the requirements of paragraph 3(b) of AU Section 341 are applicable. Paragraph 3(b) of AU Section 341 requires that if the auditor believes *there is* substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented.

Proposed Amendments to PCAOB Standards

The proposed amendments to AU sec. 722.34 would require the auditor, when conducting a review of interim financial information, to determine whether any of the matters described in the proposed auditing standard, as they relate to interim financial information, have been identified. If such matters have been identified, the accountant would be required to communicate them to the audit committee. We suggest this amendment be clarified to indicate that the auditor is not required to repeat communications that were made as part of the annual audit.

In addition, the implementation of the proposed amendments to AU sec. 722 prior to the time of the auditor's required annual communications under the proposed standard likely would result in a significant increase in the required communications related to the auditor's review of interim information. Accordingly, we recommend that the proposed amendments to AU sec. 722 only become effective for interim periods following the annual period in which the proposed standard becomes effective.

Comments Regarding the Audits of Brokers and Dealers

The SEC's proposed rule, *Broker-Dealer Reports*, in Release No. 34-64676 states there are 5,063 registered broker-dealers, of which 528 broker-dealers clear transactions or carry customer accounts. The remaining 4,535 broker-dealers are referred to as *introducing brokers* (IBs). Such IBs are generally smaller entities that typically would not have complex operations and would have relatively straightforward books and records. In addition, these IBs typically would have a very simple management structure and not have (a) an audit committee, board of directors, or equivalent body or (b) an individual other than the chief financial officer/controller who would be different than "those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company" – *i.e*., they would be one and the same. Therefore, the potential incremental benefits resulting from additional auditor communications with audit committees would not justify the additional costs of providing such communications to the "audit committees" of IBs. A practical example of such an additional cost is the difficulty of providing these communications prior to the issuance of the auditor's report because all of the IBs' financial statements must be filed with the SEC within 60 days of fiscal year end. Accordingly we recommend that the proposed communication requirements only apply to clearing and carrying firms (and proprietary trading firms, if those are not included therein).

The PCAOB's proposed standard requests comment on whether there are any communication requirements specific to the audits of brokers and dealers that should be added to the new proposed standard. We suggest that Appendix B to the Proposed Standard ultimately be updated to reference SEC Rule 17a-5 and the PCAOB's proposed attestation standards, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers,* and *Review Engagements Regarding Exemption Reports for Brokers and Dealers* that would require additional communications for brokers and dealers when they become effective.

Closing Comments

Notwithstanding our clarifying comments above regarding certain sections of the proposed standard, of utmost importance in the application of this standard will be the auditor's ability to use professional judgment in determining the nature and extent of the required communications. This is vital, for example, in allowing the auditor to determine which matters meet the thresholds of communication for "difficult," "contentious" or "significant" matters. The use of auditor judgment also is important in allowing the auditor to decide which items *not* to communicate, which will result in less use of boilerplate language. Further, it will allow the auditor to make the most appropriate communications to audit committees of smaller reporting companies and smaller brokers and dealers. Ultimately, the application of auditor judgment is critical to providing meaningful communications of the most important matters that are relevant to the audit committee and avoid boilerplate discussion that dilutes the effectiveness of the communication. We suggest that language be added to the introductory paragraph of the standard acknowledging the importance of exercising professional judgment in achieving effective communications between the auditor and the audit committee.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to Scott Pohlman, National Director of SEC Services, at 952-921-7734.

Sincerely,

McGladrey & Pullen, LLP

McGladrey & Pullen, LLP

WWW.MOSSADAMS.COM

MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

999 Third Avenue, Suite 3300
Seattle, WA 98104

T (206) 302-6800 F (206) 652-2098

Acumen. Agility. Answers.

February 29, 2012

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

Via e-mail: comments@pcaobus.org

Re: Request for Public Comment: *Proposed Auditing Standard Related to Communications with Audit Committees*, and *Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380*, PCAOB Rulemaking Docket Matter No. 030

Dear Office of the Secretary:

We appreciate the opportunity to share our views on the Public Company Accounting Oversight Board's (PCAOB or the Board) Proposed Auditing Standard related to Communications with Audit Committees, and related amendments (the Proposal).

Moss Adams LLP is the 11th largest accounting, tax and consulting firm in the United States, and the largest headquartered in the West. Founded in 1913 and headquartered in Seattle, Washington, Moss Adams has 21 locations in Washington, Oregon, California, Arizona, and New Mexico. Our staff of over 1,700 includes more than 220 partners.

We are supportive of the stated objectives in the Proposal and believe the requirements will enhance the relevance and quality of communications between the auditor and the audit committee. We appreciate the Board's efforts to revise the Proposal based on the responses it received from its original proposal. We believe the changes from the original proposal generally represent significant improvements.

After reading the Proposal we believe additional clarification is needed. Our observations are organized as following:

- Non-issuer brokers and dealers
- Matters for which the auditor consulted
- Timing of communications
- AU 722, Interim Financial Information

Non-issuer brokers and dealers

For non-issuer brokers and dealers we believe the effective date of the Proposal should be the same as the eventual effective date of the Securities and Exchange Commission's ("SEC") proposed rule in

Release No. 34-64676 that would require audits of brokers and dealers to be performed in accordance with the standards of the PCAOB. We suggest the PCAOB align the effective date of the Proposal for non-issuer brokers and dealers with the eventual effective date of the SEC Release No. 34-64676.

However, if the Board's interim standard, AU Sec. 380, is made applicable to audits of non-issuer brokers and dealers through the SEC's finalization of the rule that would require audits of brokers and dealers to be performed in accordance with the standards of the PCAOB prior to the effective date of the Proposal, we believe the PCAOB should provide application guidance to clarify the scope in paragraph 1 of AU Sec. 380 in circumstances when an entity does not have a group that is formally designated to oversee the financial reporting process or when *all* persons charged with governance are involved with managing the entity.

Matters for which the auditor consulted

We appreciate the Board's revisions from the original proposal that focuses the communication of matters for which the auditor consulted to the most important matters. In doing so, paragraph 13.e. requires communication of "*Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.*"

However, the Board's extant standards do not describe "matters that are difficult or contentious." We suggest the Board provide guidance within the standard to describe what it intends by "matters that are difficult or contentious." We observe the Board has included discussion in Appendix 4 of the Proposal, which could be the basis for the guidance included in the standard. By including this guidance prominently in the standard, we believe it is more likely to be applied consistently. The following is the referenced discussion on page A4-28 of the Proposal:

> [Portion omitted] Such matters can be complex or unusual, and the auditor believes it is necessary to consult with the firm's national office or industry specialist, or with external parties. Difficult or contentious issues might arise in various stages of the audit, including in the auditor's evaluation of management's judgments, estimates, accounting policies, or an assessment of identified control deficiencies. Difficult or contentious issues might be described as those critical matters that have concerned the auditor when he or she is making the final assessment of whether the financial statements are presented fairly.
>
> A difficult issue might not always be synonymous with a contentious issue. Rather, a difficult issue might be a matter that requires significant consultation. A contentious issue might be a matter that not only requires significant consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management. Audit committees might better appreciate the importance of difficult or contentious matters if they are aware that such consultations took place.

We also believe the Board should reinsert the note to paragraph 13 included in its original proposal or further clarify how when implemented the Proposal interacts with the Boards requirements in AS No. 7, *Engagement Quality Review*. The note in the original proposal stated, "[t]his communication does not include discussions with the engagement quality reviewer in accordance with AS No. 7, *Engagement Quality Review.*" The Proposal's release states the note was removed to focus auditors on communicating matters for which the auditor consulted, not the parties involved in the consultation. We support the requirement to communicate matters that are difficult or contentious and that are relevant to the audit committee's oversight responsibilities. However, by including this communication requirement under "[m]atters for which the auditor consulted," and removing the note that scoped out discussions with the engagement quality reviewer, it raises potential implementation questions that should be clarified. For example, in our firm we have consultation processes whereby engagement teams consult with subject matter experts or with our National Office. We do not assign consultations to the engagement quality reviewer because we interpret AS No. 7 to require that the engagement quality reviewer not significantly participate in determining the conclusions reached by the engagement team. Therefore, we would not consider discussions with the engagement quality reviewer to be consultations. Moreover, paragraph 10.h. of AS No. 7 requires the engagement quality reviewer to evaluate whether appropriate consultations have taken place on difficult or contentious matters. Without clarification, the engagement quality reviewer will be put in a position where they have to determine whether any discussion he or she had with the engagement team during an engagement period is a "consultation." With this view, it will be difficult for the engagement quality reviewer to determine whether appropriate consultations have taken place or, as required by paragraph 10.i. of AS No. 7, if appropriate matters have been communicated to the audit committee. We also believe it will be difficult for an engagement team to determine when a discussion with the engagement quality reviewer would be deemed to be "[m]atters for which the auditor consulted." As a result, we believe the Board should reinsert the note to paragraph 13 in its original proposal.

Timing of communications

We support the requirement for the auditor to communicate to the audit committee those matters initially communicated to the chair. However, all members of the audit committee are not required to be present in order to achieve a quorum when the auditor provides the required communications. Accordingly, we believe that the word "full" should be removed from the note to paragraph 25 of the Proposal.

AU 722, Interim Financial Information

We believe the proposed amendments to AU sec. 722 should become effective for interim periods following the annual period in which the Proposal becomes effective. As currently written the Proposal would appear to have the auditor providing communications that may be incremental to those required during the latest period audited.

We also recommend that the Board include as part of the amendments to AU Sec. 722 a clarification that the auditor is not required to repeat communications that were made as part of the annual audit as noted on page A4-46 of Appendix 4. We believe smaller firms would especially benefit by having this clarification prominently included in the amendments to AU Sec. 722.

*****

We appreciate the effort and time the Board and its staff have devoted to the Proposal. While are supportive of the Proposal's objectives, we believe additional clarification should be provided in the areas outlined above.

Thank you for the opportunity to comment on the Proposal. If you have any questions on our response please contact Fred Frank in our Professional Practice Group at 206-302-6800.

Very truly yours,

Moss Adams LLP

new york state society of
NYSSCPA
certified public accountants

Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

February 28, 2012

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

Submitted via email to: comments@pcaobus.org

Re: PCAOB Release No. 2011-008—Proposed Auditing Standard on Communications with Audit Committees and Related Amendments to PCAOB Standards

PCAOB Rulemaking Docket Matter No. 30

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

The NYSSCPA's Auditing Standards, SEC Practice and Stock Brokerage Committees deliberated the release and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Herringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

NYSSCPA

Richard E. Piluso
President

Attachment

new york state society of
NYSSCPA
certified public accountants

Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

PCAOB RELEASE NO. 2011-008—PROPOSED AUDITING STANDARD ON COMMUNICATIONS WITH AUDIT COMMITTEES AND RELATED AMENDMENTS TO PCAOB STANDARDS

PCAOB RULEMAKING DOCKET MATTER NO. 30

February 28, 2012

Principal Drafters

From the Auditing Standards Committee –
J. Roger Donohue
Jan C. Herringer
Elliot A. Lesser
Robert N. Waxman

From the Stock Brokerage Committee –
David Grumer
Gary R. Purwin

From the SEC Practice Committee –
Mitchell J. Mertz
Theo Vermaak

NYSSCPA 2011 – 2012 Board of Directors

NYSSCPA 2011 – 2012 Accounting & Auditing Oversight Committee

NYSSCPA 2011 – 2012 Auditing Standards Committee

NYSSCPA 2011 – 2012 SEC Practice Committee

Michele B. Amato, *Chair*
Charles Abraham
Eric H. Altstadter
Patricia Baldowski
John A. Basile
Douglas J. Beck
David Bender
Timothy Boehmer
Jeffrey M. Brinn
Thomas E. Caner
Anthony S. Chan
Henry G. Clark
Burgman E. Connolly
Neil W. Ehrenkrantz
Marc A. Engel
Rossana Ferraro
Leon J. Gutman
James Hadfield
Edward J. Halas
Michael J. Halkias
Elliot L. Hendler
Steven Kreit
David J. Lamb
Edward G. LeBrun
Steven R. Leidenfrost
Moshe S. Levitin
Helen R. Liao
Robert P. Marggraf
Thomas P. Martin
Mitchell J. Mertz
Mark Mycio
Muhammad F. Padela
Rita M. Piazza
Arthur J. Radin
John P. Rushford
Stephen A. Scarpati
Candice Sheehan
Robert E. Sohr
Jing Song
Laura C. Valentini
Theo Vermaak
George I. Victor
Liren Wei
Philip H. Weiner
Silvia S. Yehezkel

NYSSCPA 2011 – 2012 Stock Brokerage Committee

Gary R. Purwin, *Chair*
Mark Aaron
Jeffrey Abramczyk
Carney Au Yeung
John Bambino
Steven C. Bender
Maurice Berkower
Steven Berse
Naomi Bondoc-Carson
John Byrne
Mark D. Carroll
John Cavallone
Wai-Mon Chan
Scott D. Daniels
Richard M. Feldman
Chuck Fong
Robert A. Fortino
George Getz
Howard Gluckman
Robert L. Goecks
Mark K. Goodman
Melissa Gottlieb
David H. Grumer
Massamba Gueye
John C. Guttilla
Barbara Halpern
Peter Heuzey
Dean H. Hiltzik
John Iacobellis
Robert J. Kaufmann
Philip C. Kempisty
Marshall Levinson
Jay D. Levy
Mark R. Levy
Leo Lo
Guy Miller
John S. Miller
Charles J. Pagano
David Proskin
Martin Racek
Pamela Radoszycki
Robert Radovich
Robert E. Ransom
Michael F. Rosenblatt
Jeffrey I. Rosenthal
John Sacco
Marc H. Stoltz
Michael E. Stupay
John Sweeney
Helen Tang
Patrick Yaghdjian
Catherine Yung

NYSSCPA Staff

Ernest J. Markezin
William R. Lalli

New York State Society of Certified Public Accountants

Comments on

PCAOB Release No. 2011-007—Proposed Auditing Standard on Communications with Audit Committees and Related Amendments to PCAOB Standards

PCAOB Rulemaking Docket Matter No. 30

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Proposed Auditing Standard, *Communications With Audit Committees* (Proposed Standard). This letter is organized by first providing our answers to the questions posed in the proposed standard followed by our comments and suggestions for improvements.

Overall we support the provisions in the Proposed Standard. We believe that audit committees fulfill an important role in enhancing audit quality and that this standard appropriately recognizes their contribution in this regard. Further, the significance of effective two-way communication to a properly planned and executed audit cannot be overstated and we fully support those provisions in the Proposed Standard that advance such communication.

Responses to Questions Posed - Section VI (pages 11 to 13)

1. Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

Yes, we believe the Proposed Standard's requirements are aligned with the auditor performance requirements included in the risk assessment standards.

2. The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?

We do not believe there are any necessary additional requirements.

3. The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

a. Is the requirement in the standard clear?

The requirement is clear.

b. As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

We believe that this acknowledgement should be in writing to avoid any misunderstanding about the nature of the engagement and the responsibilities of each of the parties.

4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

We believe that it is appropriate to require the auditor to communicate significant unusual transactions only when such transactions have been determined to represent a significant risk in accordance with the guidance in PCAOB Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*, paragraphs 70-71 (Factors Relevant to Identifying Significant Risks). Unless the significant unusual transaction has been determined to be a significant risk, because it results in (a) extended auditing procedures, (b) there is the likelihood of a material misstatement of the financial statements, or (c) the business rationale of a significant transaction is suspect, we do not believe it is necessary to require communication of the information in Proposed Standard paragraph 14 to the audit committee. We recommend revising Proposed Standard paragraph 14 to require communication only when the transaction has been assessed as a significant risk. Nevertheless, such a requirement would not prohibit an auditor from discussing any other matter which in the auditor's judgment warrants communication under Proposed Standard paragraph 23 of the proposal.

5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

Yes. If the auditor believes that management has consulted with other accountants and a concern has been identified, then we believe the auditor should express his or her views to both the audit committee and management, stating the basis of concern and the rationale for his or her views.

6. Are the amendments to other PCAOB standards appropriate? If not, why?

Yes, the amendments to the other PCAOB standards are appropriate.

7. The Board requests comments regarding the audits of brokers and dealers on the following matters:

a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers

are to be performed under PCAOB standards before the new proposed standard becomes effective?

We support providing transitional guidance to those brokers and dealers that have been following the provisions of the American Institute of Certified Public Accountants (AICPA) Auditing Standards (SAS), specifically SAS 114, *The Auditor's Communication With Those Charged With Governance*, to address the anticipated United States Securities Exchange Commission (SEC) proposal that would require audits of brokers and dealers to comply with the auditing standards of the PCAOB, which are currently less robust than SAS 114 with respect to communicating with "those charged with governance." SAS 114 applies to all audits regardless of an entity's governance structure or size and as such we believe that the communication requirements should be applicable to all audits of brokers and dealers. However, we recognize that there are many different governance structures and we support providing flexibility and auditor judgment in determining to whom to make the required communications.

If so, should it be applicable to audits of all brokers and dealers?

See above.

b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

While we believe that the auditor's communications to audit committees, as set out in the Proposed Standard, should be applicable to all audits, we believe that (1) guidance needs to be provided regarding to whom auditors should communicate with when all those charged with governance are also involved in managing the entity, and (2) that further clarification is needed about the matters to communicate in such circumstances since many of the communications required by the Proposed Standard may not be applicable to the audits of smaller brokers and dealers.

c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard?

Brokers and dealers most frequent financial reporting responsibility is their periodic Financial and Operational Combined Uniform Single report ("FOCUS") filings with the SEC. This report presents information that is, as a practical matter, a financial report and for introducing brokers is recognized as being of greater importance than the annual audited financial statements. The PCAOB should require communications regarding this report with the audit committee (or equivalent body).

Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable [to] the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

The applicability of the communication requirements would be driven by the specific facts and circumstances of each situation. As such, and as permitted by PCAOB Section 3., Professional Standards, Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, any requirement whereby the circumstances did not exist would not be applicable.

Paragraph Level Comments and Suggestions for Improvements

Paragraph 2. "Nothing in this standard precludes the auditor from communicating other matters to the audit committee."

We believe this is also stated in Proposed Standard paragraph 23 and recommend that this duplication be deleted. However, if the Board believes this is a distinct requirement then that distinction should be more clearly stated.

This paragraph references Appendix B which lists other PCAOB rules and standards that require communication of matters to the audit committee. This listing refers to AU 316 and AU 317, while footnote 35 to Proposed Standard paragraph 23 also cites these standards. We recommend that footnote 35 be removed.

Paragraph 3. The objectives of the auditor are to:
a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

We suggest that the "objective" be contained in the engagement letter itself which sets forth the responsibilities of both the auditor and management. Therefore, we recommend the following wording: "Establish with the audit committee an understanding of the terms of the audit engagement which include communication of the auditor's and management's responsibilities in relation to the audit."

Paragraph 6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually.

In order for the audit committee to effectively oversee the audit and "establish an understanding of the terms of the audit" (for example, audit fees and the preapproval of permissible audit and nonaudit services), the final standard should require that the engagement letter be obtained prior to the start of field work. Therefore we recommend that the timing of the engagement letter be specifically addressed.

We note that Proposed Standard paragraph 7 seems to allow for the engagement letter to be at a date after the engagement begins, but before the engagement ends. That paragraph states: "If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to … continue … the engagement." In view of our recommendation, we suggest the word "continue" be deleted from paragraph 7.

Paragraph 6. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Question 3 makes it clear that the proposal allows the acknowledgment to be oral; however, we believe this evidence is insufficient "to establish an understanding of the terms" of the audit; the acknowledgement from the audit committee should be in writing.

Paragraph 7. If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept, continue, or perform the engagement.

The difference between "decline to accept" and "decline…to perform" the engagement is not clear, and we recommend deleting one or the other phrases.

Paragraph 9
Note: This overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures.

The Note to this paragraph also is applicable to paragraph 10(d) that discusses the scope of audit procedures performed by other auditors. We recommend that the Note be a footnote to both paragraphs 9 and 10(d).

Paragraph 10
b. The extent to which the auditor plans to use the work of the company's internal audit function in an audit of financial statements;
c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;

Paragraph 10(b) uses the phrase "work of the company's internal audit function" whereas 10(c) uses "work of internal auditors." We recommend that 10(c) be restated as "work of the company's internal audit function" unless there is some other distinction being made in which case these paragraphs should be clarified.

d. The names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

If the audit committee is engaging these other parties, their retention should be documented in the initial engagement letter, or in separate engagement letters. This common situation should be discussed in the final standard.

Paragraph 11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

We believe that any significant change in any of the communications in paragraphs 9 and 10 should be conveyed to the audit committee, as soon as is practicable.

Paragraph 12. Accounting policies, practices, and estimates; Critical accounting policies and practices; Critical accounting estimates

The disclosures covered in this paragraph are required disclosures in financial statements and in filings with the SEC, and the audit committee is required to read such financial statements and filings. In that all of these disclosures are prepared by management and that the audit committee has an open line of communication with management and oversees the financial reporting process, we do not believe these disclosure should be required to be made by the auditor (except to the extent already required by the SEC's rules and regulations, e.g., Reg. S-X Rule 2-07, *Communication with Audit Committees*). If the audit committee needs this information we believe it can be acquired directly from management. However, we believe that such matters as set out in paragraph 12 may, based on auditor judgment, be considered necessary to discuss based on the specific facts and circumstances and, for this reason, we suggest revising the guidance in paragraph 12 so that it is not a requirement.

Notwithstanding the above, we provide the following other comments on the requirements of paragraph 12:

Paragraph 12(a). Significant accounting policies and practices.

This term is defined in footnote 15. We recommend that it be defined in Appendix A and footnote 15 be deleted.

Paragraph 12(b). Critical accounting policies and practices.

The Note under 12(b)(2) is largely repeated in Proposed Standard Appendix A except for the substitution of "financial position" for "financial condition," and the omission of "and results [of operations]." We would include the last sentence from the Note that states "Critical accounting policies and practices are tailored to specific events in the current year and the accounting policies and practices that are considered critical might change from year to year," in the definition in Appendix A at A4.

To achieve better cohesion, we recommend placing like items together, thus paragraph 13(a) discussing qualitative aspects of "significant accounting policies and practices" should be moved to 12(a) ("significant accounting policies and practices").

The Note to 13(a) (belongs with the discussion at 12(c); whereas 13(b) is best understood in the context of paragraph 12(b) and should become 12(b)(3). Lastly, conclusions about "critical accounting estimates" should be included in the communication discussion under 12(c).

Paragraph 19. The auditor should communicate to the audit committee those corrected misstatements that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

We believe that only corrected material misstatements should be communicated or where the auditor has concluded that the company's internal controls over financial reporting were not effectively designed and/or implemented, such that they result in a significant deficiency or material weakness. Additionally, since the communication described in this paragraph, as we understand it, relates to AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, we recommend providing a cross reference to that standard to clarify the relationship between the two standards.

Appendix A – Definitions.

Definition of an audit committee.

We recommend that language similar to that found in SAS 114 (AU 380.16), *The Auditor's Communication with Those Charged with Governance*, be incorporated into the final standard. This paragraph states:

> "When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate."

Appendix C – Matters Included in the Audit Engagement Letter.

Paragraph C1.b.2. An audit includes:
a. Integrated audit: In fulfillment of the responsibilities noted above, the auditor should communicate:

> **1. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit in writing.**

Insert comma "identified during the audit, in writing."

Paragraph C1.b. 2.a.4. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion, in writing.

If the auditor determines that the audit committee is ineffective, he or she would then conclude there is a control deficiency in the company's internal control over financial reporting, therefore, we recommend that this paragraph should be footnoted and linked to paragraph 79 of AS 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements - Communicating Certain Matters*, and paragraph 5 of AU 325, *Communications About Control Deficiencies in an Audit of Financial Statements.*

Jack C Parsons
Audit Committees/Interim CFO/Financial and Risk Management Consulting
Reston, VA 20194
jcparsns@gmail.com

February 29, 2012

Sent via email: comments@pcaobus.org

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Rulemaking Docket No. 30

I appreciate the opportunity to provide comments on the PCAOB's Proposed Auditing Standard on Communications with Audit Committees.

During my career, I've been an audit partner with one of the major firms, a Professional Accounting Fellow at the SEC, CFO of several public companies, an executive with two startup entities, a financial consultant, and an investor. As a result, I've been in the role of auditor, regulator, preparer and user of financial statements. I had the opportunity to sit in on a recent Standing Advisory Group (SAG) meeting and, while listening to the dialogue among the members of the SAG, decided to provide my perspective on the various Board initiatives.

First, let me commend the Board for taking up the many important issues on its docket. Many of these issues have been discussed over a long period of time yet still remain unresolved. With respect to this proposed standard, I think we'd all agree that communication between the auditor and the audit committee is a critical component of the financial reporting system. It's clear that in order for the system to work effectively, there must be excellent and ongoing communication among management, the auditors, and the audit committee. The Sarbanes-Oxley Act of 2002 imposed additional requirements on the audit committee and, as a result, I believe the audit committees have become more effective during the past 10 years. In addition, we're all focusing more on the critical role played by the audit committee and, therefore, I'm very much in favor of doing what we can to ensure that the audit committee is fully informed of the issues that impact the company's financial reporting. Communication between the auditor and the audit committee is a key component of that communication.

Overview

I think the Board has done an excellent job getting this proposed standard to its current state through the initial release, the follow-up roundtable discussions, and this updated release. It's clear that a great deal of effort went into this very important project.

As someone who is actively seeking audit committee roles, this project is very important to me. As I read through the release, I did so from the perspective of what I'd view as critical information from the auditor in carrying out my audit committee duties. I was pleased that the Release covers many of these items.

One of the issues that I'm sure the Board and staff had to deal with was how much detail to get into as opposed to providing more general guidance to ensure an improvement in the quality of the information provided rather than simply an increase in quantity. In all of the various projects being addressed by the Board, the topic of additional boilerplate language comes up – none of us is interested in more wording that doesn't say anything of substance. I think we need to be cautious about creating such a system and be sure we're focused on efforts of trying to improve the quality of the information communicated by the auditor to the audit committee. I commend the Board for striking what appears to me to be a reasonable balance here.

Another cautionary point regards whether the communication should come from the auditor or management. When I think of communication from the auditor, I'd be looking for the auditor to inform me about their audit strategy and then to provide me with their opinions and perspectives on the financial statements and internal controls over financial reporting based on the results of their audit. The audit committee gets a substantial amount of information from management and it needs to know that the auditor has also looked at this information and has formed opinions on its accuracy and completeness. The auditor also has a perspective on what others in the company's industry are doing in certain key areas or whether there are any current discussions among the rulemaking bodies with respect to any topics, and can share that objective perspective with management and the audit committee. They can also inform the audit committee whether the policies and practices of the company are on the conservative side or are more aggressive than others. The Release addresses this to some extent with its comments on sharing with the audit committee whether the auditor sees a bias on the part of management in its various estimates. But it's this type of input that is very valuable for the audit committee to hear from the auditor. In some cases, it seems to me that the Release puts the initial communication burden on the auditor in areas where it seems that management should be the primary communicator, thus blurring to some extent the respective roles of the two.

I also find myself very concerned about the quality of financial reporting in these difficult economic times because of the additional burden that economic uncertainty places on each of management, the auditor and the audit committee in carrying out their respective roles. As I think through the various components of the balance sheet, in just about every area there are judgments that must be made about future sales, timing of cash flows, interest rates, etc that have a substantial impact on the reserves that are established and any impairment losses that should be recognized. As an audit committee member, I'd want to spend a considerable amount of time with management and the auditors reviewing each balance sheet account to ensure that reserves have been established after giving appropriate recognition to these factors. I'd also want to know what other companies are doing in these same areas. As we know, when times get tough, there's a tendency to write off as much as possible given the uncertainty, which then allows for better reported results when things improve. As an audit committee member, I'd want to be sure that all these areas were addressed by all of us in considerable detail and that appropriate documentation is prepared to support the decisions that were made.

Related to that, I believe that all three parties – management, audit committee and auditor -- should be involved together in all these discussions given the significant, yet different, role that each plays in ensuring that the financial reporting system works effectively. I understand the focus of this Release is on communication from the auditor to the audit committee, consistent with the role of the PCAOB, but in my experience all three parties participate in these discussions. I note some specific areas later in this letter where I think some revisions can be made to ensure that this is the expectation of the Release.

Separate from the issues discussed in this Release, I would encourage the Board to consider how best to ensure that the audit committee is informed when their company's audit has been selected for audit by the PCAOB inspections team and how best to communicate the findings. I'm not sure exactly how this happens today but clearly this is key information for the audit committee in evaluating the work of the auditor and assessing the scope of future audits. Further to this point, I know it would be helpful for all audit committee members to be aware of the issues the inspections teams are finding during their audits of other companies. The Board may want to find a way to summarize their findings in a manner that would be beneficial to all audit committee members.

Lastly, I found the trail in Appendix 4 from the original release to this updated release very helpful in understanding the conclusions reached by the Board. Comments were clearly considered and changes made in some cases and original positions retained in others. I was a bit surprised by the limited comment letters received from audit committee members given the significance of this release to them.

Specific Comments

In reading through the final Release and the trail in Appendix 4, and considering the expectations regarding communication from the auditor that I would have as an audit committee member, I would offer the following comments:

Appointment and Retention

Like other commenters, it seems to me that the responsibilities of the audit committee should also be addressed in the engagement letter, along with the responsibilities of the auditor and the responsibilities of management. We all recognize the important role the audit committee plays in the audit and so it seems appropriate for the Board to take this opportunity to recommend engagement letter wording that describes that important role, despite the fact that it may be described elsewhere. As stated earlier, I think the Board should take every opportunity, in this Release and others, to stress the importance of active participation and communication between all three critical parties: management, audit committee and auditor.

Obtaining Information and Communicating the Audit Strategy

As an audit committee member, I would expect to engage in a discussion with the auditor regarding the timing of audit procedures and the degree of reliance that the auditor will be placing on the company's system of internal controls. By that I mean, I would expect to understand how much work will be done at an interim date and how much will be done after year-end and to what extent the year-end substantive testing will be reduced because of the reliance on the system of internal controls. This discussion would also include a discussion of the work done at each quarter and how that work impacts the annual work. Included in this discussion would be agreement on the dates the auditors will be at the Company and the intended earnings release dates and SEC reporting dates. Maybe the fix for this would be to simply add some words about timing and internal control reliance in paragraph 9 or 10.

Results of the Audit

Accounting Policies, Practices and Estimates

I would recommend that this section be clarified to make it clear that the auditor is not the primary party responsible for communicating accounting policies, practices and estimates. I see this as the role of management and I would look to the auditor to provide the audit committee with their view of the appropriateness of management's selection and any concerns they may have regarding bias on the part of management in this area. As an audit committee member, I would want to review each of the policies and practices described as significant or critical with the auditor and determine whether the list is complete and whether the auditor has any issues or concerns in this area. I think the Note in paragraph 12c helps a bit by indicating that management is likely to make these communications but it still suggests that the responsibility is the auditor's. While I agree that all the items listed should be discussed by the auditor with the audit committee, maybe the fix here would be to simply change the wording a bit so that for each item it states that the auditor should review with, and provide its views on, management's selection, application, changes, etc regarding these key policies and practices, and that the expectation is that these discussions will occur with all three parties present.

As I mentioned earlier, I view this area as critical for substantive discussions among the auditor, management and the audit committee given the uncertain economic times and the impact that uncertainty has on management's ability to make reasonable judgments and estimates regarding future events that drive the recognition of reserves, accruals and impairment losses.

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

I think this section much more clearly defines the role of the auditor in the communications with the audit committee than does the previous section, discussed above. All of these items are those that I would expect the audit committee would discuss at length with the auditor.

In addition to matters on which the auditor consulted outside the engagement team, I think it's important for there to be a discussion between management, the auditor and the audit committee regarding any third parties engaged for the purpose of determining FMV of various holdings – those engaged by the company, and those engaged by the auditor, the respective conclusions, and how those conclusions impacted the company's financial results.

Not sure if it should be in this section or elsewhere but the issue of period-end revenue events of significance should be an area of discussion. Often, transactions are entered into at the end of a period on terms that might not be offered earlier in the period and there may be questions of whether the company has fully delivered on its commitments in order to support revenue recognition. I would suspect that the topic of end-of-period items of significance is addressed in every audit committee meeting in which a discussion of earnings results occurs and the Board may want to consider including some reference to this in the Release.

Significant Unusual Transactions

As an audit committee member, I would certainly expect the auditor to bring to the committee's attention any significant transactions they encountered during the audit that struck them as unusual. I expect that's being done now, but it seems clearly worth including in this Release.

Another thought, perhaps worthy of mention in the Release, whether in this section or another, is the issue of related party transactions. Clearly the audit committee should be made aware of all such transactions.

Uncorrected and Corrected Misstatements

I think the point about how any uncorrected differences might impact future periods is an important one so all parties understand that decisions made in the current period have implications down the road. It's also important for the audit committee to understand how the auditor assesses materiality – quantitatively and qualitatively, including the very important issue of whether the uncorrected differences would have caused the company to miss earnings estimates that support its current stock price.

I think also with respect to paragraph 19, the audit committee should be made aware of significant adjusting journal entries recorded at the end of the period to correct any system issues, to reconcile accounts, or to adjust reserves or accruals.

Form and Documentation of Communications

To the extent possible, I think matters discussed with the audit committee should be in writing. I would expect that the topics to be discussed at the audit committee meeting would be identified in a meeting outline with supporting memos for some items; other items on the agenda may simply be discussed with the committee.

Timing

Certainly all communications should occur before issuance of the auditor's report; most should occur before the release of earnings; and some should occur before the commencement of fieldwork.

Appendix C – Matters Included in the Audit Engagement Letter

As mentioned above, I would recommend including the audit committee's responsibilities, consistent with the description provided for the auditor and for management.

Once again, I appreciate the opportunity to provide comments on this Release. Please contact me if you have any questions or require any further explanation of my comments.

Sincerely,

Jack C Parsons

P B T K
PIERCY BOWLER
TAYLOR & KERN
Certified Public Accountants
Business Advisors

February 16, 2012

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

Transmitted by e-mail to: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 030

We are pleased to respond in this letter to the Board's reproposed standard (RS) entitled *Communications with Audit Committees* that is contained as Appendix 1 to its Release No. 2011-008 (the Release) of December 20, 2011. We previously responded briefly (Comment Letter No. 23) on May 28, 2010, to its earlier proposal issued March 29, 2010, in Release No. 2010-001. Our comments that follow are consistent with those made earlier.

As we stated in our response to the 2010 proposal, we agree in principle with the objectives of auditor communications with audit committees, as now set forth in the second paragraph of Part I of the Release; however, we continue to find the overall tone of the RS (as suggested in the comments of many others in response to the Board's earlier proposal) to be largely one of misplaced responsibility, *i.e.,* inappropriately shifting primary responsibilities for communicating (or inquiring) about certain matters from management (or the audit committee) to the auditors. A similar view is expressed in the excellent letter of January 10, 2012, from the distinguished Prof. Dennis R. Beresford (Comment Letter No. 1), who writes from the perspective of an audit committee member. Prof. Beresford wisely states (among other things with which we strongly concur) that the RS "does not acknowledge the proper roles of the auditor and management in certain key respects." Perhaps this phenomenon results from the practical reality that only auditors are subject to the regulatory control of the PCAOB.

Our specific responses to the seven questions posed by the Board in the Release are contained in the attachment. Our overarching concerns, however, are set forth in detail in the following five paragraphs, which are numbered to facilitate referencing, where applicable, from the responses in the attachment.

1. We believe it clearly should be management's primary responsibility, not the auditor's, to inform the audit committee of accounting and other matters involving the financial statements, rather than the audit process, including but not limited to "significant unusual transactions that are outside the normal course of business," the effects of management's decisions regarding the selection of accounting methods from available alternatives, methods used for accounting estimates, and sensitivity of estimates to changes in assumptions. Many such matters are typically disclosed in management's discussion and analysis drafts of which ordinarily should be reviewed by audit committees prior to filing with the SEC. Except as necessary to comply with the requirements of Rule 2-07 of Regulation S-X (see paragraph 4, below), auditors otherwise may rightfully be required to comment supplementally on management's communications to the audit committee if necessary. However, the auditor's communication responsibilities to the audit committee regarding such matters should always be secondary to management's.

2. Although we believe the audit committee rightfully should have a responsibility to assess and continually reassess the auditor's professional competency, the committee should not be encouraged to second guess audit strategy and scope decisions (including with respect to staffing), which should

remain primarily the responsibility of the auditor. We believe mandatory, proactive auditor communications about matters of audit scope, regardless of the required level of detail, would likely have the effect of inappropriately encouraging such second-guessing by audit committees. Rather, auditors should remain prepared to react responsively to appropriate questions about audit strategy and scope from audit committees but only to the extent, in the auditor's sole judgment, that the effectiveness of the audit process is not compromised. Accordingly, we believe the final standard should contain cautionary language to this effect regarding audit committee communications of matters of audit strategy and scope, which language should emphasize the need for auditors to guard against allowing such communications to present exposure to the risk of circumvention by management. Such language (regarding client access to engagement documentation) is contained in the Auditing Standards Board's AU sec. 339.31 but was not retained by the PCAOB when it was superseded by AS 3.

3. We believe a standard should encourage auditors to strive to preserve an ability (a) to evaluate objectively the effectiveness with which management and the audit committee interact and communicate with one another, and (b) to report perceived weaknesses in the process, and (c) to address such weaknesses appropriately in setting audit scope. However, we firmly believe that, like that of its predecessor proposal, the tone of the RS puts the auditor in the position of inappropriately attempting to regulate audit committees by telling them what the PCAOB thinks they should want to know. We see this as attempting to patch a weakness perceived in the performance of audit committees that results from a lack of regulatory pressure thereon from a more appropriate source such as the SEC. Except when seen as directly and significantly affecting the reporting entity's internal control over financial reporting, it should not be the auditor's responsibility to dictate to audit committees what they should be interested in to further the effectiveness of their oversight objectives (nor should it be the responsibility of those who set auditing standards). They should, however, report perceived weaknesses in the oversight process to the extent they are seen as deficiencies in internal control over financial reporting.

4. The Release makes several references (specifically, in paragraph 2 of Appendix 4 thereto and in several footnotes) to the SEC's Rule 2-07 of Regulation S-X (17 CFR 210.2-07), but the text of the RS, itself, does not. Several terms used in Rule 2-07 that are derived and used *verbatim* (and without explanation) from SOX Sec. 204 are unclear. We believe the utility of a final standard on audit committee communications would be substantially enhanced by including supplemental guidance that would appear within its text (or an appendix) as to the meaning of such vague and imprecise terms and otherwise as necessary to enable consistent compliance with Rule 2-07. For example, the term, "discussed with management," is a qualifying term used to determine when Rule 2-07 applies to communicating alternative accounting policies practices available under generally accepted accounting principles. Guidance as to meaning of "discussed with management" should also be made applicable when the term is used with respect to pre-appointment/retention issues now contained in paragraph 4 of the RS. In addition, the standard should contain a clear definition of what is meant by the term, "critical accounting policies," and an explanation of what is meant by the term, "to be used," with respect thereto. Moreover, guidance provided by the SEC in 2003 in its Release 33-8183 as to the content of certain communications required by Rule 2-07 is not readily accessible by many practitioners and should be included in the standard.

5. Lastly, we agree with Prof. Beresford that the final standard should not permit auditors to comply with only oral communications, as provided in paragraph 24 of the RS. Oral communications are too likely to be misunderstood (or even denied).

Thank you for this opportunity to comment. Once again, we hope the Board finds our comments useful in its deliberations on this important matter. Please contact the undersigned at hlevy@pbtk.com or 702/384-1120 if there are any questions about these comments.

Very truly yours,
Piercy Bowler Taylor & Kern, Certified Public Accountants

Howard B. Levy

Howard B. Levy, Principal and Director of Technical Services
Attachment

Q1. *Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?*

A1. No. For reasons set forth in paragraph 2 of this letter, we do not believe auditors should be required to be proactive in discussing their risk assessments and other scope judgments with audit committees, but rather they should limit such discussions to responses to direct questions and only to the extent that, in the auditor's sole judgment, the effectiveness of the audit process is not compromised.

Q2. *The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?*

A2. No. We believe there already are sufficient audit committee communication requirements in current standards relative to "results of procedures performed during the audit," as we would interpret that term or a similar term such as "results of the audit." (Neither term is defined in Appendix A to the RS.) This question, however, incorrectly asserts that the RS would limit required communication to those "based on results of procedures performed" when, in fact (and inappropriately, in our opinion, in many instances), the RS reaches far beyond such a limit. Moreover, paragraphs 12-16 of the RS deal with matters that, although quite likely to have come to the auditor's attention during the audit, and perhaps appropriate for auditors to comment upon in audit committee communications, are not appropriately characterized, in our view, as "results" of audit procedures performed.

Q3. *The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.*

a. Is the requirement in the standard clear?

A3a. Yes. However, in the event the engagement letter is executed by management rather than the audit committee or its chair (as would be permitted under paragraph 6 of the RS), we believe the letter should contain management's representation of its authority to engage the auditor on behalf of the committee, and it should be management's responsibility to provide the engagement letter to the audit committee and the committee's responsibility (or its chair's) to notify the auditor in the event it takes exception thereto.

b. *As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?*

A3b. As noted in A3a, above, we do not believe the final standard should contain a mandatory or presumptively mandatory requirement for an auditor to obtain any positive acknowledgement of agreement by the audit committee, but if such an acknowledgment were to be required, we believe it should be in writing even if only indirectly such as in the committee's minutes (if available timely). Whatever is the Board's final position on the form of acknowledgment, however, we believe it should be presented in the body of the final standard (near what is now paragraph 6 of the RS) and not merely in an appendix as it now appears.

Q4. *Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?*

A4. No. For reasons set forth in paragraph 1 of this letter, we do not believe auditors should be required to be proactive in reporting significant unusual transactions to audit committees, as set forth in paragraph 14 of the RS, but rather they should limit their audit committee communications on such matters to commenting on management's reports to the audit committee about such matters. (See A5, below.)

Q5. *Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?*

A5. No. Paragraph 12 the RS states that "if management communicates matters related to accounting policies, practices, and estimates to the audit committee, the auditor does not need to communicate these matters at the same level of detail as management as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor is required to communicate any omitted or inadequately described matters to the audit committee." However, we believe such language should be expressed positively as the preferential form of communication (the "default," if you will, *i.e.*, management reports; auditor comments), not merely an acceptable second choice alternative. Moreover, as we stated in paragraph 1 of this letter, we believe such language should be extended to clearly apply to substantially all accounting matters and others involving the financial statements.

Q6. *Are the amendments to other PCAOB standards appropriate? If not, why?*

A6. We have not undertaken to respond to this question.

Q7. *The Board requests comments regarding the audits of brokers and dealers on the following matters:*

a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?

A7a. No. We believe the financial oversight responsibilities of audit committees or their equivalents are, and should remain, intended to serve the needs of public holders of equity interests and that auditor communications have been, and should continue to be, intended primarily to assist such committees in meeting such responsibilities, rather than to assure that auditors obtain information from the committees to aid them in scope determination (which objective we believe would be met without such a standard). Accordingly, we do not believe the requirements of either the current interim standard, AU sec. 380, or the RS should be deemed applicable to securities broker-dealers that are not issuers.

b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

A7b. No. See A7a, above.

c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

A7c. No. See A7a, above.

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

February 29, 2012

RE: PCAOB Rulemaking Docket Matter No. 030, *Proposed Auditing Standard Related to Communications With Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Sec. 380*

Dear Mr. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") *Proposed Auditing Standard Related to Communications With Audit Committees; Related Amendments to PCAOB Standards;* and *Transitional Amendments to AU Sec. 380* (the "proposed standard" or "proposal"), and to respond to questions posed in the proposal's accompanying Release No. 2011-008 (the "release"). We believe that an informed and engaged audit committee is an integral element of a high quality financial reporting system. An audit committee that has robust communications with the company's independent auditor will be better able to execute its responsibilities. Likewise, the independent auditor also benefits from these communications, gaining important information and insights that can further enhance the quality of the audit.

We commend the Board for issuing a re-proposal of the proposed standard and appreciate the Board's responsiveness in considering, addressing and providing feedback with respect to comments received on the original proposal. Although we respectfully offer some suggestions that we believe will further improve the proposal, we applaud the Board for moving forward on this critical subject. In the remainder of our letter, we have organized our overall observations and suggestions about the proposal into the following topical areas:

- Applicability to the audits of brokers and dealers
- Use of others not employed by the auditor
- Establishing an understanding of the terms of the audit with the audit committee
- Use of the release to interpret requirements
- Changes in significant accounting policies
- Proposed amendment to quality control standards
- Communication of inspection results

Applicability to the audits of brokers and dealers

In response to question 7(b) of the release, we do believe that the proposed standard should be applicable to all audits of brokers and dealers. However, we also encourage the Board to address the matter discussed below to improve the clarity of the proposed standard as it relates to these audits.

In connection with the audits of nonissuer brokers and dealers that are subsidiaries of issuers, the proposed standard should clarify that auditor communications are required within the governance structure established at the nonissuer which, in the absence of an audit committee or board of directors, could be the CEO or other persons designated to oversee the accounting and financial reporting process. In such situations, requiring communications to the parent's audit committee about the audit of a subsidiary could diminish the effectiveness of the required communications. Therefore, we recommend that the definition of "audit committee" in Appendix A be clarified to indicate that communications are required within the governance structure of the subsidiary and need not be directed to the parent's audit committee.

Finally, in response to question 7(a) of the release, we support the application of the Board's interim standard, AU 380, to audits of brokers and dealers prior to the effective date of the proposed standard.

Use of others not employed by the auditor

Paragraph 10d of the Proposed Standard requires the auditor to communicate to the audit committee the "names, locations, planned roles, and responsibilities, including the scope of audit procedures, of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit."

We support a communication requirement that will enhance the audit committee's understanding of the auditor's use of others to support the audit effort. Communicating the involvement of other audit firms in the consolidated audit is routinely done now. Often the work of others who are not employed by the auditor, however, is limited to routine audit procedures such as, for example, a physical inventory observation at a foreign location, and is insignificant in terms of time. Accordingly, we recommend that the Board establish a threshold for communication about the work of others not employed by the auditor to ensure that such communications are meaningful to the audit committee. We believe a minimum threshold percentage consistent with that ultimately used in the PCAOB's proposal, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2* would be appropriate.

Establishing an understanding of the terms of the audit with the audit committee

Question 3(a) in the release asks whether the requirement that the auditor have the engagement letter executed by the appropriate party or parties on behalf of the company, and if the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement, is clear. We believe this requirement from paragraph 6 of the proposed standard could be further clarified. Specifically, we recommend the following revision (proposed deletions are in strikethrough):

> The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually. The auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company. [Footnote omitted.] If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged ~~and agreed to~~ the terms of the engagement.

Neither the proposed standard nor the release describes how "agreement" differs from "acknowledgement" and, therefore, introducing the term "agreement" has the potential to cause unnecessary confusion. Paragraphs 5 and 7 focus on "establishing an understanding of the terms of the engagement with the audit committee." In our view, the purpose of the requirement in paragraph 6 is to obtain the audit committee's acknowledgement of its understanding of the terms of the engagement when the engagement letter has been executed by parties other than the audit committee or its chair. If the PCAOB retains both "acknowledged" and "agreed," we recommend that the PCAOB describe how these terms differ.

Question 3(b) asks whether the acknowledgement by the audit committee, or its chair on behalf of the audit committee, should be required to be in a written form, or whether oral acknowledgment is sufficient. We recommend requiring the auditor to obtain written acknowledgement from the audit committee, or its chair on behalf of the audit committee, of the audit committee's understanding of the terms of the engagement to avoid potential subsequent misunderstanding that the audit committee's oral acknowledgement has been obtained.

Use of the release to interpret requirements

As discussed in our May 27, 2010 comment letter on the original proposed standard, we believe that some of the guidance and examples that have been provided in the release would drive more consistent execution if instead contained in the standard itself. Examples of requirements that we believe would be enhanced by moving guidance and examples from the release into the standard are identified below.

Obtaining information from the audit committee

Paragraph 8 of the proposed standard requires the auditor to inquire of the audit committee whether it is aware of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violation of laws or regulations and complaints or concerns raised regarding financial reporting matters. We recommend adding the following example from page A4-7 of the proposal after this requirement:

> Such matters may include, for example, strategic decisions that might significantly affect the nature, timing, and extent of audit procedures.

New accounting pronouncements

Paragraph 13(f) of the proposed standard requires the auditor to communicate to the audit committee situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. Page A4-29 of the proposal states that "The auditor might be concerned about changes to accounting or disclosure processes, or systems that could affect financial reporting or whether management has devoted adequate resources to the pending adoption." We believe this guidance adds clarity to the scope of the requirement and should be incorporated into paragraph 13(f) of the proposed standard.

Disagreements with management

Paragraph 21 of the proposed standard retains from AU 380, *Communication With Audit Committees*, the Board's interim standard, a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Page A4-38 of the proposal states that "Examples of disagreements might include disagreements with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report." We believe this clarifying guidance, which appears in the Board's interim standard, should be incorporated into paragraph 21 of the proposed standard.

Changes in significant accounting policies

Paragraph 12(a)(1) of the proposed standard requires the auditor to communicate to the audit committee "management's initial selection of, and changes in significant accounting policies, or the application of such policies in the current period." We believe the rewording of this requirement has lost the clarity of the Board's interim standard and raises questions about whether the phrase "changes in" applies to the company's application of significant accounting policies in the current period. As currently drafted, one might infer that the application of significant accounting policies needs to be communicated in the current period even if there is not a change. We do not believe such communication on an annual basis would be meaningful to audit committees unless a significant accounting policy is new or its application has changed in the current period. For example, the depreciation method may be a significant accounting policy, but its application is straightforward and need not be communicated annually unless there is a change. We recommend that paragraph 12(a)(1) be revised as shown below (proposed additions are in boldface italics; deletions in strikethrough) to clarify this requirement:

> Management's initial selection of, and changes in***,*** significant accounting policies~~,~~ or ***their*** ~~the~~ application ~~of such policies~~ in the current period;

Proposed amendment to quality control standards

Paragraph 16 of the Board's interim quality control (QC) standard, QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, currently requires that a CPA firm's policies and procedures should provide for obtaining an understanding with the client regarding the services to be performed. A proposed amendment to this paragraph would replace "client" with "audit committee." We recommend that the term "client" be retained because the quality control standards apply to attestation engagements as well as audits and interim reviews, and engagement letters for such services may be executed by management of the company, even though audit committee preapproval for such services may be required. We believe the Board's objective would be met by adding the following footnote to the word "client:"

> With respect to a financial statement audit or an audit of internal control over financial reporting that is integrated with an audit of financial statements, paragraph 5 of Auditing Standard [ ], *Communications With Audit Committees,* and paragraph 8 of AU 722, *Interim*

pwc

Financial Information, as amended, require the auditor to establish an understanding of the terms of the audit engagement with the audit committee as defined.

Communication of inspection results

In response to question 2 of the release, we agree that the communication requirements of the proposed standard are aligned with performance requirements in the risk assessment and other standards of the Board, where applicable. Although not a direct performance requirement in the current audit, we reiterate one of our comments on the PCAOB's *Concept Release on Auditor Independence and Audit Firm Rotation* and suggest that the PCAOB consider establishing standards to promote the consistency of communications with audit committees by the independent accounting firm of any PCAOB inspection results, together with any remediation related thereto, pertaining to their public company. We encourage the PCAOB to consider incorporating such communications in the proposed standard.

* * * * *

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 (646-471-6331), Brian R. Richson (973-236-5615) or Thomas Gaidimas (973-236-5036) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

From:	suzanne shatto
To:	undisclosed-recipients
Subject:	audit deficiencies and comment on PCAOB docket 030
Date:	Friday, January 20, 2012 4:37:55 AM

oh my.
the big 4 had audit deficiencies, by PCAOB standards. PCAOB is the association of auditing professionals. they are the people putting standards in place.
we cannot see the names of the companies that had deficient audits, just the names of the auditors and the PCAOB concerns.
http://pcaobus.org/News/Releases/Pages/10172011_DeloitteReportStatement.aspx

they have 12 months to cure the deficiencies found in their auditing procedures. i think that if a deficiency is found, appropriate action with the company's financial statements need to be taken. this appropriate action might be re-verifying balances, reporting to the SEC, reporting to the audit committee of the company that suffered from a deficient audit.

http://pcaobus.org/Inspections/Reports/Pages/default.aspx

i simply put them in date order by clicking on the column.
Deloitte & Touche LLP Dec. 7, 2011
Ernst & Young LLP Nov. 30, 2011
KPMG LLP Nov. 8, 2011
PricewaterhouseCoopers LLP Nov. 8, 2011

this is my comment to: Docket 030 : Proposed Auditing Standard on Communications with Audit Committees and Related Amendments to PCAOB Standards

i am quite concerned that auditors do not know what unusual transactions are, or know enough about the securities business to be able to tell when counterfeit stock has been submitted for sale or to clear a short sale, when reserve stock has been submitted for sale. then there is the practice of brokers allowing another broker to hold securities in lieu of settling short sales.

i think auditors should be very concerned to make sure that brokers have segregated their customers' portfolios. IOU's such as options or derivatives or ETFs do not substitute for stock because there is counterparty risk.

particular care should be taken with "penny stocks", a favorite of shortsellers because the size of the profit is greater.

from my review of financials of public brokers, customers owe the brokers significant $. most financials report a net figure, subtracting a certain percentage for "bad debt" from the gross amount. it may be informative to the stockholders of public brokerages to know the percentage allowed.

auditors should make sure that anti-money laundering procedures are being followed and that the brokers know the identity of their customer. recently, brokers
http://www.finra.org/Industry/Issues/AML/P123857

http://www.sec.gov/about/offices/ocie/riskalert-mastersubaccounts.pdf
http://www.sec.gov/news/press/2011/2011-198.htm

Suspense Accounts Could Be Killers
http://www.securitiestechnologymonitor.com/blogs/garaventa-morgan-stanley-lessons-to-learn-29702-1.html

FINRA Case
#2010021779801
http://www.finra.org/Industry/Enforcement/DisciplinaryActions/
there are multiple companies fined for major problems.
search for any term in the online database.

auditors might want to receive the information in this SEC compliance seminar:
http://www.sec.gov/news/press/2011/2011-256.htm
to be webcast january 31, 2012.

further, there seems to be an increasing amount of debt that the broker owes the customer. i find it hard to believe that either of these two categories describe the trading within the last two days, before settlement. rather, the amounts appear so large as to overwhelm their customer portfolios.

if a broker is allowing significant trading to delay settlement past three days, this would be a "significant" problem. while brokers have been allowed up to 13 days to "fix" transactions, it is illegal to postpone settlement because either the broker or the shortseller didn't want to settle on time.

all transactions should settle within 3 days. shortselling transactions should have borrowed stock so that imaginary short shares do not inflate the # of shares on the market. all outstanding shortselling should be covered by these borrowed shares. the borrowed shares should be shares of customers who have margin accounts that have borrowed broker funds in order to purchase those shares. it cannot be assumed that all margin customers have loans outstanding on their account. if the transaction cannot settle within 3 days, the broker must make every effort to settle the transaction for their client or buy in the position themselves.

therefore, these outstanding balances should be trading that is less than 3 days past the trade date.

auditors represent an objective opinion, to the stockholders, to the prospective stockholder, and to the market in general.

it is important to verify that customers own their stock, with complete rights of title. counterfeit stock certificates do not deliver title to the customer. imaginary stock certificates do not deliver title to the customer. margin customers also have a right to title, even if they owe some $ to the broker because they wanted to buy the title. brokers have a fiduciary duty to their clients to control and maintain custody of their customers' purchases. if a customer purchases stock, they should be able to vote, they should be able to sell that stock, and they should be able to hold that stock.

if the buying broker does not deliver stock that was purchased by settlement, the investor's broker should buy that position in. the fact that a counterparty owes the broker's customer means that the broker should take every opportunity to acquire the stock, including buying in the position. the broker's customer is not in a position to assess the financial position of the owing broker. but the customer's broker can take action to make sure that their customer does not suffer because of a prolonged debt. there is a mechanism that the customer's broker can take, and i think that it should be mandatory that the broker represent their customer well. further, simplying filling the position on a spreadsheet is insufficient to guarantee that their customer has title to real shares.

brokers do not own their customers' portfolios. there appears to be a confusion in the industry about title. however, if you rent a car, you cannot sell that car. if you buy a car, you want the car you purchased, not the promise of the car some time in the future. customers should be able to vote their shares or not vote at all.

brokers should not allow their clients (which includes correspondent brokers) to short stock without borrowing shares. at the end of every trading day, there should be no short shares that are imaginary. all short trades should have borrowed shares to make sure that the available shares of the company are not increased. this borrowing should occur on a daily basis until the transaction is settled. if no shares are available to borrow, the shares must be bought in. the selling broker has a responsibility to borrow shares or buy in, but if the selling broker does not do this, the buying broker must.

in my opinion, it is the responsibility of the auditor to make sure that these procedures are in place and followed. the operation of the stock market is part of national security.

the broker-audit rule is not new. it was just suffering from lax enforcement.

if an auditing deficiency is found, appropriate action with the company's financial statements need to be taken. this appropriate action might be re-verifying balances, reporting to the SEC, reporting to the audit committee.

people don't have a great deal of faith in the financial statement process. this is why investors are buying less stock. it is the auditor's position to restore faith in the financial position of companies. if you think this is unimportant, just think how great it would be to live in a country where the best investment would be under your mattress. money would stop flowing, disposable income would shrink, and we may have a new unelected government based on the fact that a few shortsellers and traders would have the majority of the $ and the people who earn $ by working would be poverty-stricken. if you think i am exaggerating, this would be the result of the black swan event brought on by flooding the market with imaginary shares and taking the investors' $. the stock market is barely forming capital now and the trend has been downward for a year. i think we are already having an emergency.

delay in implementing appropriate audit procedures risks such a black swan event.

suzanne hamlet shatto

SOCIETY
of Corporate Secretaries
& Governance Professionals

via e-mail to: comments@pcaobus.org

May 30, 2012

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

Re: PCAOB Release (No. 2011-008) on Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380 (PCAOB Rulemaking Docket Matter No. 030)

Ladies and Gentlemen:

The Society of Corporate Secretaries and Governance Professionals (the "Society") appreciates the opportunity to provide comments on the Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380, PCAOB Release No. 2011-008, issued on December 20, 2011 (the "Release") by the Public Company Accounting Oversight Board (the "PCAOB").

Founded in 1946, the Society is a professional membership association of more than 3,000 corporate secretaries, in-house counsel and other governance professionals who serve approximately 2,000 companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and their committees and the executive managements of their companies regarding corporate governance and disclosure. Our members generally are responsible for their companies' compliance with the securities laws and regulations, corporate law, and stock exchange listing requirements.

The Society appreciates the PCAOB's efforts to "benefit investors by establishing requirements that enhance the relevance and quality of the communications between the auditor and the audit committee,"[1] and we support the PCAOB's efforts to "encourage effective two-way communications between the auditor and the audit committee throughout the audit to assist in understanding matters *relevant* to the audit."[2] However, we believe that, due to rules adopted under the Sarbanes-Oxley Act of 2002 as well as leading practices, management and audit committees generally keep auditors well informed of developments. The Society therefore believes that the following proposed standard (the "Proposed Standard") is not needed and, if adopted, would not be helpful and indeed could be harmful to companies and their investors, and counterproductive to the stated objectives of the Release, as discussed below.

[1] Release at 2.

[2] Release at 3 (emphasis added).

240 West 35th Street, Suite 400 | New York, NY 10001 | 212.681.2000 *phone* | 212.681.2005 *fax* | governanceprofessionals.org

> "The auditor should inquire of the audit committee whether it is aware of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters."[3]

The Proposed Standard Is Overbroad and Overreaching

The Society believes that the Proposed Standard is too broad and overreaching. The Proposed Standard would require the auditor to inquire of the audit committee whether it is aware of matters that *might be* relevant to the audit. The fact that the Release repeatedly discusses the Proposed Standard in terms of actual relevance[4] to the audit is misleading because the scope of the auditor's inquiry of the audit committee under the Proposed Standard is much broader and would cover matters that are not only actually relevant, but also merely potentially relevant, to the audit.

We are concerned that the Proposed Standard would effectively impose an obligation on the audit committee to disclose to the auditors *all* matters related to the company's business, including *all* reports of violations or *possible* violations of laws or regulations by the company, as well as complaints or concerns raised by *any* person within the company or by *any* third-party. In response to the auditor's inquiry, members of the audit committee would appear to be compelled to discuss with the auditor all information, without any materiality or probability threshold,[5] that they receive from management, employees or third parties, simply due to the fact that the audit committee would be unable to conclude with any certainty that there is no chance that, in hindsight, any particular report or complaint of a potential violation of law or other matter will not have been deemed of potential relevance to the audit. The Proposed Standard would require disclosure of such reports or complaints even before they have been thoughtfully considered, evaluated, probed or properly investigated by the company. In addition, due to the breadth of the Proposed Standard, the abundance of information that the audit committee would be required to disclose in order to be responsive to the auditor's inquiry may also have the effect of obscuring material information that is truly relevant to the audit.

---

[3] Release at A1-3.

[4] The following statements in the Release imply that the Proposed Standard covers only matters actually relevant to the audit: "[t]he new proposed standard improves and enhances current auditor communication requirements by: …[e]nhancing the auditor's inquiries of the audit committee regarding matters *relevant* to the audit;" "[a]s described in the new proposed standard, the term, 'communicate to' is meant to encourage effective two-way communications between the auditor and the audit committee throughout the audit to assist in understanding matters *relevant* to the audit;" "[t]his standard requires the auditor to communicate certain matters related to the conduct of an audit to a company's audit committee and to obtain certain information from the audit committee *relevant* to the audit;" under the subheading in the Release "Obtaining Information *Related* to the Audit": "[a]dditionally, complaints or concerns may come to the audit committee's attention through the audit committee's process for reporting ethics violations or concerns related to financial reporting that are *relevant* to the audit." Release at 7, 3, A1-1, A4-7 (emphasis added).

[5] The Society acknowledges existing Paragraph 56.b.(3) of Auditing Standard No. 12, which requires the auditor to inquire of the audit committee, or equivalent, or its chair, in connection with the auditor's obligations to identify and assess the risks of material misstatements and associated inquiries regarding fraud risks, whether the audit committee is aware of tips or complaints regarding the company's financial reporting (including those received through the audit committee's internal whistleblower program) and, if so, the audit committee's responses to such tips and complaints. However, unlike the breadth of information that the audit committee would be compelled to divulge to the auditor pursuant to the Proposed Standard, existing Auditing Standard No.12 inherently contains probability and materiality thresholds, in that tips or complaints regarding the company's financial reporting are in fact relevant to the audit and thus also may, upon further inquiry as to scope, be material.

The Proposed Standard Would Confuse the Roles of the Audit Committee and Management

The Society believes that the Proposed Standard, if adopted, would fundamentally change the role of the audit committee from overseeing the accounting and financial reporting processes of the company and audits of financial statements of the company to becoming one of the original sources of information for the auditors. Ultimately, the implementation of the Proposed Standard may undermine management's responsibility for the financial statements and related disclosures and result in a confusion of the roles of the audit committee and management. Management is responsible for the preparation of the financial statements and related disclosures, and information relevant to the audit should be obtained through auditor's discussions with the management and management's representations to the auditors. The Proposed Standard, however, appears to effectively make the audit committee a guarantor of the accuracy and completeness of the financial statements and notes to financial statements, which has historically been management's, and not the audit committee's, responsibility.

The Proposed Standard Could Jeopardize the Attorney-Client Privilege and Work Product Protection and Threaten Sensitive Company Information

If the Proposed Standard is adopted and the audit committee is effectively forced to share with the auditor all of the information in its possession communicated from management, employees and others concerning potential violations and other matters, such information could be mishandled to the detriment of the company. The Proposed Standard indicates that the information provided to the auditors as a result of their inquiries to the audit committee may cause the auditor to adjust its planned audit procedures.[6] It would appear that the auditors, rather than the proper company personnel after thoughtful and careful evaluation of the information by the audit committee, Chief Compliance Officer or other authorized person(s), might in effect be deputized to conduct investigatory procedures via the audit process concerning matters that the audit committee may have not been prepared to communicate outwardly at all, and has not yet had an opportunity to properly evaluate. Directors have a fiduciary obligation to maintain company information in confidence (ordinarily deemed to be a component of the duty of loyalty), whereas auditors do not have such fiduciary duty. It would appear that all such information could lose its confidentiality status (whether incorporated into the auditor's work papers or not) with potentially significant harmful consequences to the company.

Similarly, the Proposed Standard appears to require the audit committee to disclose to the auditor violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters, including matters that can be investigated or litigated at the time of such disclosure. Such matters are typically "led by [in-house and outside] legal counsel and [result] in an accumulation of attorney-client communications, witness interviews, advice of counsel and other legal work product and analyses."[7] Attorney-client privilege encourages full and frank communications between attorneys and their clients and protects communications between attorneys and their clients. The related attorney work product doctrine prevents from production materials that disclose the

[6] The Release states that "[t]he new proposed standard does not provide specific timing for these inquiries [of the audit committee] to be made; however, information provided by the audit committee could require the auditor to adjust planned audit procedures. Therefore, performing these inquiries early in the audit process would enable the auditor to incorporate the information received from the audit committee into the audit strategy." (pp. A4-7, 8)

[7] *The Auditor's Need for its Client's Detailed Information vs. the Client's Need to Preserve the Attorney-Client Privilege and Work Product Protection: the Debate, the Problems, and Proposed Solutions* at 4 (Dec. 22, 2004).

attorney's theory or strategy regarding anticipated or pending litigation and protects the lawyer's analysis and views on litigation and potential litigation.

If the audit committee discloses privileged attorney-client communications or attorney work product to the auditor, the company may face a very substantial and serious risk that a court may later deem that such disclosures effectively waived the protections of attorney-client privilege and work product doctrine. If materials disclosed by the audit committee to the auditor become discoverable by the court due to the waiver of a privilege, it could well change the outcome of litigation and disadvantage the company's ability to win and/or negotiate a settlement negotiations, at the expense of shareholders. In the absence of consistent and uniform court decisions, companies have no guarantee that courts will protect attorney-client communication and attorney work product "from waiver as to the companies' adversaries if these materials are disclosed to auditors."[8] In addition, "companies that seek the assistance of legal counsel would only do so in the face of an unacceptable risk that counsel will be converted 'into a conduit of information between the client' and its adversaries."[9]

The Proposed Standard May Shift Oversight Responsibility for the Company's Corporate Compliance to the Auditor and May Harm the Company's Compliance Program

The Society believes that the Proposed Standard could harm a company's compliance program. Investors benefit from effective compliance programs that encourage and promote good faith reports of violations and suspected violations of laws and other compliance concerns. Such compliance programs are often tied to codes of ethics or conduct under existing SEC regulations and stock exchange requirements that require, among other things, the inclusion of standards to promote and encourage internal reporting of suspected or known misconduct to appropriate company personnel. In addition, under applicable exchange listing requirements, audit committees are charged with establishing procedures for: (i) the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters; and (ii) the *confidential*, anonymous submission by employees of such company of concerns regarding questionable accounting or auditing matters.[10]

Delaware case law, the Federal Sentencing Guidelines as well as the Sarbanes-Oxley Act, the Dodd-Frank Act and SEC rules promulgated under these acts emphasize that the board of directors, and often the audit committee in particular, should oversee the establishment and implementation of a corporate compliance program (of which the code of ethics/conduct discussed above is deemed an integral part) designed to detect corporate wrongdoing. An important part of the board's fiduciary oversight responsibility is its ability to exercise independent judgment as to how, when, what and to whom matters should be communicated, and how such matters should be handled.

The Proposed Standard, due to its breadth, may effectively eliminate the ability of the audit committee or the board to exercise independent judgment in this regard. It thus could compromise the audit committee's oversight responsibility and make it a mere conduit between management/employees and the auditor for suspected or known misconduct communicated (often with a legitimate expectation of confidentiality) to it by management and employees. The fact that the audit committee will be compelled to disclose all such information, without any materiality or probability threshold, that it

[8] Id. at 6.

[9] Id. at 6.

[10] *See* Rule 10A-3 promulgated under the Securities Exchange Act of 1934, as amended (emphasis added).

receives from management, employees or third parties, to the auditors (in many cases prematurely), who lack the fiduciary duties that the directors owe to the company and its shareholders, effectively shifts the audit committee's oversight role to the auditors. The Society believes that such shift is inappropriate and threatens to obstruct the objectives of the company's compliance efforts and the audit committee's oversight responsibilities.

In addition, critical to a company's efforts to promote and encourage internal reporting is assuring employees that they may report suspect and known violations in confidence and without fear of retaliation. The company's efforts to encourage and promote good faith reports of violations and suspected violations of laws and other compliance concerns may be compromised if employees believe that any information they share with the audit committee, will be communicated to the auditors, either directly or indirectly. The Proposed Standard would have the unintended effect of reducing candor and chilling communications between management and other employees and the audit committee regarding concerns and complaints related to potential violations and other compliance matters, thus reducing the availability of such information and impeding the effectiveness of the company's compliance program.

For all of these reasons, the Society does not support the Proposed Standard discussed in the Release.

We thank the PCAOB for its efforts to "enhance the relevance and quality of the communications between the auditor and the audit committee,"[11] and we would be happy to provide you with further information to the extent you would find it useful.

Respectfully submitted,

The Society of Corporate Secretaries and Governance Professionals

Robert B. Lamm,
Chair, Securities Law Committee

cc: James R. Doty
Lewis H. Ferguson
Daniel L. Goelzer
Jay D. Hanson
Steven B. Harris

[11] Release at 2.

STATE BOARD OF ADMINISTRATION
OF FLORIDA

1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

February 29, 2012

Mr. J. Gordon Seymour
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803
Via email: comments@pcaobus.org

RE: Proposed Auditing Standard Related to Communication with Audit Committees
PCAOB Release No. 2011-008 Rulemaking Docket Matter No. 030

Dear Secretary Seymour:

The State Board of Administration of Florida (the SBA) welcomes the occasion to provide comments to the Public Company Accounting Oversight Board (PCAOB) regarding Proposed Auditing Standard Related to Communication with Audit Committees. The SBA manages the assets of the Florida Retirement System, the fourth largest public pension plan in the United States with 1.1 million beneficiaries and retirees. The SBA's governance philosophy encourages companies to adhere to responsible and transparent practices that correspond with increasing shareowner value.

SBA staff supports the PCAOB's efforts to assess and inspect the effectiveness of current audit practices. European regulators are also currently reviewing the statutory audit of public-interest entities and the quality of financial audits. In light of the recent financial crisis, all market participants should be encouraged to continuously monitor risk and promote market stability. The key role of the audit committee is to protect the interests of investors through oversight of financial audit quality and integrity. Good communications between the audit committee and outside auditors plays an important role in the audit process and, in turn, leads to reliable financial statement information for all stakeholders.

Communication
SBA staff supports the approach that the PCAOB has taken in specifying the types of communications that should occur between the outside auditors and the audit committee. We agree that the discussions should include the audit strategy, structure, and timing, the assessment of risk areas (including fraud risks), the auditor's use of external experts and/or other auditors, difficult and contentious issues, significant unusual transactions, significant accounting policies and judgments or estimates, and going concern evaluation and issues. We also support improved disclosure surrounding the principal auditor's use of affiliated and non-affiliated firms to perform significant audit procedures. Additionally, audit committees should not agree to limit the liability of outside auditors and ensure this is clearly expressed in its communications with the outside auditors and shareowners.

Engagement

The proposed standard requires the outside auditors to have the engagement letter executed by the appropriate party or parties on behalf of the company. SBA staff believes that the acknowledgement by the audit committee, or its chair on behalf of the audit committee, should be required to be in writing. This formal record will provide assurance that each party has a clear understanding of the terms, objectives, and individual responsibilities of the audit process.

Significant Transactions

SBA staff finds the requirement for the outside auditor to communicate significant unusual transactions to the audit committee to be an appropriate standard. Additionally, it is correct to require the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters. These standards address concerns that audit committees may not be receiving adequate information from management on company financial reporting and/or that communications between the auditor and the audit committee is ineffective. This requirement can help to facilitate more complete communications and assist the audit committee in its oversight function.

As audit committees must actively communicate with outside auditors to fulfill their oversight responsibilities, institutional investors must continue to fulfill their fiduciary duty to strengthen the governance of companies in which they invest, including making informed voting decisions on the ratification of outside auditors and audit committee members.

Thank you for the opportunity to provide comments and for the PCAOB's ongoing efforts to improve audit quality. If you have any questions, please contact Michael McCauley, Senior Officer—Investment Programs and Governance, at (850) 413-1252, or governance@sbafla.com.

Sincerely,

Ashbel C. Williams

Ashbel C. Williams
Executive Director & CIO

cc: Governor Rick Scott, as Chairman of the SBA
Chief Financial Officer Jeff Atwater, as Treasurer of the SBA
Attorney General Pam Bondi, as Secretary of the SBA

Texas Society of
Certified Public Accountants

February 29, 2012

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

RE: Proposed Auditing Standard: *Communications With Audit Committees*

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of certified public accountants in Texas, as well as the public interest. The TSCPA has established a Professional Standards Committee (PSC) to represent those interests on accounting and auditing matters. The views expressed herein are written on behalf of the PSC. The PSC has been authorized by the TSCPA's Board of Directors to submit comments on matters of interest to the committee membership. The views expressed in this letter have not been approved by the TSCPA's Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the TSCPA.

In our discussion of the above referenced exposure draft, we considered each of the seven questions posed by the PCAOB (Board.) Our response to each question is indicated below.

Question 1: Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

We did not find the Appendix where the proposed standards were compared with the existing risk assessment standards. If we were to do this independently, we would be unable to provide assurance that our analysis was complete. Accordingly, we request the Board to provide this analysis and allow us to comment.

Question 2: The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing performance obligations?

We have no additional suggestions regarding matters that should be communicated to the audit committee that are based on existing performance obligations.

Office of the Secretary
Public Company Accounting Oversight Board
February 29, 2012
Page Two

Question 3: The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

a. **Is this requirement in the standard clear?**

   The requirement in the standard is sufficiently clear.

b. **As stated, the new proposed standard allows the acknowledgement by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgement sufficient?**

   Oral acknowledgement by the audit committee chair is sufficient.

Question 4: Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

We believe the Board should provide a definition of "unusual transactions." In today's business environment, it appears as though companies have wide ranging business models that make it most difficult to identify what constitutes an unusual transaction. Further, in condoning the requirement to make this communication to the audit committee, are we not putting the auditor in the position of the audit committee's business manager and a watchdog over management? We believe it would be a wise decision for the Board to rethink this requirement.

Question 5: Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

We believe it is appropriate for the auditor to communicate to the audit committee his or her views regarding significant **audit** matters when the auditor is aware that management has consulted other accountants about such matters and the auditor has identified a concern regarding these matters. However, most small- and medium-sized public companies have, as a part of their internal control over financial reporting, policies and procedures regarding consultation with other accountants regarding complex or unusual accounting matters. We believe the requirement should be modified as it relates to significant accounting matters to only communicate with the audit committee in situations where the auditor disagrees with management's conclusion on such matters (regardless of whether other accountants were consulted).

Office of the Secretary
Public Company Accounting Oversight Board
February 29, 2012
Page Three

Question 6: Are the amendments to the PCAOB standards appropriate? If not, why?

Except as addressed otherwise in this letter, the amendments to the PCAOB standards appear appropriate.

Question 7: The Board requests comments regarding the audits of brokers and dealers on the following matters:

a. **Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?**

   Yes, the PCAOB standard is a PCAOB standard audit. If we have to communicate to all audit committees, we should do it for brokers and dealers.

b. **Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?**

   If the PCAOB has authority over brokers and dealers, then it should.

c. **Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable to the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from audits covered by the new proposed standard.**

   No. Points to be covered are universal and should apply to all entities.

We appreciate the opportunity to provide input into the standards-setting process.

Sincerely,

Kathryn W. Kapka

Kathryn W. Kapka, CPA, CIA, CGAP
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants

The Institute of
Chartered Accountants
in Australia

13 March 2012

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

Email: comments@pcaobus.org

Sir / Madam,

PCAOB Rulemaking Docket Matter No. 030
PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES; RELATED AMENDMENTS TO PCAOB AUDITING STANDARDS AND TRANSITIONAL AMENDMENTS TO AU SEC. 380

The Institute of Chartered Accountants in Australia (Institute) is pleased to have the opportunity to respond to the above Rulemaking Docket.

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world.

Representing more than 70,000 professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

Chartered Accountants hold diverse positions across the business community, as well as in professional services, government, not-for-profit, education and academia. The leadership and business acumen of members underpin the Institute's deep knowledge base in a broad range of policy areas impacting the Australian economy and domestic and international capital markets.

The Institute of Chartered Accountants in Australia was established by Royal Charter in 1928 and today represents more than 58,000 members and around 12,500 talented graduates working and undertaking the Chartered Accountants Program.

The Institute is a founding member of the Global Accounting Alliance (GAA), an international coalition of accounting bodies and an 800,000-strong network of professionals and leaders worldwide.

As mentioned in previous submissions to the PCAOB we are of the view that, as a premier audit regulatory body, the PCAOB and its findings influence audit regulation globally and it is for this reason we offer our comments on this matter.

In summary we fully support efforts to improve communications between external auditors and audit committees. We consider an open and frank interchange to be a significant driver in enhancing audit quality and see the development of the proposed standard since the 2010 exposure draft to be positive.

Customer Service Centre
1300 137 322

NSW
33 Erskine Street
Sydney NSW 2000
GPO Box 9985
Sydney NSW 2001
Phone 61 2 9290 1344
Fax 61 2 9262 1512

ACT
L10, 60 Marcus Clarke Street
Canberra ACT 2601
GPO Box 9985
Canberra ACT 2601
Phone 61 2 6122 6100
Fax 61 2 6122 6122

Qld
L32, 345 Queen Street,
Brisbane Qld 4000
GPO Box 9985
Brisbane Qld 4001
Phone 61 7 3233 6500
Fax 61 7 3233 6555

SA / NT
L11, 1 King William Street
Adelaide SA 5000
GPO Box 9985
Adelaide SA 5001
Phone 61 8 8113 5500
Fax 61 8 8231 1982

Vic / Tas
L3, 600 Bourke Street
Melbourne Vic 3000
GPO Box 9985
Melbourne Vic 3001
Phone 61 3 9641 7400
Fax 61 3 9670 3143

WA
Ground, 28 The Esplanade
Perth WA 6000
GPO Box 9985
Perth WA 6848
Phone 61 8 9420 0400
Fax 61 8 9321 5141

The Institute of
Chartered Accountants
in Australia

The Institute continues to explore the role of audit committees and has recently completed a joint project with the United Kingdom's Financial Reporting Council, as well as the Institute of Chartered Accountants of Scotland, obtaining insights from members of audit committees across multiple jurisdictions. The resulting joint publication is titled *Walk the line: Discussions with leading audit committee members* and was launched in February 2012. A copy is attached for your information.

The Foreword to this paper captures the importance of the audit committee in corporate governance and interaction with the external auditor:

'The thoughts, insights and opinions presented in this paper certainly reiterate the pivotal role played by the audit committee in assisting the board of directors in enhancing the transparency and integrity of financial reporting. The paper highlights the importance of the committee having a clear remit and the right mix of skills and experience, and of the relationships it forges with management, the auditor and the rest of the board of directors to create a culture of open and frank discussion. It is this open debate and mature questioning that are fundamental to the effectiveness of the audit committee.'

Some participants even suggested that the audit committee was the single most significant board committee.

A matter which the PCAOB may wish to consider for the standard is for the inclusion of a requirement dealing with the following, which was included in the Australian equivalent of *ISA 260 Communication with Those Charged with Governance*:

Aus 19.1 If the auditor is concerned that a written report intended for those charged with governance has not been, or may not be, distributed to all members of that group, the auditor shall endeavour to ensure all members are appropriately informed of the contents of the report.

We would be happy to elaborate on the foregoing matters should you wish.

Yours sincerely

Yasser El-Ansary CA
General Manager - Leadership and Quality
Institute of Chartered Accountants in Australia

Walk the line: Discussions and insights with leading audit committee members

ICAS

FRC

The Institute of Chartered Accountants in Australia

The Institute of Chartered Accountants in Australia

The Institute of Chartered Accountants in Australia

We are the professional body for Chartered Accountants in Australia and members operating throughout the world. Members serve the public interest through their obligation to uphold high standards of service within many facets of the economy; in public practice and commerce, and sectors including government, not-for-profit and academia. The Institute has a pivotal role in promoting financial integrity in society. We do this through our leadership and our advocacy work on influencing policy and regulatory frameworks in Australia, and in relevant international settings. We represent up to 70,000 current and future business leaders, with more than 57,000 members, and around 13,000 talented graduates working and undertaking the Chartered Accountants Program. Through the Global Accounting Alliance, Institute members are also part of an 800,000-strong network of professionals and leaders worldwide. Established by Royal Charter in 1928, we have a long tradition of leading the Australian Chartered Accounting profession. You're welcome to find out more about the work we do at **charteredaccountants.com.au**

Financial Reporting Council (UK)

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC promotes high standards of corporate governance through the UK Corporate Governance Code. It sets standards for corporate reporting and actuarial practice and monitors and enforces accounting and auditing standards. It also oversees the regulatory activities of the actuarial profession and the professional accountancy bodies and operates independent disciplinary arrangements for public interest cases involving accountants and actuaries.

The Institute of Chartered Accountants of Scotland

The Institute of Chartered Accountants of Scotland (ICAS) is a professional body for around 19,000 world-class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country. We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in Europe and the UK, always acting in the public interest. ICAS is the first professional body for accountants and was created by Royal Charter in 1854. We are a member of The Global Accounting Alliance (GAA) – an alliance of the world's leading professional accountancy bodies, which was formed in 2005. The GAA is intended to promote quality services, share information and collaborate on important international issues. It works with national regulators, governments and stakeholders, through member-body collaboration, articulation of consensus views, and working in collaboration, where possible with other international bodies, especially IFAC.

Disclaimer

Copyright

First published February 2012

Published by:

The Institute of Chartered Accountants in Australia

33 Erskine Street, Sydney
NSW, 2000, Australia

Financial Reporting Council (UK)

5th Floor Aldwych House, 71-91 Aldwych,
London WC2B 4HN, United Kingdom

The Institute of Chartered Accountants of Scotland

CA House, 21 Haymarket Yards,
Edinburgh, EH12 5BH, United Kingdom

Walk the line: Discussions and insights with leading audit committee members

ISBN: 978-1-921245-91-6

Foreword

In an increasingly interconnected world with internationalisation of the business environment and major markets, it is important to invest time in forging collaborations.

The Institute of Chartered Accountants in Australia, the Institute of Chartered Accountants of Scotland and the Financial Reporting Council in the United Kingdom have collaborated to present an international view on the role of audit committees in helping their boards discharge their financial and fiduciary responsibilities to shareholders.

Our joint project involved direct meetings and telephone interviews with chairmen of audit committees and boards in different jurisdictions around the world, but with a particular focus on companies based in Australia and the United Kingdom. We would like to take this opportunity to thank each of the participants, listed in Appendix 2, who so generously gave up their time to contribute to this paper. We would also like to acknowledge the assistance of the UK Audit Committee Institute for arranging and participating in many of the interviews.

The thoughts, insights and opinions presented in this paper certainly reiterate the pivotal role played by the audit committee in assisting the board of directors in enhancing the transparency and integrity of financial reporting. The paper highlights the importance of the committee having a clear remit and the right mix of skills and experience, and of the relationships it forges with management, the auditor and the rest of the board of directors to create a culture of open and frank discussion. It is this open debate and mature questioning that are fundamental to the effectiveness of the audit committee.

A strong sentiment prevails among audit committee chairmen we interviewed: their role and responsibilities are well understood and there is a clear understanding of the leadership, knowledge and accountability needed to provide for their committees to operate effectively. This suggests that a major overhaul of the remit and the composition of audit committees is probably not necessary. But challenges still remain, not least how to communicate meaningfully to shareholders what audit committees are doing to protect their interests.

Lee White FCA
Chief Executive Officer
The Institute of Chartered Accountants in Australia

Stephen Haddrill
Chief Executive Officer
Financial Reporting Council (UK)

Anton Colella
Chief Executive
The Institute of Chartered Accountants of Scotland

Contents

Executive summary

Many of the prominent failures of corporate governance in the last couple of decades have involved breakdowns and deficiencies in communication, internal control processes and financial reporting. Unfair to some, the perception is that boards and audit committees failed to prevent these failures and the external auditor failed to discover them.

The upswing of government intervention and the general call from investors for transparency and corporate accountability demands a response from boards, management and auditors. Against this backdrop, the role and function of the audit committee has come under the spotlight.

To explore the workings of the audit committee further, the Institute of Chartered Accountants in Australia, the Financial Reporting Council (UK) and the Institute of Chartered Accountants of Scotland have interviewed audit committee chairmen and others involved in working with audit committees of top tier companies in major securities markets to learn how these committees work and the challenges they face.

Questions were designed to evoke discussions around how these leading practitioners ensure their committees are effective (these questions are summarised in Appendix 1). It is believed that these reflections will be of wider interest, particularly to other audit committee members, while recognising that there is no 'one-size-fits-all' best practice.

The interviews affirm that audit committees have grown to become one of the main pillars of the corporate governance system.

The existence of an independent audit committee is recognised internationally as an important feature of effective corporate governance. A clear sentiment resonates among audit committee chairmen interviewed: there is a robust acceptance of, and obligation to, conduct the job of providing assistance to the board to fulfil its oversight responsibilities.

The audit committee runs a balancing act: effectively dealing with its additional oversight functions while, at the same time, maintaining the collegiality and relationships that are expected of board directors.

To do this, the audit committee must give thought to the relationships it has with the board (in particular, the chairman of the company), management, other sub-committees and the internal and external auditors. The audit committee is in a key position to encourage open and frank communication.

The approach to the role of audit committee chairmen and some of the challenges facing audit committees today are discussed in this paper. Many of the regulations and governance structures imposed on audit committees across the different jurisdictions differ in the detail, and the exact remit of the committee also varies, but all share the common objective of ensuring effective, independent oversight of financial reporting.

Four clear messages were heard consistently:

- Audit committees owe their primary responsibility to the board and work best when they are an integrated part of the board process
- Open debate and mature questioning are fundamental to their effectiveness
- Audit committee members need sound commercial and financial knowledge but not necessarily deep accounting knowledge
- Audit committees need high quality and reliable information to fulfil their role and have an important responsibility in the selection of those responsible for delivering that information.

Interviewees said that the long-term effectiveness of the audit committee will in part depend on its ability to renew itself. Infusing fresh talent with new ideas will offer different perspectives. Diverse backgrounds and varied experience enhance the efficacy of committees, especially when advising newly-listed companies.

Diversity of skills and experience among committee members is seen as an essential characteristic of an effective audit committee. Financial expertise and literacy are important for most interviewees, but so is the ability of audit committee members to understand a company's business and risk profile.

While regulation is clearly relevant to the effectiveness of audit committees, it is not considered the determining factor. Rather, the key to a truly effective audit committee is the behaviour and culture emanating from the board throughout the organisation's management, committees and assurance activities. This is something that cannot be regulated for.

The volatility of capital markets combined with the thirst for transparency and investor information is increasing at a steady rate. The audit committee can play a key role in meeting these demands. At the same time, a number of interviewees warned of the danger of unrealistic expectations around what committees can achieve.

This warning was also directed to companies and, looking forward, there needs to be caution as to how far the role of the audit committee extends. In handing new responsibilities to the audit committee, there is a risk of it becoming so burdened that it is unable to carry out its core functions effectively.

The functions of the audit committee

Effective audit committees foster high quality financial reporting and good corporate governance. This emerged as a common observation from all interviewees with some even suggesting that the audit committee was the single most significant board committee.

Interviewees said their core role as audit committee chairmen was to provide oversight of the preparation of the financial statements and to examine the related internal controls. In some countries, audit committees typically also have responsibility for broader aspects of internal control.

There was an acknowledgement that nurturing and building good relationships with internal stakeholders, including the board, management and internal auditors was a key ingredient to well-functioning committees. Interviewees also highlighted the crucial oversight role committees play in managing good relationships with external auditors.

When asked about whom they believed they were responsible to, most interviewees responded that their primary responsibility was to the board as a delegate of the board. The board in turn was responsible for looking after the interests of shareholders.

> *It has been delegated to a committee that I chair to ensure that particular aspects of governance are well and truly looked after on behalf of the shareholders... Knowing that you are really doing it on behalf of the broader board.*

In markets where companies had concentrated ownership, there was a clear recognition of a potential conflict of interest when a director held his or her position as the 'representative' of a major investor. In other markets where ownership is more dispersed, such as the UK, this did not emerge as an issue. But all interviewees firmly recognised their legal responsibility to all shareholders as discharged through the board.

All interviewees recognised the crucial role played by the audit committee chairman. The chairman is the voice of the committee at board meetings. They are also responsible for ensuring open discussion in committee meetings, allowing all viewpoints to be heard and considered, and for managing the committee's relationship with the board, management and the external and internal auditor.

> *You need a strong chairman of the audit committee. That chairman should make sure that the audit committee functions correctly. He or she should be responsible back to the board to say what they did… They should be smart enough, as most of them are, to present the problems, and summarise them for the board.*

The oversight function of the audit committee

The core functions for all audit committees are oversight of the integrity of the financial reporting process and reporting to the board. As part of this role, the committee receives and considers the external audit plan, the financial statements and the external auditor's long form report to those charged with governance. The audit committee engages in a process of enquiry and discussion with both management and the external auditor, and highlights significant areas of judgement.

A general consensus among interviewees across jurisdictions was that the audit committee should carry the principal responsibility for advising the board on the selection, appointment and rotation of external auditors and, if appropriate, recommend an extension in an audit partner's rotation period.

Also sitting at the heart of the audit committee function is the oversight of the internal audit plan: reviewing and challenging management remediation plans, particularly the timing, and identifying areas of significant risk. Many of the audit committees covered by the interviews, particularly in the banking sector, also had responsibility for the selection of internal auditors.

In addition, interviewees acknowledged that audit committees have a responsibility for the overall financial governance of a company. This includes responsibility for ensuring that there is sound oversight of the processes used to maintain effective internal control over financial recording.

Fundamental to the work of an audit committee is its capacity to engage in a timely fashion in the activities that it has to monitor. The protocols to achieve this are varied but include timely engagement with auditors so that key areas of judgement can be given full consideration. In some cases this also includes protocols for the audit committee to consider the accounting consequences of major transactions while they are in progress.

Internal control and risk management

While all interviewees agree that overall responsibility for risk rests with the board, there are differences in the way in which oversight responsibilities are delegated at board committee level.

In some cases the audit committee is combined with a risk committee; in other cases the audit committee is combined with a finance committee. Many interviewees, particularly in Australia, preferred the separation of the audit committee from either the risk or the finance function but this preference was not universal. Some interviewees in the United States of America and the UK expressed little enthusiasm for separate risk committees.

If there is an evil of having two separate committees versus a single committee, I think it is the lesser of two evils. The risk of missing something or not connecting the financial implications on risk is a lesser evil than not giving it the oversight it warrants just because time runs out.

I don't think there's a one-size-fits-all solution. If you are talking financial services companies or resources companies, I would absolutely separate them. If you are talking about a manufacturer there might be an argument for combining them, because of the nature of the risks.

When the audit committee is separated from other committees with responsibilities for risk, the need for linkages between them is critical. Indeed there were concerns that without close cooperation between those committees, information could fall between the committees and not be properly addressed.

This dilemma was often dealt with by ensuring cross-membership between the different committees. Interestingly, some audit committees also had shared membership with the remuneration committee to make sure that there was consistency between them.

As chairman of the board, I have given the audit committee chairman the role of also chairing other sub-committees of the board. I feel that we need a link between these sub-committees as a way of managing risk overall. And every time we speak to corporate governance people or anybody else we sell it as a positive.

Building on relationships

There is strong consensus among interviewees about the role of the audit committee, which is seen as a vital institution in assisting the board of directors in enhancing the transparency and integrity of financial reporting. Audit committee chairmen recognise and embrace the role and function they hold within this environment.

The audit committee and the board

Across all jurisdictions, the interviewees are very strongly of the view that, as a committee of the board, the audit committee should work within the collective and collegiate responsibility of the board.

Recent regulatory litigation in Australia, the Centro case, has highlighted that financial governance and financial reporting are the responsibility of the full board and cannot be abrogated or passed to other parties, whether audit committees or the auditors. This is consistent with interviewees' experience in other countries.

> *The board can't walk away from any responsibility it has in relation to financial statements. Of all the things that the board does, the thing that's most visible out there is the financial statements.*

Interviewees consider that the audit committee works more effectively when all board members have a clear understanding of this devolved responsibility and how to work with it. Interviewees noted that there is greater understanding of the importance of collective responsibility in today's boardrooms. Whereas in the past boards often devolved substantially all of the responsibility for the financial information in the annual report and its preparation to the audit committee, interviewees reported that the full board is now more appropriately engaged in such matters.

So what are the keys to the effective working relationship between the audit committee and the board? While each will need to determine their own ways of working together, and processes and protocols will need to be tailored to the individual company, this paper has attempted to distil some fundamentals from the experiences of the interviewees. Interviewees said that the board needs:

> A clear understanding of its responsibility to appoint an audit committee with an effective balance of skills
> A process of contact and communication, generally through the company chairman, that fosters effective collective understanding of, and engagement in, the work of the audit committee
> To assess individual audit committee members not just as directors, but in relation to their suitability for their specific devolved role
> To ensure that the audit committee is fully informed of all transactions that might affect its work.

Likewise, the audit committee needs to understand its responsibility to:

> Act diligently
> Report fulsomely to the board
> Ensure all of the significant risks and value judgements that it may have to consider in its processes are brought to the attention of the board.

Of paramount importance is the fluent conversation between board members, audit committee members and those reporting to them such as auditors and corporate executives. Trust, properly earned and carefully maintained, is a fundamental attribute.

> *The board needs to be in a position, and individual directors need to be in a position, to feel as though there has been fulsome reporting back from the committee to the board. Board members must feel that they have had the opportunity to either ask questions or raise issues and participate in debate. And in that regard, I think the flow of information is important.*

Interviewees gave many different examples of how to ensure this flow of information took place. It is partly a function of board size. In some companies with smaller boards, all non-executive directors are members of the audit committee or are invited to attend some or all of its meetings. In other companies where this was not the practice, greater emphasis is placed on the committee chairman reporting to the full board. In Continental Europe, in particular, there was a tendency for the committee chairman to provide formal written reports to the board.

The relationship between the audit committee and company chairman is key. In practice they will usually determine the size and composition of the audit committee, factors that are vital to its effectiveness. Thereafter a strong relationship remains critical, not only for the purposes of communication but also so that the committee chairman is assured of the broad support of the board when it is necessary for them to challenge management. For this reason, many interviewees felt that the company chairman should attend committee meetings.

The audit committee and management

All interviewees expressed an adamant view that a good but independent working relationship with management is essential to effective oversight.

> *The audit committee and management have the same objective of ensuring robust financial reporting. Seeing the relationship as adversarial is the wrong approach. There is a virtuous circle where strong relationships enable strong oversight. Weak relationships make robust oversight very difficult if not impossible.*

Many interviewees warned about the risk of audit committees abrogating management's role. Audit committees seeking to understand their company risks and processes can become so engaged that they inadvertently assume management roles. Complex businesses are particularly vulnerable to this as their audit committees seek to understand and advise on management's processes.

That said, there are differing views about where the line between the role of management and that of the audit committee should be drawn. Interviewees sitting on American company boards, for example, seemed to take a more 'hands on' approach to the detailed aspects of financial reporting than was typical in other countries. A number of interviewees on UK boards commented on the benefits of the committee getting involved at an early stage so that they understand issues as they are developing rather than being presented with a fait accompli. This argues for regular meetings with management and the internal and external auditors.

> *You've got to be careful that you don't take on the role of manager, but you need to be alert. I mean you can't just accept or wait to receive papers and reports. You need to be proactive. If things come to your attention, you need to raise them with management and ask them have they thought of it, have they addressed it, why is this not an issue?*

There are differing views about the extent to which management should be invited to attend audit committee meetings. In practice, attendance by the chief executive officer is varied. The chief financial officer is a more regular attendee. Some Australian interviewees expressed the view that audit committee meetings were more effective when the chief executive officer was not present (at least not for the whole meeting).

All interviewees recognised that, with the possible exception of attendance by the board chairman, it was the prerogative of the audit committee to determine who should and should not attend. And all interviewees recognised the importance of 'committee only' time (a part of which would include in-camera discussions with internal and external auditors).

The audit committee and the auditor

One of the audit committee's key responsibilities is the oversight of the external auditor.

In the USA, the *Sarbanes-Oxley Act* says that the external auditor works for and is accountable to the audit committee and the board of directors as the representatives of the shareholders.

In Australia and the UK, the committee's role in overseeing the external auditor is not bound by legislation, but is considered best practice. It is recognised as important that audit committees and external auditors work together effectively to strengthen the corporate reporting and governance process.

In practice, a three-way relationship exists between the committee, management and the external auditor. The respective roles of the committee and management vary between companies but there is a view, at least among some UK interviewees, that the auditor should formally report to both.

The audit committee needs information from the auditor at critical points such as in the planning phase of the audit, during the early warning discussion on initial findings (including materiality or any other important factors), and at the close of the audit.

Interviewees felt that the role of the audit committee in providing a conduit for the external auditor to communicate freely and openly is crucial to improving audit quality overall.

> *Twice a year, I meet with all the auditors, sometimes just one-on-one unless any other audit committee member wants to come along, outside of the formal in-camera session, just to talk to them about what they're seeing. In that sort of environment they're much freer in the way they talk.*

The appointment of the external auditor is widely seen as the responsibility of the audit committee on behalf of the board, although executive input remains important. In practice it is not felt desirable to appoint an external auditor without the agreement of management as this might make it difficult to establish an effective relationship. In at least one case, the audit committee had taken over responsibility for negotiating the audit fee from management. Directors were concerned by suggestions that regulators might play a role in deciding which auditors were appointed and/or how frequently they were rotated.

Internal audit

Interviewees reported different views of the role of internal audit. In some cases internal audit is viewed as an arm of management with primary reporting responsibility to the chief executive officer. In those cases the internal audit function was perceived as a means by which executive management could achieve important insights into the functioning of the control processes for which they were responsible.

In other cases there is far more emphasis on internal audit as a function independent of management with primary responsibility to the board or the audit committee.

However, all interviewees considered that internal auditors and the audit committee chairman should have a direct or dotted-line reporting relationship as, irrespective of the primary reporting obligation, internal audit is an important source of advice and assurance for the audit committee.

The audit committee and shareholders

There are two main channels of communication between the audit committee and the shareholders: the written report which forms part of the published financial statements, and the annual general meeting, at which the audit committee chairman is available to answer questions.

The majority of audit committee chairmen interviewed do not believe that, as a sub-committee of the board, it is necessary or appropriate for them to have face-to-face contact with investors. This is felt to be the responsibility of the board chairman on governance matters and management on issues relating to the performance of the company. Rather, the sentiment is that the committee chairman should be willing to meet with investors if requested to do so.

Interviewees consider that any meeting with the audit committee chairman and investors should generally be limited to questions about governance and the manner in which the financial statements are put together, rather than financial commercial questions which are better left to the chief financial officer.

> *I don't think it's necessary... There is quite extensive dialogue, as you can imagine, between chairmen and major institutional shareholders at the moment. I don't think there's a need for the audit committee representative to get into that space.*

The experience at annual general meetings is that while the board chairman may pass questions to the chief financial officer or chief executive officer or, in the case of remuneration, to the chairman of the remuneration committee, there are almost no instances when questions are passed to the audit committee chairman.

Building an effective audit committee

Once the role of the audit committee and its key relations has been established, there is still the task of establishing and ensuring an effective committee. This involves getting the membership right, managing the meeting agenda and creating the right environment for debate and challenge.

The composition of the audit committee

All interviewees agree that audit committee members need to bring more than just narrow financial and auditing knowledge to the table. These skill sets need to be matched with strategic thinking and sound business knowledge. In the words of one interviewee:

> *I work on the basis that every member of the audit committee is capable of reading financial statements but I don't expect them all to understand and be able to repeat all of the accounting standards back.*

This means that companies need to look beyond financial and auditing professionals to get the mix of skills and experience needed for the audit committee to operate effectively.

> *The expertise of a former auditor can be very narrow. So often they understand the accounting standards, they'll ensure that the accounts are true and fair or reasonable. But sometimes they don't bring a full understanding of the broader-based commercial issues associated with being a company director.*

The optimum mix will depend on the needs of the company and the nature of its business. But interviewees on UK, European and American boards generally said that the ideal audit committee included at least one 'financial expert' and in some cases two, if one is the chairman. In Australia, interviewees put more weight on financial literacy rather than financial expertise and on the ability of audit committee members (and other board members) to understand the company's business and risk profile.

Interviewees said relevant business experience was particularly highly valued. Other attributes sought, depending on the size and type of company, included international experience, experience of the type of risks the company faced (not necessarily from the same sector – for example, one interviewee sat on the board of a company with a lot of long-term contracts, so they had selected someone with project management experience), and 'soft skills'.

One of the main benefits of having a more diverse committee is that it brings more perspectives to the questioning of management and external auditors. The willingness and confidence to ask questions is seen as perhaps the most important attribute for audit committee members. As one Scottish interviewee phrased it, every audit committee needs someone prepared to ask the 'daft laddie' question and every chairman needed to create the environment that enabled them to do so.

> *I will appoint one person because he just comes from a different space intellectually. I'll appoint another because they understand the industry; and another because they understand the broader economics. And then there is the fourth member, the one who doesn't fit any of those moulds. Why do we put him there? For a range of reasons: one because he is left field, and so he asks something different.*

Another important consideration is the size of the committee: too small and you risk not having the range of perspectives that are needed, too large and it becomes unwieldy. The audit committee chairman should work with the board chairman to ensure the size of the committee enables it to be effective.

A number of interviewees felt that it was important that the audit committee, and possibly the board more generally, receive the benefit of 'new blood'. This is to ensure the continuous and important injection of new ideas and new thinking into the board and audit committee process.

With its brief to cover all aspects of a company's business and the way in which these flow through to the financial statements, membership of the audit committee is also seen as an important way for new board members to learn and expand their understanding of the business.

Some Australian interviewees suggested that the audit committee may benefit from the inclusion of non-board members in some circumstances. These non-board members would act as 'experts' bringing new perspectives to the board.

There were three arguments which underpinned this suggestion:

- Non-board members would allow the audit committee to draw from a larger pool of industry or accounting expertise
- It may give the audit committee greater independence
- It can provide potential future board members with experience and allow the board to assess their suitability for full board membership.

> *I do believe from time to time your obligations as a board member and the views you might form as an audit committee member might not always be consistent. The way it's crafted today the audit committee is a subcommittee of the board – and I don't think that should change – but the question is: could somebody, an independent person, that's not a board member add to the debate?*

However, the vast majority of those interviewed in the UK did not support this proposal. There are concerns that there might be a temptation for audit committees to abrogate responsibility for important complex decisions to the 'experts' on the audit committee. And there are fears these independent 'advisers' could quickly transform into shadow-directors.

There were also questions around the form of legal liability these new positions would attract, as the board itself remained legally responsible for the matters addressed by the committee, and the information made available to 'co-opted' members, who may not be privy to the same information as full board members.

Finally, it was felt that, at least for larger companies, a need to bring in external committee members indicated that the board itself did not have the mix of skills and experience that it needed, in which case the problem should be addressed at board level, not committee level. However it was recognised that it could be helpful for audit committees to bring in experts to advise the committee on specific issues.

Managing the audit committee meeting

The breadth of responsibilities of an audit committee means the number and length of audit committee meetings has increased. To ensure efficient prioritisation of tasks, committee chairmen are developing innovative ways of managing the meetings and workload.

One interviewee said he would hold 'pre-meetings' over the phone with committee members to work through the routine matters which can drain time from face-to-face meetings when more critical issues should be discussed.

Similarly, another interviewee said he would hold early meetings with the external auditor so that he had a clear idea of the key issues well before the scheduled meeting. Effective financial reporting requires understanding on all sides, and as one interviewee said of his audit committee:

> *Before we [the committee] finally get to our central two-day meeting, we've met four times, maybe only for an hour or two, on key issues. And by the time management comes to the committee it has a clear understanding of what the committee's hot points are.*

The onus lies with the audit committee chairman to encourage open and frank discussion at the board level. There needs to be fair challenging of the material being reported to the committee, and it is equally important to have balance. The responsibility lies with the audit committee to ensure that the external auditor is heard as an independent source of information.

Challenges facing the audit committee

Across jurisdictions, a few common challenges were identified by the audit committee chairmen interviewed for this paper.

Unrealistic expectations

The thirst for transparency and investor information is increasing at a steady rate. The audit committee can play a key role in meeting these demands. At the same time, a number of interviewees warned of the danger of unrealistic expectations about what committees can achieve.

This warning was also directed to companies and, looking forward, interviewees felt there needs to be caution as to how far the role of the audit committee extends. In handing new responsibilities to the audit committee, there is a risk of it becoming so burdened that it is unable to carry out its core functions effectively.

Communications to bridge the expectation gap

There is recognition of a need to bridge what is referred to as the 'expectation gap' between investors' understanding of what financial statements and reports convey and the underlying reality of the processes used to compile them. And very clearly there is the view that companies should be prepared to give investors what they need to understand the business within the limits bounded by commercial discretion.

Initiatives being put in place by the Financial Reporting Council (UK) are intended to provide greater transparency around the subjective judgements and risk assessments in financial reports and provide a vehicle for more communication between audit committees and investors.

However, these ideas are being viewed with caution by Australian committee chairmen. There were concerns that further reporting might increase the 'clutter' in the financial statements and result in an unhappy mixture of boilerplate statements and heavily cautious wording to avoid any potential risk or liability. There were also concerns about releasing information that was commercially sensitive.

It is also felt that reporting requirements should not give the impression that the audit committee is anything other than part of the board collectively.

Legal responsibilities and liabilities

Interviewees felt that there was little need for further rules which define the membership of audit committees, the frequency of their meetings or the scope of their work and responsibilities. The current framework is basically sound, and the onus should be on fostering and promoting good practice. Indeed, it is felt that imposing detailed rules defining the operation of the audit committee risked being counterproductive.

At the same time, from all of the interviewees, there is no sense that there is need for a material change in legislation or regulation to give audit committee members more protection from litigation liability. However, in the event that audit committees or their chairmen were given additional legal responsibilities, thought would need to be given to how to:

> Avoid creating board division through the allocation to the audit committee of matters formerly part of the whole board's collective responsibility

> Provide the audit committee, and in particular its chairman, with sufficient discrete defences to allow them to undertake their more extended responsibilities.

Keeping the flow with new members

To the question, 'is there a sufficient supply of skills for audit committee roles in your jurisdiction?', the response, in relation to larger corporations, was that notwithstanding all the apparent risks that a board director might face there were significant numbers of people with a variety of operational and professional skills prepared to seek board roles.

In the UK there was a perception that it was becoming more difficult to recruit currently-serving chief financial officers to sit on audit committees because of the time commitment needed, but otherwise recruitment of suitable board members who could serve on the audit committee was not seen as a problem.

There is a clear recognition among interviewees in Australia that smaller companies may face difficulties in recruiting the right quality of audit committee member. Potential candidates were not always attracted to the boards of such companies, with the result that there was a potential or an actual shortage, both in terms of technical and professional skills useful to those boards and, more importantly, breadth of board experience. It was considered unlikely that regulation could provide any effective way of compensating for this skills gap.

As already noted, a key challenge facing all companies is how to introduce new blood and deliver a next generation of board members and audit committee members with the skills and experience to run those roles effectively. This is an area for further experimentation and consideration.

Quality of information

A principle challenge facing audit committees is the quality of the information they receive. Views were mixed on whether the information currently provided was fit for purpose. For example, most UK interviewees were satisfied on this score, but all interviewees agreed that an audit committee is only as good as the information at its disposal.

There is an imperative that audit committees undertake all reasonable steps to ensure they have access to the 'right' information, in an appropriate form and on a timely basis. This encompasses formal reports and presentations, but also informal discussions with management and professional development activities for audit committee members.

The ways in which interviewees deal with this challenge include:

- Effective involvement in the selection of key reports, from external and internal audit and the chief financial officer in particular
- Effective questioning of reports and information both during and outside of audit committee meetings
- Free and open discussion in meetings
- The use of pre-meetings to identify issues for discussion and sometimes to deal with routine matters
- Effective communication with auditors and executives, including access to management below the senior executive team
- Developing committee members' understanding of the business, for example through site visits.

In some cases, where a board had grown accustomed to delegating almost all the responsibility for financial reporting matters, audit committees faced the challenge of increasing board engagement and board understanding of major financial reporting issues.

Knowledge of accounting standards

While there is much discussion within investment and financial circles about the complexity of international accounting standards, these complexities are seen as part of life by the interviewees. There was a broad consensus that all board members should have an understanding, not in detail but in principle, of the interaction between those standards and the transactions that their companies were undertaking. Each company appeared to have developed different processes to achieve that level of board awareness.

However, there was at least one dissenting voice who considered that the fact that most current non-executive directors were of a generation who were not brought up with International Financial Reporting Standards created difficulties, as it made them too reliant on management and the external auditor.

Reflections and questions

What is clear from all interviewees is that the audit committee chairman's role is critical to the effective workings of an audit committee. Each audit committee will function differently depending on the company's business, the composition of the board and the committee, the quality of management and internal processes. This series of interviews did, however, identify some universal questions to be answered by audit committee chairmen:

> How do you keep the board fully informed?

> What sorts of reports should be given to the board before they are asked to approve financial statements?

> Should those reports come from the audit committee chairman or management?

> How do you ensure the audit committee and the board are up to speed with the changing regulatory framework?

> How do you ensure you get the best out of the external auditor?

> How often should the audit committee meet with the external auditor?

> How do you best deal with commentary from the external auditor that may be critical of management?

> How do you ensure you get the best from the internal auditor?

> How do you ensure you get the best out of the audit committee members?

> How do you ensure diversity of membership across the audit committee?

> How do you ensure frank and open discussions in audit committee meetings?

Resources

frc.org.uk

icas.org.uk

kpmg.co.uk/aci

charteredaccountants.com.au

companydirectors.com.au

asic.gov.au

Appendices

Appendix 1

Questions used as basis of meetings and telephone interviews:

> How would you define your role?

> How should your role discharge its obligations to the board (however they are defined)?

> In whose interests is the audit committee acting?

> What is the proper relationship between the audit committee and the rest of the board?

> What are the skill requirements of an audit committee?

> How should audit committees identify risk? For example, what regular reports should be available to audit committees (external and internal auditors, compliance reports and reports from chief financial officer/chief executive officer)?

> To what extent should the audit committee have responsibility for reviewing all material activities and transactions and management's assessment of the financial risks in those transactions – and reporting thereon to the board?

> What part should audit committees play in the appointment of the chief financial officer, internal auditors, and external auditors?

> Should audit committee chairmen have a governance responsibility to meet with investors?

> Should the audit committee be limited to consideration of financial reporting matters or should it also consider other audit/ financially related risks?

> What are the main challenges facing audit committees?

Appendix 2

All discussions in interviews and meetings were held under a modified version of the Chatham House Rule, whereby views expressed during private discussions are not attributed to individuals or their organisations.

Participants included:

Geoff Brayshaw
Fortescue Metals Group

Jann Brown
Cairn Energy, Hansen Transmissions International

Angus Cockburn
Aggreko, Howden Joinery Group

David Crawford
BHP Billiton, Lend Lease

Andrew Dougal
Carillion, Premier Farnell, Creston

Paulett Eberhart
CDI Corporation, Anadarko Petroleum Corporation, Advanced Micro Devices, Inc

Alan Ferguson
Johnson Matthey, Croda International, Weir Group

David Gonski
ASX Group, Coca-Cola Amatil, Singapore Airlines

Djunaedi Hadisumarto
National Development Planning Agency (Bappenas)

Philip Hodkinson
BT Group, Resolution, Travelex Holdings

Mark Johnson
PwC

Brian Long
Commonwealth Bank of Australia

Iain Mackay
HSBC

Lindsay Maxsted
BHP Billiton, Westpac Bank, Transurban

Anne McDonald
GPT Group, Spark Infrastructure Group, Specialty Fashion Group

Iain McLaren
Cairn Energy, Baillie Gifford Shin Nippon

Dave Merritt
Charter Communications Inc, Calpine Corporation, Outdoor Channel Holdings Inc, Buffets Restaurants Holdings Inc

Brendan Nelson
BP, RBS

John Ormerod
ITV, Misys, Computacenter, Gemalto NV, Tribal Group

Kieran Poynter
International Consolidated Airlines SA, Nomura, British American Tobacco, F&C Asset Management

Mark Rolfe
Sage Group, Barratt Developments, Hornby, Debenhams

Nick Rose
BAE Systems

Fergus Ryan
Commonwealth Bank of Australia, Australian Foundation Investment Company

Brian Schwartz
Brambles, Westfield Holdings, Football Federation Australia

Lim Swe Guan
GPT Group, Thakral Holdings Group in Australia

Alan Thomson
Hays, Bodycote, Alstom

Contact details

The Institute of Chartered Accountants in Australia

National Office

33 Erskine Street
Sydney NSW 2000
GPO Box 9985, Sydney, NSW 2001

Service 1300 137 322
Phone +61 2 9290 1344
Fax +61 2 9262 1512
Email service@charteredaccountants.com.au

charteredaccountants.com.au

Financial Reporting Council (UK)

5th Floor Aldwych House
71 – 91 Aldwych
London
WC2B 4HN
United Kingdom

Phone +44 20 7492 2300
Fax +44 20 7492 2301

frc.org.uk

The Institute of Chartered Accountants of Scotland

CA House
21 Haymarket Yards
Edinburgh
EH12 5BH
United Kingdom

Phone +44 131 347 0240
Fax +44 131 347 0114
Email accountingandauditing@icas.org.uk

icas.org.uk

100% recycled

Printed on ecoStar – a 100% recycled paper
supporting responsible use of forest resources.

ICAS FRC The Institute of Chartered Accountants in Australia

29 February 2012

Our ref: ICAEW Rep 19/12

Your ref: PCAOB Rulemaking Docket Matter No. 030

Office of the Secretary,
PCAOB, 1666 K Street,
N.W., Washington, D.C. 20006-2803
USA

Dear Sir

RE-PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES AND RELATED AND TRANSITIONAL AMENDMENTS

ICAEW is pleased to respond to your request for comments on PCAOB Release No. PCAOB Release No. 2011-008 of December 20, 2011 entitled *Proposed Auditing Standard Related to Communications With Audit Committees; Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Katharine E Bagshaw FCA
ICAEW Audit and Assurance Faculty
T+ 44 (0)20 7920 8708
F + 44 (0)20 7920 8708
E: kbagshaw@icaew.com

ICAEW REPRESENTATION

ICAEW RESPONSE TO THE PCAOB'S REQUEST FOR COMMENT ON ITS PROPOSED AUDITING STANDARD RELATED TO COMMUNICATIONS WITH AUDIT COMMITTEES; RELATED AMENDMENTS TO PCAOB STANDARDS; AND TRANSITIONAL AMENDMENTS TO AU SEC. 380.

Memorandum of comment submitted in February 2012 by ICAEW, in response to the PCAOB's consultation *Proposed Auditing Standard Related to Communications With Audit Committees; Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380* published in December 2011.

Contents	**Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the PCAOB's *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to Au Sec. 380* published on 11 October 2011 a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond magazine.

MAJOR POINTS

Re-exposure and Improvements

5. We welcome the re-exposure of these important proposals and we support PCAOB's desire to improve communications with audit committees. In particular, we welcome greater focus on the provision of quality information by management, on ensuring that information is not duplicated, and on narrowing the scope of some excessively wide and extensive communication requirements. These include:

   - the requirement to communicate 'significant' issues regarding the application of accounting standards (rather than all of them);

   - limiting communications regarding the need for specialist auditor skills or knowledge to those relevant to significant risks;

   - the removal of requirements to communicate (a) matters in emerging areas; (b) how management subsequently monitors critical accounting estimates; and (c) the auditor's evaluation of the 'quality' of significant accounting policies;

   - the restriction of the requirement to communicate matters on which the auditor consulted to 'difficult or contentious' matters that are relevant to the oversight of the audit; and

   - clarification of the requirements to disclose details of the roles, responsibilities and locations of the firms participating in the audit. We urge the PCAOB to ensure that it aligns its October 2011 proposed *Amendments to Improve Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits* with these proposals; it makes sense for the audit committee to receive detailed information and for higher level information to appear in the auditor's report. We also re-emphasise our belief that while these disclosures will satisfy a need to know who is involved in the audit, they are unlikely to change auditor behaviour as there are compelling reasons in multi-national audits to involve local auditors practising in the same jurisdiction as the entities subject to audit.

Changing Behaviour

6. We noted in our 28 May 2010 response to the PCAOB on its original proposals that in order for the standard to be effective, a number of factors outside the standard need to be in place. These include the need:

- to address any issue of under-communication by auditors through the inspection process;
- to recognise the importance of good quality audit committee members to audit committee effectiveness and the need for auditors and auditor committees to use their judgement in determining the nature and extent of communications;
- for the PCAOB to set out the high-level improvements to audit quality it expects to see as a result of the implementation of these proposals. i.e. the overall objectives of enhancing the level of communication between auditors and audit committees, beyond the requirements, which inspectors can look to in evaluating whether the changes have been implemented successfully. This might be included in the basis for conclusions referred to in paragraph 9, below.

7. For these reasons, when the PCAOB issues its final standard we urge that it highlight its intention to seek changed behaviour in this area through its inspection process.

Two-Way Communication

8. We are disappointed that evaluation of the adequacy of the two-way communication process has been dropped as a requirement, and that the promotion of the two-way process has been dropped as an objective. We do not believe that the PCAOB has made an adequate case for this. Firstly, the fact that other standards require an auditor assessment of the audit committee's effectiveness does not substitute for this specific evaluation and 'obtaining information' is a poor substitute for two-way communication. Secondly, the difference this creates with ISAs is egregious. IAASB debated this subject long and hard in the development of ISA 260 and we encourage the PCAOB to revisit this area with IAASB.

9. We understand that auditing standard-setters set standards for auditors and they do not have locus to impose requirements on companies. None the less we do not believe that evaluation of the two-way communication process is a *de facto* imposition of a requirement on the audit committee. We do believe that it not only forces auditors to evaluate themselves, but it also forces them to engage with the audit committee, particularly if the audit committee is providing a bare minimum of information for compliance purposes. Evaluation provides auditors with a tool to improve audit committee performance without imposing requirements on the audit committee.

Accounting Policies, Critical Accounting Estimates, Misstaetments

10. Paragraph 10 of our May 2010 response on the PCAOB's original proposals notes that the:

...requirement to report a detailed schedule of uncorrected misstatements seems unrealistic because in practice, summaries are reported and we would not expect audit committees to find additional value in being provided with the same level of detail as management.

11. We continue to maintain that summaries, which permit the auditor to use a modicum of judgement, will better serve audit committees' needs for high quality information than an unedited mass of raw data, provided of course that auditors are required to use appropriate categories for grouping misstatements and are not permitted to offset anything other than trivial amounts.

Basis of Conclusions

12. A great deal of what appears in appendix 4 is useful in understanding the proposed standard. Many standard-setters now routinely publish their bases of conclusions and we encourage the PCAOB to consider doing the same with the contents of appendix 4.

Alignment with Other Standards and Need for a Framework

13. We are confident that the work diligently performed by PCAOB staff means that there is a good chance that any misalignments between the risk standards and the proposals will be minor. However, absent a framework of fundamental principles underpinning auditing standards, it is inevitable that some misalignment will become apparent after the event, regardless of staff efforts. We re-iterate our belief that a framework of fundamental principles underpinning auditing standards would not only reduce the risk of misalignment, but would enable seasoned auditors and inspectors to exercise their judgement with confidence and skill, and form reasonable expectations about the likely shape of pronouncements in new areas. This would increase certainty and confidence, and avoid surprises, all of which are sorely needed in the capital markets. While we appreciate the enormous pressures brought to bear on the PCAOB to deal with specific issues at various time, and the often unrealistic expectations of some stakeholders, the PCAOB moved straight to standard-setting when it was set up and we believe that the continued absence of some sort of framework continues to hamper its efforts. Once again, we urge PCAOB to think about developing some framework of fundamental principles for its standard-setting activities.

RESPONSES TO SPECIFIC QUESTIONS

1. *Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?*

14. We note above our confidence that the proposed conforming amendments mean that misalignments between the risk standards and the proposals should be minor. But we also note that absent a framework of fundamental principles, it is inevitable that some misalignment will become apparent after the event. The continued absence of some sort of framework for standard-setting continues to impede progress.

15. We are not aware of the need for any further specific conforming amendments either on a detailed basis, or at a higher level but we have not performed a review of the alignment of the proposals and the risk standards.

2. *The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?*

16. We are not aware of any such procedures.

3. *The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement. a. Is the requirement in the standard clear? b. As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the*

audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

17. The requirement is clear. However, some documentary record of the oral acknowledgment would always be expected and we can see little justification for omitting such an elementary requirement.

4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

18. We do not believe it is necessary to communicate significant unusual transactions separately because all such transactions will be reported as significant risks in any case. This catch-all requirement could trap matters of little interest to the audit committee and we believe its inclusion betrays a lack of confidence in existing standards. PCAOB should deal with any residual uncertainty in this area through enforcement, not further regulation, because the existing requirements are not deficient.

5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

19. It is helpful that the communication requirement has been narrowed to areas in which auditors have identified a concern.

6. Are the amendments to other PCAOB standards appropriate? If not, why?

20. We refer to our comments in paragraphs 13 and 14, above.

7. The Board requests comments regarding the audits of brokers and dealers on the following matters: a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers? b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers? c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

21. We do not comment on this matter.

E kbagshaw@icaew.com

icaew.com

The Institute of Internal Auditors

Richard F. Chambers
Certified Internal Auditor
Certified Government Auditing Professional
Certification in Control Self-Assessment
Certification in Risk Management Assurance
President and Chief Executive Officer

T: +1-407-937-1200
E-mail: richard.f.chambers@theiia.org

February 29, 2012

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Response e-mailed to comments@pcaobus.org

RE: PCAOB Rulemaking Docket Matter No. 030 – "*Proposed Auditing Standard Relating to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*"

Dear Sir/Madam:

The Institute of Internal Auditors (IIA) welcomes the opportunity to comment on the *Proposed Auditing Standard Relating to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*. Our comments are based on a thorough analysis and discussion, utilizing a core team of internal audit experts who serve on The IIA's Professional Issues Committee. These individuals consist of experienced Certified Public Accountants and Certified Internal Auditors who have worked in public accounting and in audit management positions in small, medium, and large multinational companies.

The proposed standard is extremely important to The IIA. The board of directors, management, internal audit and external audit are the pillars of corporate governance. As defined in The IIA's International Professional Practices Framework (IPPF), "Internal auditing helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." As internal audit professionals, we understand the implications of the proposed standard on audit, risk management, control, and governance practices within companies. In addition, in many organizations, the internal audit leader reports to the audit committee, communicates with the audit committee on a regular basis, and provides administrative support for the audit committee on matters such as preparing the core audit committee meeting agenda and compiling audit committee meeting materials. These experiences enable internal audit to provide unique insights on external auditors' communication with the audit committee.

We remain in strong support of the proposed PCAOB standard that addresses the need for improved communication between the auditor and the audit committee and appreciate the considerations and changes made to the March 2010 exposure draft, particularly the consideration afforded to The IIA's comments thereon. We firmly believe that a properly

Global Headquarters
247 Maitland Avenue
Altamonte Springs, FL
32701-4201 USA
T: +1-407-937-1100
F: +1-407-937-1101
www.theiia.org
www.globaliia.org

organized and resourced internal audit function compliments and supports the external audit of the organization's financial statements and internal controls over financial reporting.

The following are our principal comments and observations. More detailed responses to the exposure document are included in Attachment A.

1. Overall, the document is very well written. We agree the audit committee is the appropriate governance body to engage and oversee the work of the external auditor. We also agree the external auditor has a responsibility to clearly communicate with the audit committee the terms of the engagement, the strategy, objectives, approach, risk assessment process, significant risks of financial misstatement, and timing of work. This two-way communication should occur throughout the audit to maintain a strong governance structure.

2. We would like to clarify a matter from our response to the PCAOB's previous exposure draft. With respect to the PCAOB's comment in Appendix VI B, our previous response, "...other chartered or mandated responsibilities ..." was related to the internal audit charter and responsibilities, not those of the external auditor.

3. We appreciate the compromise made in the Note following paragraph 12 (c) 3 of the proposed standard, reinforcing management's responsibility for numerous disclosures to the audit committee. That Note, with appropriate revisions, should also apply to paragraphs 13G, 14, 16, 18 and 19.

The IIA welcomes the opportunity to discuss any and all of these recommendations with you. We offer our assistance to the PCAOB in the continued development of this standard.

Best Regards,

Richard F. Chambers

Richard F. Chambers, CIA, CGAP, CCSA, CRMA
President and Chief Executive Officer

About The Institute of Internal Auditors
The IIA is the global voice, acknowledged leader, principal educator, and recognized authority of the internal audit profession and maintains the *International Standards for the Professional Practice of Internal Auditing* (*Standards*). These principles-based standards are recognized globally and are available in 29 languages. The IIA represents more than 170,000 members across the globe and has 105 Institutes in 165 countries that serve members at the local level.

Attachment A

PCAOB release 2011-008 - Request for Comment on Audit Committee Communications

The Board requests comments on all aspects of the new proposed standard and is particularly interested in responses to the specific questions below.

1. Are the communication requirements in the new proposed standard appropriately aligned with the performance requirements in the risk assessment standards, where applicable? If not, why?

   Yes, they are reasonably aligned, with the exception of paragraph 8 of the proposed standard. When the external auditor's inquires about information that may be relevant to the audit, the external auditor should also inquire about the audit committee's view regarding fraud risks and how they exercise oversight of the company's assessment of fraud risks (per AS No. 12 – paragraph 56b).

2. The communication requirements included in the new proposed standard are based on the results of procedures performed during the audit. Are there additional matters that should be communicated to the audit committee that also are based on existing auditor performance obligations?

   No, the standard provides adequate flexibility for emerging areas by virtue of the provisions in paragraphs 2 and 23 that state, "Nothing in this standard precludes the auditor from communicating other matters to the audit committee" and "...the auditor should communicate...other matters..."

3. The auditor is required to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties is other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

   a. Is the requirement in the standard clear? Yes.

   b. As stated, the new proposed standard allows the acknowledgment by the audit committee to be oral. Should the acknowledgement by the audit committee, or its chair on behalf of the audit committee, be required to be in a written form or is oral acknowledgment sufficient?

Oral is sufficient if corroborated by the company's minutes of the audit committee meeting and the auditor's documentation.

An additional comment about communications with audit committees relates to the Note following paragraph 25. Our interpretation is that a written communication to the full audit committee prior to issuance of the external auditor's report will suffice where a discussion with the full audit committee did not take place. The Board might consider clarifying the intent of the words "communicate to" to reflect this option.

4. Is the requirement for the auditor to communicate significant unusual transactions to the audit committee appropriate? If not, how should the requirement be modified?

   The requirement is appropriate. However, consistent with the Note following paragraph 12 (c) 3, we believe the external auditor should actively participate in the disclosure process. A discussion between management and the audit committee on these significant matters is important; the external auditor should then provide commentary based on that discussion coupled with the auditor's observations.

   Additionally, paragraph 14 states, "The auditor should communicate....significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature." We recommend that "Normal course of business" be defined.

5. Is the requirement appropriate for the auditor to communicate to the audit committee his or her views regarding significant accounting or auditing matters when the auditor is aware that management has consulted with other accountants about such matters and the auditor has identified a concern regarding these matters? If not, how should the requirement be modified?

   Management should have primary responsibility for communicating significant accounting matters and consultation(s) with other accountants to the audit committee. If the communication is inadequate or if the auditor has different views, the auditor should communicate any omitted or inadequately described matters to the audit committee. The proposed standard should add the Note following paragraph 12 (c) 3, which allows for and reinforces management's responsibility for disclosures to the audit committee, such that the Note, with appropriate revisions, also applies to paragraphs 13G, 14, 16 (we observe the external auditor's awareness is primarily based upon management's disclosures of such conversations with other accountants), 18 and 19.

6. Are the amendments to other PCAOB standards appropriate? If not, why?

   We did not perform a comprehensive review of all standards to determine completeness and appropriateness of amendments to those other standards.

7. The Board requests comments regarding the audits of brokers and dealers on the following matters:

   a. Whether the communication requirements under the Board's interim standard, AU sec. 380, should be applicable to audits of brokers and dealers if audits of brokers and dealers are to be performed under PCAOB standards before the new proposed standard becomes effective? If so, should it be applicable to audits of all brokers and dealers?

   b. Whether the auditor's communications to audit committees included in the new proposed standard should be applicable to all audits of brokers and dealers?

   c. Are there any communication requirements specific to audits of brokers and dealers that should be added to the new proposed standard? Alternatively, are there any communication requirements contained in the new proposed standard that should not be applicable the audits of brokers and dealers? If so, provide examples and explanations for why the communication requirements for audits of brokers and dealers should be different from other audits covered by the new proposed standard.

   We have elected to not respond to this question.

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

February 29, 2012

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: PCAOB *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380* (PCAOB Release No. 2011-008, December 20, 2011 and PCAOB Rulemaking Docket Matter No. 030)

Dear Mr. Seymour:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness. Healthy communications between auditors and audit committees are an important part of that process and we appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") *Proposed Auditing Standard Related to Communications with Audit Committees* ("the Proposal").

The CCMC believes that the Proposal is an improvement over the initial draft that had been issued by the PCAOB. However, the CCMC still questions the overall authority of the PCAOB over some aspects of the standard. Additionally, the CCMC still has concerns that the Proposal may in fact degrade audit quality and reduce meaningful communications between the auditor and audit committee. Furthermore, the CCMC believes that more clarity is needed regarding broker-dealers since many do not use a public company business structure. Finally, the CCMC believes that the PCAOB should form a business advisory group to increase the scope of meaningful dialogue before a standard is proposed.

Our concerns are listed in more detail below.

Discussion

The Proposal is the second time that the PCAOB has exposed for public comment a standard on auditor communications with audit committees. The PCAOB's initial draft was proposed on March 29, 2010 ("the initial draft"). The PCAOB received 44 comment letters on the initial draft—a number of which, including the CCMC's,[1] expressed concerns over that proposed guidance. The CCMC requested the PCAOB withdraw the initial proposal for reconsideration and re-exposure. As an essential part of the reconsideration process, the CCMC urged the PCAOB to engage in outreach to better understand the entire dialogue that occurs in the management of a public company and appreciate the realities of the auditor-audit committee dynamic.

The Proposal represents a substantive change from the initial draft. The CCMC applauds the PCAOB for its efforts to address the concerns raised by the CCMC and others and holding a roundtable to solicit greater feedback.

Nonetheless, serious issues remain that need to be addressed before this standard is finalized.

1. Sarbanes-Oxley and the Audit Committee

In passing the Sarbanes Oxley Act of 2002 ("SOX"), Congress granted the PCAOB oversight powers over the audit and auditors, while giving the SEC

---

[1] *See* the May 28, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on *Proposed Auditing Standard Related to Communications with Audit Committees.*

jurisdiction over corporate governance issues including the audit committee. Therefore, as we stated in our comment letter on the initial draft, it would seem that the PCAOB does not have jurisdiction over the audit committee and that the Proposal would seem to infringe upon the prerogative of the SEC to oversee corporate governance issues as mandated under SOX. This has led to a confusion of the proper roles that were established by Congress and could distort both governance and audit oversight. Accordingly, we would recommend that the Proposal be reviewed with this in mind and confined to the appropriate areas of PCAOB oversight.

2. Approach to Auditing Standard Development

The CCMC is concerned about the level of prescriptivness in the Proposal. While the Proposal articulates an objective for audit committee communications, it goes on to require a large number of specific actions of the auditor. To illustrate, the 25-paragraph Proposal contains at least 26 "should"—prescriptive directives—which under the PCAOB's rules are presumptively mandatory responsibilities.[2] In addition, approximately 35 more actions are required of the auditor when counting the items listed under these prescriptive directives. As such, the Proposal can hardly be considered an objective or principles-based standard.

Indeed, the Proposal reads like a rule-book leaving little room for the exercise of judgment and common sense by auditors. While the individual actions required of auditors are not necessarily objectionable, considered as a whole, the Proposal builds a good deal of boilerplate disclosure into auditor-audit committee communications. As a result, the Proposal engenders what can be called a "check-the-box" compliance mentality to auditor communication. Such a result does not promote audit quality and in fact compromises fluid free flowing communications between the auditor and audit committee.

---

[2] PCAOB Rule 3101 on *Certain Terms Used in Auditing and Related Professional Practice Standards* states: "The word 'should' indicates responsibilities that are presumptively mandatory. The auditor must comply with requirements of this type … unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard." The rule contemplates that alternative actions would be rare. However, "[i]f a Board standard provides that the auditor 'should consider' an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not."

In addition, the CCMC is concerned that the PCAOB is embarking on this prescriptive approach to bulk up on inspection metrics. If so, this seems a short-sighted convenience that may be sacrificing overall audit quality for a "gotcha" system of regulation. Moreover, it is not obvious that rules-based auditing standards are necessary for the efficacy of an inspection process.

All things considered, it is questionable whether investors are being well served by the PCAOB's current approach to audit standards development. Given that the issue is central to audit quality, the CCMC recommends that the PCAOB's prescriptive approach to writing auditing standards be added to the agenda of the PCAOB's Standing Advisory Group ("SAG") for a fulsome discussion of its usefulness and limitations in an open and transparent manner. Indeed, we believe that this should also be the subject of discussion of a business advisory group that will be discussed later in this letter.

3. Use of Release Text

The CCMC is concerned, as we have written before,[3] that release text is being used to modify the standard and provide guidance and interpretations not found in the standard itself. The following examples from the Proposal illustrate this concern:

- **Obtaining Information Relevant to the Audit**

The proposed standard states in part:

> *The auditor should inquire of the audit committee whether it is aware of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters.*[4]

On the other hand, in discussing this requirement, the release text gives "strategic decisions that might significantly affect the nature, timing, and extent of

---

[3] For example, see the March 2, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (PCAOB Rulemaking Docket Matter No. 026).

[4] PCAOB Release No. 2011-008, December 20, 2011, Paragraph 8.

audit procedures" as an example of matters that audit committees might be aware of that might be relevant to the auditor in planning and performing audit procedures.[5] This example should be included in the standard if it is indeed the PCAOB's intent that the auditor should include it in inquiries of the audit committee.

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

In the section of the proposed standard on the auditor's evaluation of the quality of the company's financial reporting, the matters listed that the auditor should communicate to the audit committee include:

> *New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipate application of accounting pronouncements that have been issued but not yet effective and might have a significant effect on future financial reporting.*[6]

It would be natural to conclude that this communication requirement is around the "quality" of the company's disclosures related to new accounting pronouncements. However, the release text explains that "[t]he auditor might be concerned about changes to accounting or disclosure processes, or systems that could affect financial reporting or whether management has devoted adequate resources to the pending adoption. Requiring the timely discussion of such matters is intended to allow time for the audit committee to properly consider the effects on future financial statements".[7] If the PCAOB intends that this audit committee communication address operational matters and internal controls over financial reporting, then the PCAOB should so state in the standard itself because a reasonable reading of the proposed standard does not reveal this intent.

- **Disagreements with Management**

The proposed standard states:

---

[5] Ibid, Appendix 4, Page A4-7.
[6] Ibid, Paragraph 13(f)
[7] Ibid, Appendix 4, Page A4-29

> *The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report.*[8]

The release text explains that the Proposal retains the requirement from AU Sec. 380.13. However, the release text goes on to provide examples of disagreements that are part of AU Sec. 380.13 but not included in the proposed standard. In other words, the Proposal deletes the examples from the standard and moves them to release text.[9] It is not clear why the PCAOB has made this alteration, although perhaps it is because the examples use the word "might," which under PCAOB Rule 3101 invokes a responsibility for the auditor to consider rather than a presumptively mandatory responsibility. If so, this likewise reinforces the CCMC's previously expressed concern about the prescriptive approach the PCAOB is taking to writing auditing standards.

The CCMC recognizes that release text has merit, particularly in exposure drafts of proposed standards, as it can facilitate better public input. Nonetheless, since release text in any final standard will be referenced by plaintiff attorneys, PCAOB inspectors, and other regulators as a touchstone for the PCAOB's intent, we encourage the PCAOB to be very cautious and transparent in crafting release text for adopting standards.

4. Appropriately Recognizing Management's Responsibilities

The CCMC's comment letter to the PCAOB's initial draft emphasized that auditor-audit committee communications are part of a three-sided triangle made up of auditors, management, and directors. The Proposal represents a significant improvement over the initial draft in appreciating the respective roles and responsibilities of each of the three parties in the triangle.

---

[8] Ibid, Paragraph 21.

[9] Ibid, Appendix 4, Page A4-38. The release text states: "Examples of disagreements might include disagreement with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report."

Nonetheless, in some areas, the Proposal fails to appropriately recognize that management has the primary responsibility for financial reporting. Accordingly, management has the primary responsibility for initiating communications with the audit committee related to this responsibility, which includes communications on significant accounting policies and practices and critical accounting policies, practices, and estimates. For example, the Proposal includes requirements for the *auditor* to communicate to the audit committee a number of matters regarding accounting policies, practices, and estimates that are in reality the management's responsibility,[10] and therefore it is management's responsibility to initiate communications with audit committees on these matters.

The proposed standard does contain a note that recognizes some or all of the matters required to be communicated by the auditor *might* be communicated by management.[11] And, if so, the auditor does not need to communicate them at the same level of detail as management. Unfortunately, the standard goes on to say that this holds only so "long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical".[12] As such, the Proposal appears to be creating a financial reporting partnership between management and the auditor that blurs a responsibility that is primarily management's. In addition, it will result in duplicate communications to the audit committee and exacerbate the use of non-communicative boilerplate language in communications from auditors.

Furthermore, the proposed requirements regarding auditor communications of significant accounting policies and practices <u>and of critical accounting policies and practices</u> lack clarity.[13] For example, it is not clear if the intent is to have the auditor communicate to the audit committee *each year* management's significant accounting policies and practices or only changes in such policies or their application. If the former, this will lead to more boilerplate disclosures that are of little use to investors. <u>In regards to critical accounting policies and practices, it is unclear what disclosures</u>

[10] Ibid, Paragraph 12
[11] Ibid, Appendix 1, Page A1-8
[12] Ibid.
[13] Ibid, Paragraph 12.a and 12.b

the PCAOB has in mind; as such disclosures are not required by generally accepted accounting principles ("GAAP") but rather in management's discussion and analysis. Thus, it appears the PCAOB may be asking the auditor to assess disclosures within the GAAP notes to the financial statements that management does not necessarily have a responsibility to provide.

5. **Other Matters**

The Proposal includes a requirement that "[t]he auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters".[14]

More clarity around this requirement seems necessary. For example, public statements by PCAOB board members have suggested that PCAOB auditing standards should require auditors to communicate to the audit committee PCAOB inspection findings and any necessary remediation by the auditor. If this type of communication is what the PCAOB intends by this "catch-all" paragraph, this intent should be clearly stated and limited to the extent such findings and remediation relate to the company's audit engagement.

6. **Brokers and Dealers**

Since the issuance of the initial exposure draft, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") has given the PCAOB oversight of the audits of brokers and dealers registered with the Securities and Exchange Commission ("SEC"). The SEC has proposed to amend its rules to require that audits of the financial statements of brokers and dealers be performed under PCAOB standards. If so, the Proposal would apply to audits of broker dealers. However, the CCMC is concerned that the PCAOB may not fully understand the governance structures and complexities that can occur in brokers and dealers and,

---

[14] Ibid, Paragraph 23.

accordingly, whether the proposed requirements will realistically work for these organizations.

For example, the Proposal acknowledges that some brokers and dealers may have governance structures that do not include boards of directors or audit committees. In these circumstances, for non-public brokers and dealers, the Proposal would extend the definition of audit committees to include those persons designated to oversee the accounting and financial reporting processes of the company and its financial statement audit. The CCMC suggests that the PCAOB provide more clarity on the oversight level intended. In doing so, the CCMC recommends that the designated persons not be a CFO or similar officer, but, but rather a chief executive officer. Further, in these circumstances would all the requirements in the Proposal really make sense and apply?

This seems to be an area where a proposed standard may clash with the reality of differing business models that the PCAOB has not contemplated.

Another example is the circumstances that can occur in investment company complexes ("ICC") where issuers (with audit committees) that have investment houses (with audit committees) that are parents for broker dealer subsidiaries that have no audit committees. Perhaps it would be worthwhile for the PCAOB to clarify that the intended communications go to the audit committee of the parent of the broker dealer subsidiary, and not to the audit committee of the issuer or to both.

7. Business Advisory Group

The CCMC respectfully recommends that the PCAOB form a business advisory group consistent with the recommendation of The Financial Instruments Reporting and Convergence Alliance ("FIRCA").[15]

Often the business community is not consulted or input solicited, in the early stages of standard development, to the detriment of development of high quality audit standards.

---

[15] *See* February 23, 2012 letter from The Financial Instruments Reporting and Convergence Alliance to the Honorable James Doty, Chairman of the Public Company Accounting Oversight Board.

If the PCAOB had a business advisory group, it could have consulted with them and received input early in the process to understand the business and audit committee concerns with an issue. In this instance, such communication may have lead to a differently tailored Proposal all together. Consequently, a business advisory group could also be an important resource for the PCAOB on many other issues as well. The formation of a business advisory group will allow for a more consistent means for the PCAOB to consult on issues as it develops priorities and moves forward on them.

Following the fair value debate in 2008-2009, the Financial Accounting Foundation and Financial Accounting Standards Board have dramatically increased business input and communications. This has led to a better means of standard development during the difficult convergence process. We would recommend that the PCAOB follow this example.

Conclusion

The CCMC reiterates its acknowledgement of the improvements that the PCAOB has made in the Proposal. Some of these improvements result from the PCAOB's outreach activities, such as a roundtable, to better understand the entire dialogue that occurs in the management of a public company. However, the fact that much of this outreach was done subsequent to the release of the initial exposure draft reinforces a CCMC concern that there is an insufficient level of input from the business community on auditing proposals. While we believe that roundtables are an important means of developing input, they are also done on an ad-hoc basis.

The CCMC believes that standard setters should have a wide range of input to ensure the proper consideration of business operations and potential unintended consequences in the development and implementation of accounting and auditing standards. An insular approach may cause the PCAOB to expend resources that may best be allocated elsewhere, while developing standards that do not provide for adequate financial reporting structures to convey decision useful information to investors or businesses.

Accordingly, we request that the PCAOB review the Proposal to address the concerns outlined in this letter. Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

February 29, 2012

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

Subject: PCAOB Rulemaking Docket Matter No. 030: PCAOB Release No. 2011-008: *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Section 380*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) re-proposed auditing standards on auditor communications with the audit committee. Our comments will build upon those already transmitted to the PCAOB in our May 28, 2010 letter relating to PCAOB Release No. 2010-001: *Proposed Auditing Standards Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*.

We appreciate the PCAOB's efforts to update its auditing standard on auditor communications with audit committees and agree that effective two-way communication between the auditor and the audit committee benefits the auditor in performing an effective audit. Similarly, we believe that well informed, proactive audit committees are necessary to protect the interests of investors, financial statement users, and other interested parties.

However, we do have concerns about the appropriateness of the auditor being primarily responsible for communicating to the audit committee significant unusual transactions and the business rationale for such transactions as discussed in paragraph 14 of the proposed standard. It is management's responsibility to communicate these matters to those charged with governance. Accordingly, the requirement to communicate significant unusual transactions in paragraph 14 of the proposed standard should include the following note similar to that following paragraph 12:

> Note: As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, and estimates in paragraph 12. If

> management communicates any of these matters, the auditor does not need to communicate them at the same level of detail as management, as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor should communicate any omitted or inadequately described matters to the audit committee.

We believe adding this note to paragraph 14 will enable the auditor and the audit committee to engage in a dialogue on the most important issues and is more likely to benefit the audit committee in conducting its role in protecting the interests of investors and the auditor in conducting an effective audit.

We caution that, absent the addition of such a note, requiring the auditor to perform an activity that is inherently a management responsibility or is outside the context of the audit may impair the auditor's independence. *Government Auditing Standards*[1] states that reporting to those charged with governance on behalf of management is an example of an activity that is considered a management responsibility if performed for an audited entity. Consequently, a requirement for the auditor to be primarily responsible for reporting significant unusual transactions to those charged with governance, including the audit committee, may constitute a management participation threat that impairs the independence of the auditor. If the auditor identifies significant unusual transactions that have not been previously disclosed to the audit committee by management, then the auditor, based on their professional judgment and in accordance with current auditing standards, may communicate these significant unusual transactions to those charged with governance.

We thank you for considering our comments on this important issue which will provide auditors valuable guidance for enhancing the substance of their communications with audit committees.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

---

[1] GAO *Government Auditing Standards, December 2011 Revision (GAO-12-331G)* Washington, D.C.: December 2011 (3.36)

MAZARS

WeiserMazars

February 28, 2012

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

Re: Request for Public Comment: Proposed Auditing Standard on Communications with Audit Committees; and Related Amendments to Certain PCAOB Auditing Standards and Transitional Amendments to AU Sec. 380; PCAOB Rulemaking Docket Matter No. 030

Dear Office of the Secretary:

WeiserMazars LLP ("WeiserMazars") is an independent U.S. member firm of the Mazars Group, one of the world's most prominent international accounting, audit, tax and advisory services organizations with access to over 14,000 professionals in more than sixty countries on six continents. In the US, we are headquartered in New York City, with additional offices in Long Island, New York, New Jersey, Pennsylvania and Chicago, Illinois. We have a staff of more than 700 professionals working with clients in many industry niches including real estate, automotive, media, apparel, manufacturing, distribution, financial services, health care services, entertainment, not-for-profit, and textile rental, among others. WeiserMazars has built a significant practice in servicing many of the leading private equity groups and various public companies active across these industries. The firm also has prominent international tax and forensic accounting practices.

WeiserMazars appreciates the opportunity to respond to the Public Company Accounting Oversight Board (United States) (PCAOB or the Board) on its release, Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards and Transitional Amendments to AU Sec. 380 (the Proposed Standard). We are pleased to submit for the Board's consideration our observations on the Proposed Standard.

Communications with the audit committees:
The proposed standard includes various required communication matters. However, the Board should consider including the following additional matters as part of the auditors communication to the audit committee:

- AU Sec. 315, "Communications Between Predecessor and Successor Auditors", requires successor auditors to inquire about management integrity; disagreements with management about accounting principles, auditing procedures, or other similarly significant matters, communications to the audit committee, or in lieu of an audit committee or those charged with governance (i.e. Board of Directors) about fraud, illegal acts by clients, and internal control

WeiserMazars LLP
3000 Marcus Avenue – Lake Success, New York – 11042
Tel: 516.488.1200 – Fax: 516.488.1238 – www.weisermazars.com

matters; and the predecessor auditor's understanding of the reasons for the change of auditors. Depending on the circumstances, the successor may consider it necessary to review the predecessor auditors' working papers. The results of the communication with the predecessor auditors and review their working papers should be part of the successor auditors' communication with the audit committee.

- Changes in accounting systems as well as changes in responsibilities of key personnel directly impacts the financial reporting process and very often warrants changes in the audit plan.

- Impact of significant changes in the economy (for example the change in credit rating of the company) which will have a significant impact on the financial statements.

Engagement letter and appointment of auditor:

The requirements with regard to engagement letters in the proposed standard are clear.

Audit committees have oversight responsibility for the audit on behalf of investors. Therefore, appointment of the auditor should be performed by the audit committee. This will add independence and greater oversight of the auditor and the audit process. The appointment should be in writing and signed by the audit committee or a person authorized by the audit committee to avoid any ambiguity in terms of the engagement. An auditor expects management to assume certain responsibilities and communicate these responsibilities through the engagement letter. Based on the foregoing, it would be appropriate that an audit engagement letter be signed by the audit committee as well as management.

In addition, the engagement letter should include a paragraph on audit committee responsibilities apart from management responsibilities which will facilitate two-way communication between the auditor and the audit committee.

Significant unusual transactions:

AU Sec. 316, "Consideration of Fraud in a Financial Statement Audit", provides that the auditor should gain an understanding of the business rationale for significant unusual transactions and whether that rationale (or the lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets. In understanding the business rationale for transactions, the auditor should consider whether management has discussed the nature of and accounting for such transactions with the audit committee or board of directors. Based on this, communication of significant unusual transactions in the proposed standard is appropriate if these transactions posed a significant risk and are likely to cause a material misstatement in the financial statements. However, requiring an auditor to communicate the auditor's understanding of the business rationale for such transactions seems to stretch the auditor's basic responsibilities, and amounts to putting the auditor in the place of management. The audit committee should seek such information regarding the business rational for significant unusual transactions directly from management.

Other independent public accounting firms or other persons who are not employed by the auditor that are involved in the audit (Paragraph 10 (d) of Appendix 1 of the Proposed Standard):

The responsibility of communication of involvement of other independent public accounting firms or other persons who are not employed by auditors should rest with the audit committee. First, such firms or persons are appointed by the audit committee as indicated in our suggestions earlier and secondly, the other firms or persons are required to agree to the terms of the engagement with the audit committee. In other words, the audit committee is in a position to know the facts of involvement of the other independent accounting firms before the auditors are aware of it.

The basis for the auditor's determination that he or she can serve as principal auditor if significant parts of the audit will be performed by other auditors, (Paragraph 10 (e) of the Appendix 1 of the Proposed Standard):

The basis for the auditor's determination that he or she can serve as principal auditor should be communicated during planning, especially if the determination under AU Sec.543, "Part of Audit Performed by Other Independent Auditors", is both qualitative and quantitative. The audit committee should be responsible for evaluating an auditor's ability to serve as principal auditor during the approval process in the case of the use of other auditors.

Critical accounting policies and practices, (Paragraph 12 (b) (2) of Appendix 1 of the Proposed Standard:

An auditor should not be required to comment on the impact of current and future anticipated events on critical policies and practices. This requirement would put the auditor in the place of management, which would appear to be a conflict of interest. In fact, the auditor should refrain from commenting on such matters. This is clearly a management responsibility.

Comments regarding the audits of brokers and dealers:

- The auditors communication to the audit committee included in the Proposed Standard should only be applicable to clearing brokers and dealers and not introducing brokers and dealers. In addition, clearing brokers and dealer should be subject to the Proposed Standards and not the interim standard, AU Sec. 380.

MAZARS

WeiserMazars

- Management should be required to review the computations of Net Capital and Aggregate Indebtedness as well as the SIPC General Assessment with the audit committee. The auditors should be present for this presentation and comment as necessary. The auditors should communicate any issues and/or changes to the computations based on the audit work performed. These computations are specific to brokers and dealers and are critical aspects of the business.

We would be pleased to respond to any questions the Board or its staff may have about these comments. The Board or its staff may direct any questions on our observations to either David Rubenstein, Partner 212.375.6822, Wendy Stevens, Partner-Technique & Innovation 212.375.6699, or Mitesh Jain, Senior Manager 646.435.1611.

Sincerely,

WeiserMazars LLP

WeiserMazars, LLP

1666 K Street, NW
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

AUDITING STANDARD No. 16 – COMMUNICATIONS WITH AUDIT COMMITTEES; RELATED AMENDMENTS TO PCAOB STANDARDS; AND TRANSITIONAL AMENDMENTS TO AU SEC. 380	PCAOB Release No. 2012-004 August 15, 2012 PCAOB Rulemaking Docket Matter No. 030

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is adopting (i) Auditing Standard No. 16, *Communications with Audit Committees,* that would supersede the Board's interim standards AU sec. 380, *Communication With Audit Committees,* and AU sec. 310, *Appointment of the Independent Auditor*, (ii) transitional amendments to AU sec. 380, and (iii) related amendments to PCAOB standards.

Board Contacts: Jennifer Rand, Deputy Chief Auditor (202/207-9206, randj@pcaobus.org), Jessica Watts, Associate Chief Auditor (202/207-9376, wattsj@pcaobus.org), and Hasnat Ahmad, Assistant Chief Auditor (202/207-9349, ahmadh@pcaobus.org).

*****

I. Introduction

With the passage of the Sarbanes-Oxley Act of 2002 (the "Act") and the establishment of the PCAOB, Congress acknowledged that auditors play an important role in protecting the interests of investors by preparing and issuing informative, accurate, and independent audit reports.[1/] The audit committee[2/]

1/ *See* Section 101(a) of the Act, 15 U.S.C. § 7211(a); Senate Report No. 107-206, at 5-6 (July 3, 2002).

2/ The term "audit committee," as defined in Auditing Standard No. 16, is a committee (or equivalent body) established by and among the board of also plays an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to a company's shareholders and others to oversee the integrity of a company's accounting and financial reporting processes and audits. The audit committee, among other things, serves as the board of director's principal interface with the company's auditors and facilitates communications between the company's board of directors, its management, and its independent auditors on significant accounting issues and policies. The roles of auditors and audit committees are critical to the efficiency and integrity of the capital markets.

Both the auditor and the audit committee benefit from a meaningful exchange of information regarding significant risks of material misstatement in the financial statements and other matters that may affect the integrity of the company's financial reports. Communications between the auditor and the audit committee allow the audit committee to be well-informed about accounting and disclosure matters, including the auditor's evaluation of matters that are significant to the financial statements, and to be better able to carry out its oversight role. Communications with the audit committee provide auditors with a forum separate from management to discuss matters about the audit and the company's financial reporting process.

The Board is adopting Auditing Standard No. 16, *Communications with Audit Committees* (the "standard"), and related amendments to improve the audit by enhancing communications between auditors and audit committees. Auditing Standard No. 16 will replace interim standards AU sec. 380, *Communication With Audit Committees* ("AU sec. 380"), and AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310"). Adoption of the standard is in the public interest because the standard establishes requirements that enhance the relevance, timeliness, and quality of the communications between the auditor and the audit committee. The enhanced relevance, timeliness, and quality of communications should facilitate audit

---

directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to a company, the entire board of directors of the company. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

committees' financial reporting oversight, fostering improved financial reporting, thereby benefitting investors.

Auditing Standard No. 16 is aligned with the requirements of the Act. For many public companies, the Act served to strengthen and expand the role of the audit committee in the financial reporting process. For example, the Act requires that audit committee members of listed companies be independent and that audit committees be responsible for the appointment, compensation, and oversight of the work of the external auditor for the purpose of preparing or issuing an audit report or related work.[3/] These requirements place the audit committee at the center of the relationship between management of a public company and its auditor.

Auditing Standard No. 16 is intended to improve the audit[4/] by fostering constructive dialogue between the auditor and the audit committee about significant audit and financial statement matters. The standard requires the auditor to communicate certain matters regarding the audit and the financial statements to the audit committee, which should assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Effective two-way communication between the auditor and the audit committee on such relevant matters also will benefit the auditor in performing an effective audit.

Auditing Standard No. 16 encourages effective two-way communication between the auditor and the audit committee throughout the audit to assist both parties in understanding matters relevant to the audit. Communications that are tailored to the circumstances and informative, rather than "boiler-plate" or standardized, will enable the auditor and the audit committee to engage in a dialogue that is more likely to benefit both the audit committee, in conducting its oversight responsibilities, and the auditor, in conducting an effective audit. Effective communication between the auditor and the audit committee may

---

3/ *See* Section 301 of the Act and Section 10A(m)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j-1(m)(2).

4/ For purposes of this release and standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

involve many forms of communication, such as presentations, charts, written reports, or robust discussions.

AU sec. 380, which became effective in January 1989, indicated that audit committee communications are incidental to the audit and are not required to occur prior to the issuance of the auditor's report. In contrast, Auditing Standard No. 16 recognizes the importance of the auditor's communications with the audit committee in today's business and regulatory environment; therefore, Auditing Standard No. 16 requires the auditor to communicate the audit strategy and results of the audit to the audit committee in a timely manner and prior to the issuance of the auditor's report to provide an opportunity for the audit committee and the auditor to take appropriate action to address the matters communicated.

Timely communications with the audit committee help the auditor improve the audit by, among other things (i) informing the audit committee, which has responsibility for the oversight of financial reporting, about significant matters related to the audit and the financial statements, (ii) enabling the auditor to obtain the audit committee's insights and information about transactions and events, (iii) enabling the auditor to learn about complaints regarding accounting or auditing matters, and (iv) assisting the auditor in gaining a better understanding of the company and its control environment.

Auditing Standard No. 16 generally links the new communication requirements to the results of related audit performance requirements in other PCAOB standards, or the conduct of the audit. The standard does not otherwise impose new performance requirements, other than communications. Because other PCAOB standards already require the auditor to perform procedures underlying the communications required in Auditing Standard No. 16, and the standard primarily requires communication of the results of the auditor's procedures, the Board does not anticipate a significant increase in cost as a result of the implementation of the standard.

Some of the matters to be communicated under Auditing Standard No. 16 relate specifically to matters involving management's preparation of the company's financial statements. In many companies, management might communicate these matters or take the lead on communicating these matters to the audit committee. The PCAOB does not have the authority to require management to communicate to the audit committee. Additionally, certain communications by the auditor are mandated by federal securities laws and

Securities and Exchange Commission ("SEC") rules.[5/] Therefore, Auditing Standard No. 16 establishes required communications by the auditor to the audit committee but, at the same time, clearly recognizes and acknowledges that management might communicate to the audit committee certain matters related to the company's financial statements. In such circumstances, the auditor does not need to communicate those matters at the same level of detail as management, as long as certain conditions are met, as specified in the standard.

Auditing Standard No. 16 is scalable for audits of companies of various sizes and complexities. A company's size and complexity might affect the risks of misstatements, the audit strategy, and other significant matters that warrant the attention of the audit committee. Based on the specific company's circumstances, the standard requires communications only to the extent that the matters are relevant to the audit of the financial statements of the company or of internal control over financial reporting. For example, an auditor of a smaller, less complex company with fewer difficult auditing or financial reporting issues may have fewer matters to communicate than the auditor of a larger, more complex company.

II. Background

On March 29, 2010, the Board proposed a standard, *Communications with Audit Committees* (the "original proposed standard"), to improve the audit by enhancing the relevance and effectiveness of the communications between the auditor and the audit committee.[6/] The original proposed standard was informed by, among other things, the increased use of risk-based audit methodologies, the emphasis on judgments and estimates in the financial

---

[5/] *See e.g.,* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k); SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"), 17 C.F.R. § 210.2-07; and Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

[6/] *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards,* PCAOB Release No. 2010-001 (March 29, 2010).

reporting frameworks and discussions with the Board's Standing Advisory Group ("SAG").[7/]

The Board received 35 comment letters on the original proposed standard.[8/] Most commenters were supportive of the original proposed standard, although several commenters suggested that additional outreach to stakeholders might be beneficial. The comments were discussed with the SAG on July 15, 2010.[9/] Additionally, on September 21, 2010, the Board held a roundtable[10/] to obtain insight from additional stakeholders, including investors, audit committee members, auditors, and preparers.[11/] The roundtable discussion explored many key issues that commenters had raised in response to the original proposed standard regarding:

i. Communications beneficial to audit committees;

ii. Accounting policies, practices, and estimates;

iii. Effective two-way communication between the auditor and the audit committee;

iv. Balance between written and oral communications;

[7/] The SAG discussed the audit committee communications standard at a number of its meetings, including meetings on: June 21-22, 2004, June 8, 2005, October 5-6, 2005, and October 14-15, 2009.

[8/] Comments on the original proposed standard are available at http://pcaobus.org/Rules/Rulemaking/Pages/Docket030Comments.aspx.

[9/] A transcript of the portion of the meeting related to the original proposed standard is available at http://pcaobus.org/Rules/Rulemaking/Docket030/Communications_with_Audit_Committees.pdf.

[10/] A listing of the roundtable participants is available at http://pcaobus.org/News/Releases/Pages/09162010_RoundtableParticipants.aspx.

[11/] A transcript of the roundtable is available at http://pcaobus.org/Rules/Rulemaking/Docket030/Roundtable_Transcript.pdf.

v. Audit committee responsibilities in the engagement letter;

vi. Management communications; and

vii. Uncorrected misstatements.

To provide all interested parties with an opportunity for additional comments on the topics discussed at the roundtable, the Board reopened the public comment period on the original proposed standard. The Board received nine additional comment letters during this extended comment period.[12/]

The original proposed standard was revised in response to comments received in comment letters and at the roundtable, and discussions with the SAG. The Board reproposed the standard for public comment on December 20, 2011 (the "reproposed standard") to seek comment on:[13/]

- The revisions to the original proposed standard to align many of the audit committee communication requirements with the auditor performance requirements included in the risk assessment standards, which were adopted subsequent to the issuance of the original proposed standard;

- The applicability of the proposed standard to the audits of brokers and dealers; and

- The addition of the requirement to communicate significant unusual transactions to the audit committee and to communicate the auditor's understanding of the business rationale for such transactions.

[12/] Comments on the original proposed standard are available at http://pcaobus.org/Rules/Rulemaking/Pages/Docket030Comments.aspx.

[13/] *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380,* PCAOB Release No. 2011-008 (Dec. 20, 2011).

The Board received 39 comment letters in response to the reproposed standard.[14/] Commenters to the reproposed standard generally were supportive of the changes made to the original proposed standard to enhance the communications between the auditor and the audit committee. Commenters indicated that the changes made enhanced the quality of information exchanged between the auditor and the audit committee. Commenters also indicated that fuller and more relevant communications between the auditor and the audit committee would enable the audit committee to effectively fulfill its oversight responsibilities regarding the financial reporting process, and allow the auditor to perform a more informed, and thus more efficient and effective, audit.

Commenters on the reproposed standard specifically commented on, among other things, the following matters:

- The definition of audit committee in relation to nonissuers without an audit committee or board of directors;

- Management's communication of significant unusual transactions;

- The communication of the auditor's evaluation of the company's ability to continue as a going concern; and

- The application of the standard to the audits of brokers and dealers.

The Board took all comments received during this standard-setting project into consideration in revising the standard. The definition of audit committee was retained substantially in the form as reproposed, with additional clarification provided in Appendix 4 of this release. Auditing Standard No. 16 was revised to acknowledge that management might communicate certain matters related to significant unusual transactions and that the auditor would not have to communicate such matters at the same level of detail as long as certain criteria within the standard are met. Additionally, communication requirements related to the auditor's evaluation of the company's ability to continue as a going concern were revised to align the communications more precisely with the auditor's procedures related to such evaluation. Section IV

[14/] Comments on the reproposed standard are available at http://pcaobus.org/Rules/Rulemaking/Pages/Docket030Comments.aspx.

below discusses the application of Auditing Standard No. 16 to the audits of brokers and dealers.

Significant comments received regarding the reproposed standard are addressed in detail in Appendix 4 of this release.

III. **Overview of Auditing Standard No. 16**

Auditing Standard No. 16 provides a definition of audit committee, retains or enhances existing communication requirements, incorporates certain SEC auditor communication requirements to audit committees, and adds new communication requirements that are generally linked to performance requirements in other PCAOB standards.

For audits of issuers, Auditing Standard No. 16 incorporates the Act's definition of audit committee as a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, then the audit committee is the entire board of directors of the company. For audits of nonissuers, the definition of audit committee contained in Auditing Standard No. 16 provides that if no audit committee or board of directors (or equivalent body) exists with respect to the company, then the audit committee is the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

AU sec. 310 requires the auditor to establish an understanding with the client regarding the services to be performed. Auditing Standard No. 16 requires the auditor to establish the understanding of the terms of the audit engagement with the audit committee. This requirement aligns the auditing standard with the provision of the Act that requires the audit committee of listed companies to be responsible for the appointment of the external auditor.[15/]

Additionally, Auditing Standard No. 16 requires the auditor to record the terms of the engagement in an engagement letter and to have the engagement

---

[15/] *See* Section 301 of the Act, and Sections 10A(m)(2) of the Exchange Act, 15 U.S.C. § 78j-1(m)(2).

letter executed by the appropriate party or parties on behalf of the company and determine that the audit committee has acknowledged and agreed to the terms. These requirements are an expansion of the requirement in AU sec. 310 for the auditor to document the understanding in the working papers, preferably through a written communication with the client.

Auditing Standard No. 16 retains many of the communication requirements in AU sec. 380 and also incorporates the SEC communication requirements.[16/] The standard improves the current communication requirements of AU sec. 380 by requiring the communications with the audit committee to occur before the issuance of the audit report. Additionally, the standard enhances certain existing auditor communication requirements by requiring the auditor to communicate:

- Certain matters regarding the company's accounting policies, practices, and estimates;

- The auditor's evaluation of the quality of the company's financial reporting;

- Information related to significant unusual transactions, including the business rationale for such transactions; and

- The auditor's views regarding significant accounting or auditing matters when the auditor is aware that management consulted with other accountants about such matters and the auditor has identified a concern regarding these matters.

Auditing Standard No. 16 expands the inquiries of the audit committee required by Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* which requires the auditor to inquire of the audit committee regarding the matters important to the identification and assessment of risks of material misstatement and fraud risks. The additional inquiries in Auditing Standard No. 16 address whether the audit committee is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations.

[16/] *See* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k) and SEC Rule 2-07(a)(1)-(3).

Additionally, Auditing Standard No. 16 adds new communication requirements that provide the audit committee with additional information about significant aspects of the audit. These communications are generally linked to the results of the audit procedures or the conduct of the audit. Under Auditing Standard No. 16 the auditor would be required to communicate:

- An overview of the overall audit strategy, including timing of the audit, significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks;

- Information about the nature and extent of specialized skill or knowledge needed in the audit, the extent of the planned use of internal auditors, company personnel or other third parties, and other independent public accounting firms, or other persons not employed by the auditor that are involved in the audit;

- The basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit will be performed by other auditors;

- Situations in which the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting;

- Difficult or contentious matters for which the auditor consulted outside the engagement team;

- The auditor's evaluation of going concern;

- Departure from the auditor's standard report; and

- Other matters arising from the audit that are significant to the oversight of the company's financial reporting process, including complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit.

In addition to the communication requirements included in Auditing Standard No. 16, other PCAOB standards and rules that require the auditor to communicate specific matters to the audit committee are referenced in Appendix B to Auditing Standard No. 16.

While the standard establishes certain requirements regarding auditor communications to the audit committee, Auditing Standard No. 16 does not preclude the auditor from providing additional information to the audit committee. Nor does the standard preclude the auditor from responding to audit committee requests for additional information from the auditor.

IV. Audits of Brokers and Dealers

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[17/] gave the Board oversight of the audits of brokers and dealers registered with the SEC. In September 2010, the Commission issued interpretive guidance clarifying that the references in Commission rules and staff guidance and in the federal securities laws to generally accepted auditing standards ("GAAS") or to specific standards under GAAS, as they relate to nonissuer brokers or dealers, should continue to be understood to mean the auditing and attestation standards established by the American Institute of Certified Public Accountants ("AICPA"), but noted that it intended to revisit this interpretation in connection with a SEC rulemaking project to update the audit and attestation requirements for brokers and dealers in light of the Dodd-Frank Act.[18/] On June 15, 2011, the SEC proposed to amend its rules, including SEC Rule 17a-5 under the Exchange Act, to require, among other things, that audits of brokers' and dealers' financial statements and examinations of reports regarding compliance with SEC requirements be performed in accordance with the standards of the PCAOB.[19/]

If the SEC adopts its proposed amendments to SEC Rule 17a-5 or provides other direction that auditors of brokers and dealers are to comply with PCAOB professional standards, the Board's auditing, attestation, quality control, and, where applicable, independence standards would then apply to

---

17/ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

18/ SEC, *Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers*, Exchange Act Release No. 62991 (Sept. 24, 2010).

19/ SEC, *Broker-Dealer Reports,* Exchange Act Release No. 64676 (June 15, 2011).

audits of brokers and dealers as required by Section 17 of the Exchange Act and SEC Rule 17a-5.[20/]

Further, if the SEC adopts its proposed amendments to SEC Rule 17a-5 or provides other direction that auditors of brokers and dealers are to comply with PCAOB standards, prior to the effective date of Auditing Standard No. 16,[21/] the Board's interim standard, AU sec. 380, would be in effect for audits of brokers and dealers conducted for periods prior to the effective date of Auditing Standard No. 16. The Board's interim standard, AU sec. 380, which was last amended in 1999, indicates that it is not applicable to the audit of a broker or dealer if the broker or dealer does not have an audit committee[22/] or is registered with the SEC only because of Section 15(a) of the Exchange Act.[23/] Conversely, the auditor communication requirements under GAAS, which are contained in Statement on Auditing Standards ("SAS") 114, *The Auditor's Communication With Those Charged With Governance,* which was issued by the Auditing Standards Board ("ASB") of the AICPA in 2006, are applicable to audits of all brokers and dealers.[24/] Because of this difference in the

---

20/ 17 C.F.R. § 240.17a-5.

21/ As noted in Section VII of this release, the Board anticipates that Auditing Standard No. 16 will be effective, subject to SEC approval, for audits of fiscal years beginning on or after December 15, 2012.

22/ AU sec. 380.01 states that the communications required by AU sec. 380 are applicable to entities that either have an audit committee or that have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee (such as a finance committee or budget committee).

23/ *See* AU sec. 380.01, which states that the communications required by the standard "are applicable to . . . all Securities and Exchange Commission (SEC) engagements." As noted in footnote 2 to AU sec. 380.01, the audits of brokers and dealers do not fall within an SEC engagement as defined in AU sec. 380 if the broker or dealer is registered only because of Section 15(a) of the Exchange Act.

24/ *See* paragraph 1 of SAS 114 which states "[t]his statement . . . establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial applicability of the auditor communication standards to the audits of brokers and dealers, there could be a gap in required audit committee communications if the SEC amendments to SEC Rule 17a-5 are adopted and become effective prior to the effective date of Auditing Standard No. 16. To eliminate this gap, the Board is amending AU sec. 380 to delete the current exception for audits of brokers and dealers that do not have an audit committee or are registered with the SEC only because of Section 15(a) of the Exchange Act. The transitional amendment, which is contained in Appendix 2 to this release, would eliminate the above-referenced gap in audit committee communications by making the communication requirements in AU sec. 380 applicable to audits of issuers and brokers and dealers, as those terms are defined in the Act, prior to the effective date of Auditing Standard No. 16.

If PCAOB standards are applicable to audits of brokers and dealers prior to the effective date of Auditing Standard No. 16, the communication requirements under Auditing Standard No. 16 would be applicable to the audits of brokers and dealers upon the effective date of the standard.

V. Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act"), any rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of emerging growth companies ("EGCs") (as defined in Section 3(a)(80) of the Exchange Act) unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."[25/] Auditing Standard No. 16 is the first auditing standard adopted by the Board subsequent

---

statements," and section 5.129 of the *AICPA Audit & Accounting Guide: Brokers and Dealers in Securities* (July 2010), which states, in part: "AU section 380, *The Auditor's Communication with Those Charged with Governance* … has been updated for the issuance of SAS No. 114…. AU 380 is applicable to all broker-dealers being audited under GAAS, regardless of their governance structure or size."

[25/] Pub. L. No. 112-106, 126 STAT. 306 (April 5, 2012). *See* Section 103(a)(3)(C) of the Act, 15 U.S.C. § 7213 (a)(3)(C), as added by Section 104 of the JOBS Act.

to enactment of the JOBS Act and accordingly is subject to a separate determination by the SEC regarding its applicability to audits of EGCs.

Pursuant to Section 107(b) of the Act, the Board will file Auditing Standard No. 16 for approval by the SEC. The Board will also request that the SEC approve the application of Auditing Standard No. 16, and the related amendments, to the audits of EGCs.

VI. Appendices

Appendix 1 to this release contains the text of Auditing Standard No. 16, *Communications with Audit Committees,* which has three appendices:

(1) Appendix A - Definitions,

(2) Appendix B - Communications with Audit Committees Required by Other PCAOB Rules and Standards, and

(3) Appendix C - Matters Included in the Audit Engagement Letter.

Appendix 2 to this release contains the transitional amendments to AU sec. 380. Appendix 3 to this release contains amendments to other existing PCAOB standards. Appendix 4 provides additional discussion of Auditing Standard No. 16, the amendments to other PCAOB standards, and comments received on the reproposed standard. Appendix 5 to this release discusses certain significant differences between the objectives and requirements of Auditing Standard No. 16 and the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board of the AICPA. In developing the standard, the Board considered the requirements of the relevant standards of the IAASB and the ASB.

VII. Effective Date

The Board anticipates that the transitional amendments to AU sec. 380 included in Appendix 2 would be effective, subject to SEC approval, for the periods that PCAOB standards become applicable to audits of brokers and dealers, as designated by the SEC upon adoption of its amendments to SEC Rule 17a-5, if such periods precede the effective date of Auditing Standard No. 16.

The Board anticipates that Auditing Standard No. 16 and related amendments, included in Appendices 1 and 3, respectively, will be effective, subject to SEC approval, for audits of fiscal years beginning on or after December 15, 2012.

On the 15th day of August, in the year 2012, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

APPENDIX 1

Auditing Standard No. 16

Communications with Audit Committees

Introduction

1. This standard requires the auditor to communicate with the company's **audit committee**[1/] regarding certain matters related to the conduct of an audit[2/] and to obtain certain information from the audit committee relevant to the audit. This standard also requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee and to record that understanding in an engagement letter.

2. Other Public Company Accounting Oversight Board ("PCAOB") rules and standards identify additional matters to be communicated to a company's audit committee (see Appendix B). Various laws or regulations also require the auditor to communicate certain matters to the audit committee.[3/] The communication requirements of this standard do not modify or replace communications to the audit committee required by such other PCAOB rules and standards, and other laws or regulations. Nothing in this standard precludes the auditor from communicating other matters to the audit committee.

1/ Terms defined in Appendix A, *Definitions,* are set in **boldface type** the first time they appear.

2/ For purposes of this standard, an audit is either an audit of internal control over financial reporting that is integrated with an audit of financial statements or an audit of financial statements only.

3/ *See e.g.,* Section 10A(k) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j-1(k); Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07; and Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

Objectives

3. The objectives of the auditor are to:

   a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

   b. Obtain information from the audit committee relevant to the audit;

   c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

   d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

   Note: "Communicate to," as used in this standard, is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit.

Appointment and Retention

Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention

4. The auditor should discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

Establish an Understanding of the Terms of the Audit

5. The auditor should establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the following:

   a. The objective of the audit;

   b. The responsibilities of the auditor; and

c. The responsibilities of management.

6. The auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the engagement letter to the audit committee annually. The auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[4/] If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Note: Appendix C describes matters that the auditor should include in the engagement letter about the terms of the audit engagement.

7. If the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee, the auditor should decline to accept, continue, or perform the engagement.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

8. The auditor should inquire of the audit committee about whether it is aware of matters relevant to the audit,[5/] including, but not limited to, violations or possible violations of laws or regulations.[6/]

[4/] Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

[5/] In addition to this inquiry, paragraphs 5.f. and 54-57 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* describe the auditor's inquiries of the audit committee, or equivalent (or its chair) regarding the audit committee's knowledge of the risks of material misstatement, including fraud risks. These inquiries include, among other things, whether the audit committee is aware of tips or complaints regarding the company's financial reporting.

[6/] *See* AU sec. 317, *Illegal Acts by Clients*, for a description of the auditor's responsibilities when a possible illegal act is detected. For audits of

Overall Audit Strategy, Timing of the Audit, and Significant Risks

9. The auditor should communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit,[7/] and discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures.[8/]

> Note: This overview is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures.

10. As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;[9/]

b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;[10/]

---

issuers, *see also* Section 10A(b) of the Exchange Act, 15 U.S.C. § 78j-1(b), and Rule 10A-1 under the Exchange Act, 17 C.F.R. § 240.10A-1.

7/ *See* paragraphs 8-9 of Auditing Standard No. 9, *Audit Planning,* for a description of the auditor's responsibilities for establishing an overall audit strategy.

8/ Auditing Standard No. 12 requires the auditor to determine whether identified and assessed risks are significant risks. A significant risk is defined as a risk of material misstatement that requires special audit consideration.

9/ *See* paragraph 16 of Auditing Standard No. 9 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

10/ *See* AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* which describes the auditor's responsibilities related to the work of internal auditors.

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;[11/]

d. The names, locations, and planned responsibilities[12/] of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

> Note: The term "other independent public accounting firms" in the context of this communication includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.

e. The basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.[13/]

[11/] *See* paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

[12/] *See* paragraphs 8-14 of Auditing Standard No. 9, which discuss the auditor's responsibilities for determining the audit strategy, audit plan, and extent to which audit procedures should be performed at selected locations or business units involving multi-location engagements.

[13/] *See* AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, which discusses the professional judgments the auditor makes in deciding whether the auditor may serve as principal auditor.

11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.[14/]

Results of the Audit

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions

12. The auditor should communicate to the audit committee the following matters:

a. Significant accounting policies and practices.[15/]

(1) Management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and

(2) The effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

[14/] *See* paragraph 15 of Auditing Standard No. 9, which discusses changes in audit strategy and the audit plan during the course of the audit.

[15/] *See, e.g.*, Financial Accounting Standards Board Accounting Standards Codification, Topic 235, Notes to Financial Statements, paragraph 235-10-50-1, which requires the entity to disclose a description of all significant accounting policies as an integral part of the financial statements, and paragraph 235-10-50-3, which describes what should be disclosed.

b. **Critical accounting policies and practices**. All critical accounting policies and practices to be used, including:[16/]

(1) The reasons certain policies and practices are considered critical; and

(2) How current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

Note: Critical accounting policies and practices, as defined in Appendix A, are a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. Critical accounting policies and practices are tailored to specific events in the current year, and the accounting policies and practices that are considered critical might change from year to year.

c. **Critical accounting estimates**.

(1) A description of the process management used to develop critical accounting estimates;[17/]

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;[18/] and

---

[16/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(1) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(1).

[17/] *See* AU sec. 342, *Auditing Accounting Estimates*, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

[18/] *Id.*

(3) Any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.[19/]

d. Significant unusual transactions.

(1) Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature;[20/] and

(2) The policies and practices management used to account for significant unusual transactions.

Note: As part of its communications to the audit committee, management might communicate some or all of the matters in paragraph 12. If management communicates any of these matters, the auditor does not need to communicate them at the same level of detail as management, as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the auditor considers critical. The auditor should communicate any omitted or inadequately described matters to the audit committee.

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

13. The auditor should communicate to the audit committee the following matters:

a. Qualitative aspects of significant accounting policies and practices.

[19/] *Id.*

[20/] *See* paragraph 71.g. of Auditing Standard No. 12*.*

(1) The results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements;[21/] and

(2) The results of the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management.[22/]

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates.[23/]

d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.[24/]

[21/] *See* paragraphs 24-27 of Auditing Standard No. 14, *Evaluating Audit Results*, which describe the auditor's responsibilities related to evaluating the qualitative aspects of the company's accounting practices.

[22/] *See* paragraph 27 of Auditing Standard No. 14.

[23/] *See* AU sec. 342, which discusses the auditor's responsibilities to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates in an audit of financial statements.

[24/] *See* paragraph .66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

e. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth.[25/]

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.[26/]

Other Information in Documents Containing Audited Financial Statements

14. When other information is presented in documents containing audited financial statements, the auditor should communicate to the audit committee

---

[25/] *See* paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Other PCAOB standards, such as AU sec. 334, *Related Parties,* and AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, describe the auditor's responsibilities related to evaluation of specific disclosures in financial statements.

[26/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Rule 2-07(a)(2) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(2).

the auditor's responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.[27/]

Difficult or Contentious Matters for which the Auditor Consulted

15. The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

Management Consultation with Other Accountants

16. When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, the auditor should communicate to the audit committee his or her views about such matters that were the subject of such consultation.

Going Concern

17. The auditor should communicate to the audit committee, when applicable, the following matters relating to the auditor's evaluation of the company's ability to continue as a going concern:[28/]

[27/] *See, e.g.*, AU sec. 550, *Other Information in Documents Containing Audited Financial Statements.* In addition to AU sec. 550, discussion of the auditor's consideration of other information is included in AU sec. 558, *Required Supplementary Information,* and AU sec. 711, *Filings Under Federal Securities Statutes.*

[28/] *See* AU sec. 341 for the requirements regarding an auditor's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. Additionally, AU secs. 341.03a-c provide the auditor with an overview of the requirements for evaluating whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

a. If the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the conditions and events that the auditor identified that, when considered in the aggregate, indicate that there is substantial doubt;[29/]

b. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events;[30/]

c. If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains:[31/]

   (1) The effects, if any, on the financial statements and the adequacy of the related disclosure;[32/] and

---

29/ *See* AU sec. 341.06, which provides examples of such conditions and events and AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

30/ *See* AU sec. 341.08, which discusses the auditor's responsibilities related to the auditor's evaluation of management's plans.

31/ *See* AU sec. 341.12, which describes the effects on the auditor's report. *See also* AU sec. 341.03c, which discusses the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

32/ *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

(2) The effects on the auditor's report.[33/]

Uncorrected and Corrected Misstatements

18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures[34/] that the auditor presented to management.[35/] The auditor should discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[36/] considered. The auditor also should communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

19. The auditor should communicate to the audit committee those corrected misstatements, other than those that are clearly trivial,[37/] related to accounts

---

33/ *See* AU secs. 341.12-.16, which discuss the auditor's consideration of the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

34/ Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include omission and presentation of inaccurate or incomplete disclosures.

35/ *See* Section 13(i) of the Exchange Act, 15 U.S.C.§ 78m(i), which states, in part, that financial statements prepared in accordance with generally accepted accounting principles and filed with the Securities and Exchange Commission "shall reflect all material correcting adjustments that have been identified by a registered public accounting firm …."

36/ Appendix B of Auditing Standard No. 14 discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

37/ *See* paragraph 10 of Auditing Standard No. 14, which requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial.

and disclosures that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

Material Written Communications

20. The auditor should communicate to the audit committee other material written communications between the auditor and management.[38/]

Departure from the Auditor's Standard Report

21. The auditor should communicate to the audit committee the following matters related to the auditor's report:

a. When the auditor expects to modify the opinion in the auditor's report, the reasons for the modification, and the wording of the report; and

b. When the auditor expects to include explanatory language or an explanatory paragraph in the auditor's report, the reasons for the explanatory language or paragraph, and the wording of the explanatory language or paragraph.

Disagreements with Management

22. The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information prior to the issuance of the auditor's report.

[38/] *See also* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k) and Rule 2-07(a)(3) of Regulation S-X, 17 C.F.R. § 210.2-07 (a)(3).

Difficulties Encountered in Performing the Audit

23. The auditor should communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

a. Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;

b. An unreasonably brief time within which to complete the audit;

c. Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;

d. Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and

e. Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

Note: Difficulties encountered by the auditor during the audit could represent a scope limitation,[39/] which may result in the auditor modifying the auditor's opinion or withdrawing from the engagement.

Other Matters

24. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have

---

[39/] *See* paragraphs .22-.32 of AU sec. 508, *Reports on Audited Financial Statements,* for a discussion of scope limitations.

come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.[40/]

Form and Documentation of Communications

25. The auditor should communicate to the audit committee the matters in this standard, either orally or in writing,[41/] unless otherwise specified in this standard. The auditor must document the communications in the work papers, whether such communications took place orally or in writing.[42/]

> Note: If, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.

Timing

26. All audit committee communications required by this standard should be made in a timely manner and prior to the issuance of the auditor's report.[43/] The

---

[40/] AU secs. 316.79-.81 and AU sec. 317.17 include specific communication requirements relating to fraud or illegal acts, respectively.

[41/] *See* paragraphs .07-.11 of AU sec. 532, *Restricting the Use of an Auditor's Report,* which apply to certain written reports on matters coming to the auditor's attention during the course of the audit.

[42/] Consistent with the requirements of Auditing Standard No. 3, *Audit Documentation*, the audit documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of this standard.

[43/] Consistent with Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.

> Note: An auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit. The auditor, however, should communicate such matters to the audit committee prior to the issuance of the auditor's report.

---

provide an update in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

***APPENDIX A* – Definitions**

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Audit committee – A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

A3. Critical accounting estimate – An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

A4. Critical accounting policies and practices – A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

APPENDIX B – Communications with Audit Committees Required by Other PCAOB Rules and Standards

This appendix identifies other PCAOB rules and standards related to the audit that require communication of specific matters between the auditor and the audit committee.

- Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist,* paragraphs 60, 62, and 64
- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* paragraphs 78-81, 91, C7, and C14
- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* paragraphs 5.f. and 54-57
- PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*
- PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting*
- PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* paragraphs .79-.81
- AU sec. 317, *Illegal Acts by Clients,* paragraphs .08, .17, and .20
- AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* paragraphs 4-7 and 9
- AU sec. 328, *Auditing Fair Value Measurements and Disclosures,* paragraph .50

- AU sec. 333, *Management Representations*, paragraph .05

- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*, paragraphs .04 and .06

- AU sec. 711, *Filings Under Federal Securities Statutes*, paragraph .13

- AU sec. 722, *Interim Financial Information*, paragraphs .08-.09, .30-.31, and .33-.36

APPENDIX C – Matters Included in the Audit Engagement Letter

C1. The auditor should include the following matters in the engagement letter.[1/] The auditor's description of these matters will vary depending on whether the auditor is engaged in a financial statement audit or in an audit of internal control over financial reporting that is integrated with an audit of financial statements ("integrated audit").

a. The objective of the audit is:

1. Integrated audit: The expression of an opinion on both the effectiveness of internal control over financial reporting and the financial statements.

2. Audit of financial statements: The expression of an opinion on the financial statements.

b. Auditor's responsibilities:

1. The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

a. Integrated audit: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance.

[1/] Certain matters should not be included in an engagement letter; for example, under Securities and Exchange Commission, *Section 602.02.f.i. of the Codification of Financial Reporting Policies*, indemnification provisions are not permissible for audits of issuers.

Also, an integrated audit is not designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

b. Audit of financial statements: Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

2. An audit includes:

a. Integrated audit: In fulfillment of the responsibilities noted above, the auditor communicates:

1. To the audit committee and management: all material weaknesses in internal control over financial reporting identified during the audit, in writing.

2. To the audit committee: all significant deficiencies identified during the audit, in writing, and informs the audit committee when the auditor has informed management of all internal control deficiencies.

3. To management: all internal control deficiencies identified during the audit and not

previously communicated in writing by the auditor or by others, including internal auditors or others within the company.

4. To the board of directors: any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, in writing.

b. Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed.[2/] An audit of financial statements is not designed to provide assurance on internal control or to identify internal control deficiencies. However, the auditor is responsible for communicating:

1. To the audit committee and management: all significant deficiencies and material weaknesses identified during the audit, in writing.

2. To the board of directors: if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion, in writing.

c. Management's responsibilities:

1. Management is responsible for the company's financial statements, including disclosures.

2. Management is responsible for establishing and maintaining effective internal control over financial reporting.

[2/] AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, provides direction on control deficiencies identified in an audit of financial statements.

3. Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities.

4. Management is responsible for making all financial records and relevant information available to the auditor.

5. At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.

6. Management is responsible for adjusting the financial statements to correct material misstatements relating to accounts or disclosures and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

C2. In connection with a review of interim financial information, to confirm and document the understanding, the auditor should either: (a) document in the audit engagement letter the nature and objectives of the engagement to review interim financial information and the responsibilities of management and the auditor or (b) issue a separate engagement letter that addresses such matters.[3/]

[3/] Paragraphs .08-.09 of AU sec. 722, *Interim Financial Information*, discuss the auditor's responsibilities related to establishing an understanding with the audit committee in connection with a review of the company's interim financial information.

APPENDIX 2

Transitional Amendments to AU sec. 380, Communication With Audit Committees

Auditing Standard

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is amended as follows:

a. The last sentence of paragraph .01 is replaced with:

> The communications required by this section are applicable to the audits of (i) issuers and (ii) brokers and dealers, as those terms are defined in the Sarbanes-Oxley Act of 2002, as amended.[2]

b. Footnote 2 to paragraph .01 is replaced with:

> *See* Sections 2(a)(7), 110(3), and 110(4) of the Sarbanes-Oxley Act of 2002.

APPENDIX 3

Amendments to PCAOB Standards

Auditing Standards

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, as amended, is amended as follows:

a. The following sentence is added at the end of paragraph 80:

   This communication should be made in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

b. The following sentence is added after the first sentence of paragraph 81:

   The auditor should communicate this information to the audit committee in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting.

Auditing Standard No. 9, *Audit Planning*

Auditing Standard No. 9, *Audit Planning*, is amended as follows:

a. Paragraph 6.c. is replaced with:

   Establish an understanding of the terms of the audit engagement with the audit committee in accordance with Auditing Standard No. 16, *Communications with Audit Committees.*

b. Footnote 4 to paragraph 6 is deleted.

c. In footnote 7 to paragraph 9.a., the references to AU sec. 310 and AU sec. 380, *Communication with Audit Committees*, are replaced with a reference to Auditing Standard No. 16, *Communications with Audit Committees*.

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, is amended as follows:

The note to paragraph 5.d. is deleted.

AU sec. 310, "Appointment of the Independent Auditor"

SAS No. 1, "Codification of Auditing Standards and Procedures" section 310, "Appointment of the Independent Auditor" (AU sec. 310, "Appointment of the Independent Auditor"), as amended, is superseded.

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), as amended, is amended as follows:

a. The third sentence of paragraph .79 is replaced with:

   Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to the audit committee in a timely manner and prior to the issuance of the auditor's report.

b. The second sentence of paragraph .81 is replaced with:

   Such a communication may be a part of an overall communication to the audit committee of business and financial statement risks affecting the entity and/or in conjunction with the auditor communication about the qualitative aspects of the entity's accounting policies and practices (see paragraphs 12–13 of Auditing Standard No.16, *Communications with Audit Committees*). The auditor should communicate these matters to the audit committee in a timely manner and prior to the issuance of the auditor's report.

c. Within footnote 10 to paragraph .88, the reference to section 380, *Communication With Audit Committees*, is replaced with a reference to Auditing Standard No.16, *Communications with Audit Committees*.

AU sec. 317, "Illegal Acts by Clients"

SAS No. 54, "Illegal Acts by Clients" (AU sec. 317, "Illegal Acts by Clients"), as amended, is amended as follows:

a. The fourth sentence of paragraph .08 is replaced with:

The auditor should make inquiries of management and the audit committee[1] concerning the client's compliance with laws and regulations and knowledge of violations or possible violations of laws or regulations.

b. Footnote 1 is added to paragraph .08 after the term "audit committee":

For this standard, audit committee is defined as a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, the person(s) who oversee the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.

c. The first sentence of paragraph .17 is replaced with:

The auditor should assure himself that the audit committee is adequately informed as soon as practicable and prior to the issuance of the auditor's report with respect to illegal acts that come to the auditor's attention.

d. Footnote 1 to paragraph .17 is deleted.

AU sec. 328, "Auditing Fair Value Measurements and Disclosures"

SAS No. 101, "Auditing Fair Value Measurements and Disclosures" (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), as amended, is amended as follows:

Paragraph .50 is replaced with:

Paragraphs 12-13 of Auditing Standard No. 16, *Communications with Audit Committees,* require the auditor to communicate to the audit committee matters related to critical accounting estimates, which may include fair value measurements.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows:

The following sentence is added as the last sentence of paragraph .05:

The auditor should provide a copy of the representation letter to the audit committee if management has not already provided the representation letter to the audit committee.

AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"

SAS No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), as amended, is amended as follows:

Paragraph .17A is added, along with the heading preceding this paragraph:

Communications with Audit Committees

Paragraph 17 of Auditing Standard No. 16, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the auditor's evaluation of a company's ability to continue as a going concern for a reasonable period of time.

AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is superseded.

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380"

AU sec. 9380, "Communication With Audit Committees: Auditing Interpretations of Section 380," is superseded.

AU sec. 532, "Restricting the Use of an Auditor's Report"

SAS No. 87, "Restricting the Use of an Auditor's Report (AU sec. 532, "Restricting the Use of an Auditor's Report"), as amended, is amended as follows:

In the second bullet point of paragraph .07, the reference to Section 380, *Communication With Audit Committees,* is replaced with a reference to Auditing Standard No. 16, *Communications with Audit Committees.*

AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"

SAS No. 8, "Other Information in Documents Containing Audited Financial Statements" (AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"), as amended, is amended as follows:

a. The sixth sentence of paragraph .04 is replaced with:

If the other information is not revised to eliminate the material inconsistency, he should communicate the material inconsistency to the audit committee and consider other actions, such as revising his report to include an explanatory paragraph describing the material inconsistency, withholding the use of his report in the document, and withdrawing from the engagement.

b. The second sentence of paragraph .06 is replaced with:

He should communicate the material misstatement of fact to the client and the audit committee, in writing, and consider consulting his legal counsel as to further appropriate action in the circumstances.

AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), as amended, is amended as follows:

The last sentence of paragraph .13 is replaced with:

In either case, the accountant should communicate the matter to the audit committee and also consider withholding his consent to the use of his report on the audited financial statements in the registration statement.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), as amended, is amended as follows:

a. The heading preceding paragraph .08, "Establishing an Understanding With the Client" is replaced with the heading, "Establishing an Understanding with the Audit Committee."

b. Paragraph .08 is replaced with:

   The accountant should establish an understanding of the terms of an engagement to review interim financial information with the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee).[6] This understanding includes the objective of the review of interim financial information, the responsibilities of the accountant, and the responsibilities of management. Such an understanding reduces the risk that either the accountant or the audit committee may misinterpret the needs or expectations of the other party. The accountant should record this understanding of the terms of the engagement in an engagement letter and should provide the engagement letter to the audit committee. The accountant should have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the accountant should determine that the audit committee has acknowledged and agreed to the terms of the engagement. If the accountant believes he or she cannot establish an understanding of the terms of an engagement to review interim financial information with the audit committee, the accountant should decline to accept, continue, or perform the engagement.

c. Footnote 6 to paragraph .08 is replaced with:

   See paragraph .16 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

d. In the first sentence of paragraph .09, the word "client" is replaced with the words "audit committee."

e. Paragraph .30 is replaced with:

If management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should communicate these matters to the audit committee as soon as practicable and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

f. The following sentence is added at the end of paragraph .33:

The accountant should communicate significant deficiencies or material weaknesses of which the accountant has become aware to the audit committee or those responsible for oversight of the company’s financial reporting in a timely manner and prior to the registrant filing its periodic report with the SEC.

g. Paragraph .34 is replaced with:

When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Auditing Standard No. 16, *Communications with Audit Committees,* as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee in a timely manner and prior to the registrant filing its periodic report with the SEC. For example, the accountant should communicate a description of the process management used to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and uncorrected misstatements aggregated by the accountant that management determined to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole.[23] As part of its communications to the audit committee, management might communicate some or all of the matters related to the company's accounting policies, practices, estimates, and significant unusual transactions described in paragraph 12 of Auditing Standard No.

16, *Communications with the Audit Committees*. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as the accountant (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the accountant considers critical. The accountant should communicate any omitted or inadequately described matters to the audit committee.

h. Footnote 23 to paragraph .34 is replaced with:

The schedule of uncorrected misstatements related to accounts and disclosures provided to the audit committee should be the same schedule that was included in or attached to the management representation letter that is described in paragraph .24(*k*) of this section.

i. The last two sentences of paragraph .35 are replaced with:

Therefore, any communication the accountant may make about the entity's accounting policies, practices, estimates, and significant unusual transactions as applied to its interim financial reporting, generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the qualitative aspects of the entity's accounting policies and practices that would be identified as a result of an audit.

j. Paragraph .36 is replaced with:

If the accountant has identified matters to be communicated to the audit committee, the accountant should communicate such matters to the audit committee, or at least its chair, in a timely manner and prior to the registrant filing its periodic report with the SEC. The communications to the audit committee should be made and documented in accordance with paragraph 25 of Auditing Standard No. 16, *Communications with Audit Committees.*

APPENDIX 4

Additional Discussion of* Auditing Standard No. 16*, Related Amendments to PCAOB Standards, and Comments on the Reproposed Standard

This appendix discusses Auditing Standard No. 16, *Communications with Audit Committees* (the "standard"), presented in Appendix 1, and the related amendments to PCAOB standards in Appendix 3.[1/] In particular, this appendix provides additional background information for certain requirements in the standard and related amendments.

The standard was originally proposed on March 29, 2010[2/] (the "original proposed standard"), a roundtable was held on September 21, 2010,[3/] and the standard was reproposed on December 20, 2011[4/] (the "reproposed standard"). This appendix also discusses the Board's responses to significant issues raised by the comments on the reproposed standard, as well as the basis for the Board's conclusions regarding certain requirements.

I. Definition of Audit Committee (Paragraph A-2 of Auditing Standard No. 16)

Auditing Standard No. 16 defines an audit committee as a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such

---

1/ The transitional amendments to AU sec. 380, *Communication With Audit Committees* ("AU sec. 380"), in Appendix 2 are discussed on pages 12-14 of the release.

2/ *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*, PCAOB Release No. 2010-001 (March 29, 2010).

3/ A transcript of the roundtable is available at http://pcaobus.org/Rules/Rulemaking/Docket030/Roundtable_Transcript.pdf.

4/ *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU sec. 380*, PCAOB Release No. 2011-008 (Dec. 20, 2011).

committee exists with respect to the company, the entire board of directors of the company. This definition largely incorporates the definition of "audit committee" from the Sarbanes-Oxley Act of 2002 (the "Act").[5/] The parenthetical phrase "or equivalent body" after the term "committee" clarifies that entities with bodies performing a function similar to that of an audit committee would fit within this category.

The standard modifies the Act's version of the definition of an audit committee as it relates to audits of nonissuers. Specifically, for audits of nonissuers, Auditing Standard No. 16 states that, if no such committee or board of directors (or equivalent body) exists with respect to the company, the audit committee would be considered the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company. This modification was made to recognize that some nonissuers, including brokers and dealers, may have governance structures that do not include boards of directors or audit committees. In those cases, the auditor would identify those persons at the nonissuer company who oversee the company's accounting and financial reporting processes and audits. This modification is meant to indicate that senior persons in an oversight role in such circumstances would be the recipients of the auditor communications.

Using the definition of "audit committee," the auditor would identify the bodies or persons that oversee the company's accounting, auditing, and financial reporting processes to find the appropriate recipient of the communications under the standard.[6/] For issuers, the definition is the same as the definition included in the Act.[7/] For nonissuers, the definition contains three categories of bodies or persons. The first two categories (audit committee and the entire board of directors of the company) are the same as those included in the definition of audit committee for an issuer. The third category covers situations in which the company does not have an audit committee, board of directors, or equivalent

---

[5/] Section 2(a)(3) of the Act, 15 U.S.C. § 7201.

[6/] The Board's proposed definition is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, or an entity's governing documents regarding the establishment, approval, or ratification of board of directors or audit committees, or the delegation of responsibilities of such a committee or board.

[7/] Section 2(a)(3) of the Act, 15 U.S.C. § 7201.

body, such as certain non-public brokers and dealers. The parenthetical phrase "or equivalent body" after the term "board of directors" clarifies that entities with bodies performing a function similar to that of a corporate board of directors would fit within this category.

The reproposed standard required the auditor to communicate to those persons designated to oversee the financial reporting processes of the company in situations in which a nonissuer does not have an audit committee, board of directors, or equivalent body. Some commenters indicated that, for certain nonissuers, the person designated to oversee the accounting and financial reporting processes of the company could be the chief financial officer, in which case the communication would be made to the person preparing the financial statements. Therefore, commenters suggested that the auditor should make relevant communications to the chief executive officer, or equivalent officer of the company.

The definition was revised to focus on the person(s) identified by the auditor as responsible for overseeing the accounting and financial reporting processes of the company. However, the definition was not revised to exclude from the definition of audit committee those persons with oversight responsibility who also have management responsibilities for the preparation of the financial statements of the company. As adopted, for nonissuers with no existing audit committee or board of directors (or equivalent body), the auditor would be expected to identify senior persons at the company who have decision-making authority and responsibility to oversee the accounting and financial reporting processes of the company and audits of the financial statements, and to make the required communications to those persons. For example, in an owner managed entity, the person with oversight of financial reporting within the company could be the owner. Under a limited partnership, the person with oversight of financial reporting within the company could be the managing or general partner responsible for preparation of the financial statements and oversight of the partnership's audits.

Nevertheless, if all persons identified by the auditor as having responsibility for oversight of the company's accounting and financial reporting processes and audits also have management responsibilities for the preparation of the financial statements, then the auditor could also make the communications specified in the standard to other individuals at the company. For example the auditor might identify that the chief executive officer has oversight responsibility for the company's accounting and financial reporting processes; therefore, in those circumstances communications to the chief executive would be in compliance with the audit committee definition in Auditing Standard No. 16.

Additionally, the auditor might identify others in charge of the company's operations and performance, who may benefit from the communications.

Some commenters suggested that the standard should clarify to whom the auditor should communicate when the company is a subsidiary of another entity. Auditing Standard No. 16 does not require communication outside the governance structure of the audited entity because the standard designates the appropriate party to receive the auditor communications within the audited entity. If directed by the audit client, or if the auditor otherwise deems it appropriate, the auditor could also communicate to a parent company audit committee or equivalent body.

II. Objectives (Paragraph 3 of Auditing Standard No. 16)

Auditing Standard No. 16 states that the objectives of the auditor are to (a) communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee; (b) obtain information from the audit committee relevant to the audit; (c) communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and (d) provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process. The objectives of the standard are intended to highlight the overall context for the requirements in the standard.

III. Significant Issues Discussed with Management in Connection with the Auditor's Appointment or Retention (Paragraph 4 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards. This requirement was retained from AU sec. 380.[8/]

This requirement is included in the standard because the audit committee might ask management for its views concerning the appointment or retention of the auditor. Management's views might be influenced by the interaction between

[8/] AU sec. 380.15.

the auditor and management and the auditor's evaluations and conclusions regarding the application of accounting principles or auditing standards.

Some commenters suggested that these discussions should include a robust fee discussion or a discussion about the results of the auditor's considerations during the client acceptance and continuance process, such as the auditor's views of the entity's accounting and financial reporting practices or management's integrity. The standard was not revised to include such additional matters because the requirement in the standard specifically addresses the auditor's discussions with management related to accounting and auditing matters in connection with the appointment or retention of the auditor. However, Auditing Standard No. 16 requires the auditor to communicate any matters arising from the audit to the audit committee that the auditor believes are significant to the audit committee's oversight of the company's financial reporting process.[9/]

IV. Establish an Understanding of the Terms of the Audit (Paragraphs 5-7 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a specific requirement for the auditor to establish an understanding of the terms of the audit engagement with the audit committee. Having a mutually clear understanding of the terms of the engagement, including the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management in connection with the audit, should benefit both the auditor and the audit committee.

The requirement in Auditing Standard No. 16 is similar to the requirement in AU sec. 310, *Appointment of the Independent Auditor* ("AU sec 310"), which requires the auditor to establish an understanding with the client regarding the services to be performed. However, Auditing Standard No. 16 more specifically requires that the understanding be with the audit committee due to the audit committee's financial reporting and audit oversight role, rather than with the "client," which could be understood to mean others besides the audit committee in certain circumstances.

Auditing Standard No. 16 also requires the auditor to record the understanding of the terms of the audit engagement in an engagement letter. Appendix C of Auditing Standard No. 16 describes matters that should be

---

9/ Paragraph 24 of Auditing Standard No. 16.

included in an engagement letter, including the objective of the audit and the responsibilities of the auditor and management. This is an expansion of the requirement in AU sec. 310, which requires the auditor to document the understanding of the engagement in the working papers, preferably through a written communication with the client.

Some commenters indicated that the engagement letter should describe the responsibilities of the audit committee related to the audit. The Board considered this suggestion and did not change the standard to include the responsibilities of the audit committee, as those responsibilities are governed by the rules of other organizations, such as the Securities and Exchange Commission ("SEC") and the national securities exchanges.[10/] However, the standard does not prohibit the auditor from including other matters in the engagement letter, as agreed upon by the auditor and the audit committee, so long as those matters are not in violation of other standards or rules, for example, independence requirements.

Auditing Standard No. 16 requires the auditor to provide the engagement letter to the audit committee annually. Additionally, the auditor should have the engagement letter executed by the appropriate party or parties on behalf of the company.[11/] The standard also states that if the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor also should determine that the audit committee has acknowledged and agreed to the terms of the engagement. This acknowledgment may be obtained in a variety of ways, such as obtaining the audit committee members' signatures, or its chair's signature on behalf of the audit committee, or obtaining another form of acknowledgement and agreement by the audit committee regarding the terms of the audit engagement. Obtaining this acknowledgement reduces the risk that either the auditor or the audit committee might misinterpret the needs or expectations of the other party. An acknowledgement by the audit committee, the signatures of the audit committee members, or the signature of its chair on behalf of the audit committee on the engagement letter is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, applicable exchange requirements, or the company's

---

[10/] *See, e.g.,* New York Stock Exchange, Listed Company Manual at Section 303A.07, Audit Committee Additional Requirements.

[11/] Absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter.

governing documents, regarding the authority or lack of authority of the audit committee to enter into any contract or agreement with the auditor.

Several commenters suggested that the standard should specify that the engagement letter should be executed by management in addition to the audit committee or by management alone, along with a representation that it has the authority to do so on behalf of the audit committee. The Board considered these comments and decided that, absent evidence to the contrary, the auditor may rely on the company's identification of the appropriate party or parties to execute the engagement letter. Therefore, the standard does not specify the party that should execute the engagement letter on behalf of the company.

Some commenters suggested that the standard should indicate that the audit committee's acknowledgement can be either written or oral. Other commenters suggested that the audit committee's acknowledgement should be written, either evidenced by a signature on the engagement letter or in the audit committee's minutes, to avoid the potential for subsequent misunderstandings of whether the audit committee's acknowledgement has been obtained.

The Board considered these comments and determined that the audit committee's acknowledgement may be provided in writing, such as a signed engagement letter or through the minutes of the audit committee meeting, or orally. The primary focus of this requirement is that the auditor receives acknowledgment and agreement from the audit committee rather than the method the audit committee uses to provide that acknowledgement; therefore, a change to the standard was not warranted. The reproposed standard did not specify the form of acknowledgment and, therefore, the standard was not revised. However, the auditor could request that the audit committee acknowledge the terms of the audit engagement in writing. If the audit committee's acknowledgement is received orally, in accordance with paragraph 25 of Auditing Standard No. 16, the auditor is required to document the acknowledgement in the auditor's work papers.

V. Obtaining Information Relevant to the Audit (Paragraph 8 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to inquire of the audit committee about whether it is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations. This inquiry contributes to a two-way dialogue between the auditor and the audit committee concerning matters relevant to the audit. This inquiry would complement the requirement for the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement, including inquiries related to fraud risks, in accordance with Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.[12/] This requirement is included in the standard because, in addition to the inquiries required as part of the risk assessment procedures, audit committees may be aware of other matters relevant to the auditor in performing audit procedures.

Auditing Standard No. 16 does not include the reference to "complaints or concerns received by the audit committee regarding financial reporting matters" previously included in the reproposed standard. This change is not intended to signal a change in the scope of this communication between the audit committee and the auditor. Rather, the Board notes that such inquiry by the auditor of the audit committee is already included in paragraph 56.b(3) of Auditing Standard No. 12, which requires the auditor to inquire of the audit committee about tips or complaints regarding the company's financial reporting.[13/] Since the inquiry in the reproposed standard was similar to the inquiries in Auditing Standard No. 12, Auditing Standard No. 16 was revised to remove the inquiry regarding complaints or concerns.

Auditing Standard No. 16 does not provide specific timing for these inquiries to be made. Depending on the circumstances of the audit, it may be appropriate for the auditor to conduct such inquiries of the audit committee at the outset of the audit and/or at other various stages of the audit. For example, the auditor may want to conduct these inquiries early in the audit to consider any information received from the audit committee in designing the nature, timing, and extent of audit procedures. In other circumstances, as the audit progresses, an auditor may want to inquire of the audit committee as to whether any additional matters or concerns relevant to the audit have come to the attention of the audit committee not previously discussed with the auditor.

The reproposed standard required the auditor to inquire of the audit committee about "whether it is aware of matters that might be relevant to the

---

12/ *See* paragraph 5.f. and 54-57 of Auditing Standard No. 12.

13/ Auditing Standard No. 12 also includes inquiries regarding the audit committee's views about fraud risks, its knowledge of fraud, and the audit committee's response to tips or complaints regarding the company's financial reporting, and how the audit committee exercises oversight of the company's assessment of fraud risks. *See* paragraphs 56.b(1)-(4) of Auditing Standard No. 12.

audit." One commenter raised concerns about this provision of the reproposed standard as being "too broad and overreaching," which could obscure information that is truly relevant to the audit. Other commenters suggested that the inquiries of the audit committee should be expanded to include other matters, such as the audit committee's awareness of significant changes in company conditions or activities.

After considering the comments received on the scope of the information to be communicated under this provision, the term "might be" was excluded from this paragraph of the standard. The deletion of the term "might be" is appropriate to avoid an overly broad interpretation of the standard to require discussion of matters that may not be directly connected to the audit.

Although the Board did not revise the requirement to list all the matters of which the auditor could inquire in this provision, the requirement in the standard is not meant to be limited only to matters that are related to violations or possible violations of laws. The Board did not consider it practical to revise the requirement in an attempt to list all the matters of which the auditor could inquire in this provision. Such matters can and should vary from audit to audit. Rather, the inclusion of such matters was meant to serve only as an example of a matter that the auditor should discuss with the audit committee.

The same commenter who objected to the breadth of the inquiry also raised concerns related to the audit committee providing information to the auditor about violations or possible violations of laws or regulations and complaints or concerns received regarding financial reporting matters contained in the reproposed standard. The commenter indicated that the audit committee's communication of such information could cause the information to lose its confidentiality status with potential significant harmful consequences to the company, such as reducing the candor and chilling communications between management, employees, and the audit committee. The commenter also indicated that if the audit committee discloses information covered by privileged attorney-client communications or attorney work product to the auditor as part of this communication, the company may face a risk that a court may later deem the company to have waived the protection of such privilege or work product doctrine.

The Board did not change the requirement to exclude inquiries regarding violations or possible violations of laws or regulations that are relevant to the audit. Limiting the scope of information that the audit committee might provide to the auditor could severely affect the auditor's ability to conduct an effective audit.

The purpose of this requirement is to enable the auditor to have the information necessary to conduct the audit to support the auditor's opinion on the company's financial statements. Due to the audit committee's oversight responsibilities, it is appropriate for the auditor to ask the audit committee for information relevant to the audit, including matters related to violations or possible violations of laws or regulations. Without such inquiry, the auditor may not have information that could influence the performance of the audit.

The same commenter also indicated that if the audit committee provides information relevant to the audit, the audit committee's role would change fundamentally from overseeing the accounting and financial reporting process of the company and audits of financial statements to becoming the original source of information for the auditor and guarantor of the accuracy and completeness of the financial statements, a role that historically has been that of management. It is possible, that in some situations, the communication from the audit committee is the first instance in which a matter is brought to the attention of the auditor. For example, in some situations the audit committee may have unique insight into management's performance. By providing the opportunity for the audit committee to discuss information with the auditor, the standard enables the auditor to obtain the audit committee's perspective on matters which may be different from management's perspective.

VI. Overall Audit Strategy, Timing of the Audit, and Significant Risks (Paragraphs 9-11 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and to discuss with the audit committee the significant risks[14/] identified during the auditor's risk assessment procedures. Under this requirement, the auditor communicates to the audit committee the results of audit procedures performed in accordance with other PCAOB standards, such as Auditing Standard No. 9, *Audit Planning,* which requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan. As part of the

[14/] *See* paragraph A5 of Auditing Standard No. 12, which defines significant risk as a risk of material misstatement that requires special audit consideration.

auditor's risk assessment process, the auditor is required to identify and assess the risk of material misstatement, including significant risks.[15/]

The timing of communications related to the audit strategy may vary from audit to audit based on the facts and circumstances. However, early communication of these matters might enable the audit committee to understand the auditor's views regarding risk and thereby provide an opportunity for the audit committee to communicate insights regarding additional risks that the auditor did not identify and allow the auditor to more effectively incorporate the additional risks into the audit strategy.

Some commenters indicated that the requirement for the auditor to communicate the audit strategy might result in the audit committee second guessing the auditor's strategy and the scope of the audit. These commenters suggested that the standard should emphasize that the auditor should not disclose details about the audit strategy that would allow management or the audit committee to take steps that could reduce the effectiveness of the audit strategy. Another commenter suggested the standard should require the auditor to provide specific details about the type and timing of procedures. Auditing Standard No. 16 includes a note, which indicates that the overview of the audit strategy is intended to provide information about the audit, but not specific details that would compromise the effectiveness of the audit procedures. Communicating certain details might reduce the effectiveness of those audit procedures. The Board considers that the language in Auditing Standard No. 16 strikes the appropriate balance; therefore, the standard was not revised.

Some commenters suggested that significant risks should be communicated throughout the audit rather than communicating just those significant risks identified during the auditor's risk assessment procedures. It is not the intent of the standard for the auditor to communicate only the significant risks that are identified during the auditor's risk assessment procedures. Paragraph 11 of Auditing Standard No. 16 requires the auditor to communicate significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

A commenter suggested that the communication of risks be expanded to include business risks and the auditor's views of the company's internal controls,

---

15/ *See* paragraphs 59, 70, and 71 of the Auditing Standard No. 12.

in addition to the significant risks of material misstatement to the financial statements. As part of obtaining an understanding of the company and its environment, Auditing Standard No. 12 requires the auditor to obtain an understanding of the company's objectives, strategies, and related business risks that could reasonably be expected to result in risks of material misstatement.[16/] Under Auditing Standard No. 16, the auditor is required to communicate significant risks to the audit committee. If the auditor determines that a business risk results in a significant risk of material misstatement, the auditor should communicate the significant risk to the audit committee. Additionally, under Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* and AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* the auditor is required to communicate to the audit committee material weaknesses and significant deficiencies in internal control over financial reporting identified during the audit.[17/] Therefore, the standard was not revised.

Auditing Standard No. 16 also requires communications regarding others involved in the audit, such as persons with specialized skill or knowledge, internal audit, and other firms or persons performing audit procedures. Communications of others involved in the audit might be important for an audit committee to understand as part of the audit committee's oversight of the financial reporting process.

A. Specialized Skill or Knowledge (Paragraph 10.a. of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee the nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks. This requirement is designed for the auditor to communicate the determination the auditor is required to make as part of developing the audit strategy in Auditing Standard No. 9.[18/] Many audit firms

---

[16/] *See* paragraph 14 of Auditing Standard No. 12.

[17/] *See* paragraphs 78 and 80 of Auditing Standard No. 5 and paragraph 4 of AU sec. 325.

[18/] *See* paragraph 16 of Auditing Standard No. 9 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to have employees with specialized skill or knowledge that the engagement team can utilize. However, other firms might not have such in-house expertise. The focus of this requirement is on the communication about the need for specialized skill or knowledge, regardless of whether the specialist is from within the firm or outside the firm.

B. Internal Audit (Paragraphs 10.b. and 10.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements, including when internal audit provides direct assistance to the auditor. In addition, Auditing Standard No. 16 requires the auditor to communicate the extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting.

Auditing Standard No. 9 requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan, including the nature, timing, and extent of resources necessary to perform the engagement.[19/] Other standards, including AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* and Auditing Standard No. 5, provide additional requirements and impose limits on the use of internal audit staff*.* The requirement in Auditing Standard No. 16 is to communicate to the audit committee the extent to which the auditor plans to use the work of the company's internal auditors and others as determined in the audit plan.

C. Other Firms or Persons Performing Audit Procedures (Paragraph 10.d. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by

---

perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

[19/] *See* paragraphs 8-9 of Auditing Standard No. 9.

the auditor, that perform audit procedures in the current period audit. The standard includes a note stating the term "other independent public accounting firms" includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.

In planning and performing the audit, the auditor determines whether to use other auditors or other persons to perform audit procedures at individual client locations, business units, or to perform work related to specific audit areas or procedures. Those other auditors might be affiliated firms, non-affiliated firms, or other persons not employed by the auditor.

The note to Auditing Standard No. 16 was revised from the reproposed standard to clarify that the communication regarding other independent public accounting firms is not based on the type of relationship the auditor otherwise has with the other firms. Rather, the requirement for the auditor to communicate the names, locations, and planned responsibilities of other independent public accounting firms and other persons is to provide information to the audit committee regarding the parties involved in the audit. This requirement also might facilitate a discussion of how the work of other parties would affect the audit.

The reproposed standard also required the auditor to communicate to the audit committee the "planned roles" of others involved in the audit and the "scope of audit procedures." One commenter suggested that the requirement to communicate the "scope of audit procedures" should be clarified in the standard. Another commenter suggested that the communication should be expanded to be more robust when other participants are used to audit foreign components of a company. Auditing Standard No. 10, *Supervision of the Audit Engagement,* requires the auditor to inform engagement team members of their responsibilities[20/] and AU sec. 543, *Part of Audit Performed by Other Independent Auditors,* discusses situations in which the auditor uses the work and reports of other independent auditors who have audited financial statements of one or more subsidiaries, divisions, branches, components or investments included in the financial statements.[21/] To align with these requirements, the standard was revised to require the auditor to communicate only the "planned responsibilities" of other participants involved in the audit, the requirements to

---

20/ *See* paragraph 5.a. of Auditing Standard No. 10.

21/ *See* AU sec. 543.01.

communicate the "planned roles" of others involved in the audit and the "scope of audit procedures" were removed from the standard, and the standard was not expanded to include other considerations.

Many commenters suggested that the standard provide a threshold for determining when to make communications regarding others involved in the audit, such as when another auditor performs procedures related to a percentage of the company's total assets or addresses significant risks. Others suggested that the communication include only non-affiliated accounting firms. The standard was not revised because audit committees have oversight of the entire audit engagement, which includes work performed by other auditors. The audit committee should be aware of all the participants in the audit. This communication regarding other participants in the audit would enable the audit committee to inquire or otherwise determine, for example, whether the other participants are registered with the Board and are subject to PCAOB inspections and whether they have disciplinary history with the Board or other regulators.

This communication requirement is intended to be scalable. For example, the amount of detail the auditor generally would communicate to the audit committee regarding the participation of other auditors would be greater for participants that perform a significant portion of the audit or that perform procedures related to significant risks.

D. Principal Auditor (Paragraph 10.e. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the basis for the auditor’s determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors. This communication requirement is based on the auditor's determination that the auditor can serve as the principal auditor in accordance with AU sec. 543. This communication would enable the audit committee to evaluate the extent of work performed by the principal auditor in relation to work performed by other auditors.

The reproposed standard included a note to describe situations where such communications would be required. The Board determined that this note was not necessary because AU sec. 543, governs the determination of whether the auditor can serve as the principal auditor.

VII. Accounting Policies and Practices, Estimates, and Significant Unusual Transactions (Paragraph 12 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the company's accounting policies and practices, estimates, and significant unusual transactions. However, the standard recognizes that management also might make communications to the audit committee regarding these matters and that the auditor might not need to communicate the information at the same level of detail as management as long as the auditor meets certain criteria specified in the standard. In such circumstances, the auditor should communicate any omitted or inadequately described matters to the audit committee.

A. Accounting Policies and Practices (Paragraphs 12.a. and 12.b. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain information regarding the company's significant accounting policies and practices and also critical accounting policies and practices.

The standard uses the terms "significant accounting policies and practices" and "critical accounting policies and practices." The Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") and the International Accounting Standards Board ("IASB"), require that companies disclose a description of all significant accounting policies as an integral part of the financial statements.[22/] For example, the FASB ASC recognizes that an entity's description of its significant accounting policies is an integral part of the financial statements.[23/] Additionally, the term "significant

---

[22/] *See* FASB ASC, Topic 235, Notes to Financial Statements, section 235-10-50. As part of this disclosure, the entity is required to disclose accounting policies and to describe the accounting principles followed by the entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations. Additionally, *see* paragraph 117 of International Accounting Standard 1, *Presentation of Financial Statements,* which requires the entity to disclose the summary of significant accounting policies, including the measurement basis used in preparing the financial statements and other accounting policies that are relevant to understanding the financial statements.

[23/] *See* FASB ASC paragraphs 235-10-50-1 through 235-10-50-6.

accounting policies and practices" is consistent with the term used in AU sec. 380 and understood in practice and, therefore, has not been separately defined.

The definition of "critical accounting policies and practices" in Auditing Standard No. 16 is based on the SEC's description of the term "critical accounting policies and practices" as a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.[24/] The selection of significant accounting policies and practices involves a broader range of transactions and events over time, while the selection of critical accounting policies and practices is tailored to specific events in the current year. Therefore, critical accounting policies and practices might be viewed as a subset of significant accounting policies and practices.

1. Significant Accounting Policies and Practices (Paragraph 12.a. of Auditing Standard No. 16)

Auditing Standard No. 16 generally retains the requirements from AU sec. 380 related to communication of the company's significant accounting policies and practices, including:

- Management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and

- The effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to significant accounting policies and practices,

---

[24/] *See* SEC, *Strengthening the Commission's Requirements Regarding Auditor Independence*, Securities Act Release No. 8183 (Jan. 28, 2003).

whereas, AU sec. 380 required the auditor only to determine that the audit committee was "informed." This change in wording is intended to indicate that the auditor should make these communications, rather than determine that the audit committee was informed, as required in AU sec. 380. However, the note to paragraph 12 of Auditing Standard No. 16 acknowledges that such communications may be made by management, and if the auditor meets certain conditions, these communications need not be duplicated by the auditor.

Some commenters suggested that it was unclear whether the communication of the initial selection of, or changes in, significant accounting policies or the application of such policies in the current period would require communication annually if there is no change. Another commenter indicated that the auditor may not be in a position to provide information on areas for which there is diversity in practice because the auditor may not be knowledgeable of accounting practices used by other entities.

Auditing Standard No. 16 was not revised in response to these comments. The standard indicates that the auditor should communicate to the audit committee the initial selection in the current period of significant accounting policies. The standard also indicates that the auditor should communicate to the audit committee changes in those policies or changes in the application of those policies in the current period if they differ from those policies that management previously utilized or how they were previously applied.

Additionally, the auditor's responsibility to communicate the effect of significant accounting policies includes (i) controversial areas or (ii) areas for which there is lack of authoritative guidance or consensus, or diversity in practice. The auditor should be aware of diversity in practice related to significant accounting policies and practices used by the company because Auditing Standard No. 12 requires the auditor to evaluate whether the company's selection of and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and accounting principles used in the relevant industry.[25/] Based on this evaluation, the auditor should be in a position to make such communication.

[25/] Paragraph 12 of Auditing Standard No. 12.

2. Critical Accounting Policies and Practices (Paragraph 12.b. of Auditing Standard No. 16)

Auditing Standard No. 16 incorporates the Securities Exchange Act of 1934's ("Exchange Act") requirement for the auditor to communicate to the audit committee all critical accounting policies and practices to be used.[26/] Auditing Standard No. 16 also requires the auditor to communicate the reasons certain accounting policies and practices are considered critical and how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.[27/]

Some commenters recommended deleting the requirement for the auditor to communicate how anticipated future events might affect the determination of whether certain policies and practices are considered critical since the auditor cannot predict the future. The standard retains the SEC requirement regarding communication of anticipated future events related to critical accounting policies and practices, as this is a component of the required communication the SEC identified in adopting SEC Rule 2-07.[28/] The standard notes that critical accounting policies and practices are tailored to specific events in the current year and that the accounting policies and practices that are considered critical might change from year to year. For example, a significant merger or acquisition may result in the related accounting policy being considered critical in the current year in which the related transaction occurs, but not in subsequent years. Auditing Standard No. 16 is aligned with the SEC requirement, therefore the standard was not revised.

[26/] Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), requires the auditor to report this information to the audit committee. *See also* SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"), 17 C.F.R. § 210.2-07.

[27/] *See* Securities Act Release No. 8183, which describes the SEC's expectations regarding the discussion related to critical accounting policies and practices. In this release, the SEC indicated that it anticipated that the discussion of accounting policies and practices would include how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

[28/] *Id.*

B. Critical Accounting Estimates (Paragraph 12.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the following matters related to critical accounting estimates:

(1) A description of the process management used to develop critical accounting estimates;

(2) Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and

(3) Any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.

As the term "critical accounting estimate" implies, the communication is not designed to encompass a long list of accounting estimates resulting from the application of accounting policies that cover a substantial number of line items in the company's financial statements. Rather, Auditing Standard No. 16 defines the term "critical accounting estimate" as an accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

The definition of "critical accounting estimate" is based on SEC interpretive guidance in connection with management's discussion and analysis ("MD&A") of the company's financial condition and results of operations.[29/] The alignment of the term critical accounting estimates in PCAOB standards with the same term in the SEC's interpretive guidance allows auditors to use the same concept under SEC requirements and PCAOB standards when communicating matters to the audit committee. The term critical accounting estimate is used to help focus the communication to the audit committee on those estimates that might be subject to a higher risk of material misstatement, such as certain fair

---

[29/] *See* SEC, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (Dec. 19, 2003).

value estimates. The definition of a critical accounting estimate is intended to replace the term "particularly sensitive" in AU sec. 380.[30/]

The requirement to communicate the process management used to develop critical accounting estimates is adapted from the requirement in AU sec. 380 related to particularly sensitive accounting estimates.[31/] Additionally, the communication requirements are designed to communicate the results of the auditor's performance requirements under AU sec. 342, *Auditing Accounting Estimates*, which requires the auditor to evaluate the reasonableness of accounting estimates. In evaluating the reasonableness of the accounting estimate, AU sec. 342 also requires the auditor to obtain an understanding of how management developed the estimate.[32/] AU sec. 342 also states that in evaluating the reasonableness of an estimate, the auditor normally concentrates on key factors and assumptions that are (a) significant to the accounting estimate, (b) sensitive to variations, (c) deviations from historical patterns, and (d) subjective and susceptible to misstatement and bias.[33/]

One commenter suggested that the communication requirement also include how management subsequently monitors critical accounting estimates and, 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. Although these requirements are not included in Auditing Standard No. 16, the Board notes that the SEC has stated that management should disclose the company's critical accounting estimates in MD&A.[34/] According to the related SEC release, management's discussion should present, among other matters, the company's

---

30/ *See* AU sec. 380.08, which stated in part, "[c]ertain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments."

31/ AU sec. 380.08.

32/ *See* AU sec. 342.10.

33/ *See* AU Sec. 342.09.

34/ *See* Securities Act Release No. 8350.

analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time and analyze an estimate's specific sensitivity to change based on other outcomes that are reasonably likely to occur and would have a material effect.[35/] The commenter's concerns, therefore, may be addressed through a company's MD&A disclosures.

AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires the auditor to read the other information, such as MD&A in documents containing audited financial statements, and consider whether the information, or the manner of its presentation, is materially inconsistent with information in the financial statements or is a material misstatement of fact.[36/] Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee the results of such procedures (see Section IX of this appendix, "Other Information in Documents Containing Audited Financial Statements," for further discussion). Accordingly, no change was made to the standard.

C. Significant Unusual Transactions (Paragraph 12.d. of Auditing Standard No. 16)

Auditing Standard No. 16 includes requirements for the auditor to communicate to the audit committee (1) significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature;[37/] and (2) the policies and practices management used to account for significant unusual transactions. Communication of significant unusual transactions would enable the audit committee to gain the auditor's insight into those transactions and to take any appropriate action.

The requirement in the standard for the auditor to communicate the policies and practices management used to account for significant unusual

---

[35/] *Id.*

[36/] AU secs. 550.04-.05.

[37/] *See* paragraph 71.g. of Auditing Standard No. 12.

transactions is similar to the requirement in AU sec. 380.[38] Under Auditing Standard No. 16, such communication also would include the identification of significant unusual transactions.

The reproposed standard required the auditor to communicate significant unusual transactions, of which the auditor is aware, that are outside the normal course of business for the company or otherwise appear to be unusual due to their timing, size, or nature. Many commenters indicated that management also might communicate matters related to significant unusual transactions to the audit committee and that the standard should acknowledge that management might make the communications related to significant unusual transactions. The standard was revised to recognize that management might make these communications to the audit committee and that, in those situations, the auditor might not need to communicate the information at the same level of detail as management as long as certain criteria specified in the standard are met. However, the auditor should communicate any omitted or inadequately described matters to the audit committee.

Additionally, some commenters suggested that the communication should be limited to significant unusual transactions that are considered significant risks. While a significant unusual transaction might also be considered a significant risk, this communication provides the audit committee with additional information regarding the significant unusual transactions and the policies and practices management used to account for such transactions, even if such transactions do not constitute significant risks. Significant unusual transactions, at times, have been considered to be a contributing factor in attempts to mislead investors about a company's financial condition. Therefore, providing the audit committee with information regarding significant unusual transactions could benefit the audit committee in its oversight of the financial reporting process.

Some commenters suggested that the standard include a definition of the term "significant unusual transactions." Auditing Standard No. 16 describes significant unusual transactions as significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature, which is consistent with the description of this term in other PCAOB standards, such as Auditing Standard

[38] AU sec. 380.07.

No. 12.[39/] Therefore, the standard was not revised to further define significant unusual transactions.

D. Consideration of Communications Made by Management (Note to Paragraph 12 of Auditing Standard No. 16)

Auditing Standard No. 16 retains the substance of the communication requirements in AU sec. 380 regarding accounting policies, practices, and estimates. The requirement in the standard for the auditor to communicate critical accounting policies and practices is consistent with Section 10A(k) of the Exchange Act, which requires auditors of issuers to report all critical accounting policies and practices to the issuer's audit committee.[40/] In addition, Auditing Standard No. 16 includes a new requirement related to the communication of significant unusual transactions.

Many commenters suggested that the standard should recognize that management has the primary responsibility for reporting to the audit committee and that the auditor's responsibility should be to confirm that management has appropriately communicated. No change was made in response to this comment because, similar to AU sec. 380, Auditing Standard No. 16 acknowledges that management also may be communicating certain matters related to the financial reporting process to the audit committee. The Board recognizes that management as well as the auditor might discuss accounting policies, practices, estimates, and significant unusual transactions with the audit committee and that it would not be cost-effective or practical for the audit committee to listen to essentially the same presentation twice. Therefore, Auditing Standard No. 16 indicates that, in situations in which management communicates matters in paragraph 12, the auditor's communication requirement under the standard would be met if the auditor: (1) participates in management's discussion with the audit committee,[41/] (2) affirmatively confirms to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identifies for the audit committee those accounting policies and practices that the auditor considers critical. In

---

39/ Paragraph 71.g. of Auditing Standard No. 12.

40/ *See also* SEC Rule 2-07.

41/ The auditor's participation in management's discussion with the audit committee could be satisfied in person or via audio or video conference.

addition, the auditor should communicate any omitted or inadequately described matters to the audit committee.

In situations in which management makes those communications to the audit committee, in order to satisfy the communication requirement in Auditing Standard No. 16, the auditor would be required to participate during discussions between management and the audit committee regarding accounting policies, practices, estimates, and significant unusual transactions, which may include discussions of the importance of critical accounting policies, practices or estimates, or the difficult, subjective, or complex nature of the judgment involved in significant unusual transactions, or the selection or application of accounting policies, practices, or estimates. If the auditor to identifies the accounting policies and practices that the auditor considers critical to the portrayal of the company's financial condition and results and affirmatively confirms that management has adequately communicated the accounting policies, practices, estimates, and significant unusual transactions to the audit committee in a meeting in which the auditor participated the auditor would be deemed to satisfy the requirement for the auditor to report all critical accounting policies and practices to the audit committee, without the need for the auditor to repeat management's presentation on the same topic.

Conversely, if the auditor (1) did not participate in management's meeting with the audit committee in which communication regarding accounting policies, practices, estimates, and significant unusual transactions occurred, (2) did not affirmatively confirm that accounting policies, practices, estimates, and significant unusual transactions had been discussed adequately by management, or (3) with respect to critical accounting policies and practices, did not identify those accounting policies and practices that the auditor considers critical, then the auditor would be required to communicate to the audit committee the matters described in paragraph 12 of Auditing Standard No. 16, regardless of any management communication regarding those matters.

VIII. Auditor's Evaluation of the Quality of the Company's Financial Reporting (Paragraph 13 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate certain matters to the audit committee regarding the auditor's views of the audit and the financial statements as described below.

A. Qualitative Aspects of Significant Accounting Policies and Practices (Paragraph 13.a. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements. This requirement is similar to certain communication requirements that have been superseded. AU sec. 380 required the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the company's accounting principles.[42/] Additionally, AU sec. 9312, *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312,* required the auditor to consider whether matters related to management bias should be communicated to the audit committee.[43/]

The requirement in Auditing Standard No. 16 is designed for the auditor to communicate the results of the auditor's procedures under Auditing Standard No. 14, *Evaluating Audit Results,* which requires the auditor to, among other things, evaluate the qualitative aspects of the company's accounting practices,[44/] including potential bias in management's judgments about the amounts and disclosures in the financial statements.[45/]

Additionally, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the results of the auditor's evaluation of the differences between (i) estimates best supported by audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management. This communication is designed for the auditor to discuss the results of the auditor's

---

[42/] AU sec. 380.11.

[43/] Following the original proposal of this standard, AU sec. 9312 was superseded when the Board adopted the risk assessment standards. The performance requirement of AU sec. 9312, however, was substantially included in the risk assessment standards.

[44/] *See* paragraphs 24-27 of Auditing Standard No. 14.

[45/] *Id*.

evaluation of these matters as required under Auditing Standard No. 14.[46/] Linking the communication requirements with performance requirements in Auditing Standard No. 14 provides context regarding the matters to be communicated.

Some commenters suggested that the standard should retain the requirement in AU sec. 380 for the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles. Auditing Standard No. 16 modifies the requirement from AU sec. 380 by requiring the auditor to communicate to the audit committee the results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, while linking the communication requirement to the performance requirement in Auditing Standard No. 14. Therefore, no change was made in response to these comments.

B. Assessment of Critical Accounting Policies and Practices (Paragraph 13.b. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosures of those policies and practices proposed by the auditor that management did not make. This requirement is based on the Exchange Act's requirement that the auditor report to the audit committee all critical accounting policies and practices.[47/] In the release adopting the SEC's related rule, the SEC indicated that it anticipated that the auditor's communications to the audit committee regarding critical accounting policies would include an assessment of management's disclosures along with any significant proposed modifications by the auditor that were not included in those disclosures.[48/]

46/ *See* paragraph 27 of Auditing Standard No. 14.

47/ *See* Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k); and SEC Rule 2-07.

48/ *See* Securities Act Release No. 8183.

C. Conclusions Regarding Critical Accounting Estimates (Paragraph 13.c. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate the basis for the auditor's conclusions regarding the reasonableness of the critical accounting estimates. This requirement is similar to a requirement in AU sec. 380.[49/] This requirement is designed to require the auditor to communicate the results of the auditor's procedures regarding critical accounting estimates under PCAOB standards, such as AU sec. 342.[50/] Communicating these results will provide the audit committee with the auditor's assessment of the critical accounting estimates based on the auditor's procedures.

D. Significant Unusual Transactions (Paragraph 13.d. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's understanding of the business rationale for significant unusual transactions. This communication requirement is aligned with the performance requirement in AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* which requires the auditor to gain an understanding of the business rationale regarding significant transactions that are outside the normal course of business or that otherwise appear unusual.[51/] This communication would provide the audit committee with an opportunity to receive the auditor's perspective of such transactions.

In a separate rulemaking project, the Board has proposed amendments to AU sec. 316 that would require the auditor to design and perform procedures to obtain an understanding of the business purpose (or lack thereof) of each significant unusual transaction and evaluate whether the business purpose (or the lack thereof) indicates that the significant unusual transaction may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.[52/] If, at the conclusion of that rulemaking project, the

---

49/ *See* AU sec. 380.08.

50/ *See* AU secs. 342.04, 09-.10.

51/ *See* AU sec. 316.66.

52/ *Proposed Auditing Standard - Related Parties*, *Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant*

Board adopts the proposed amendments to AU sec. 316, the Board will consider, as appropriate, amending Auditing Standard No. 16 to align the communication with any new performance requirements.

E. Financial Statement Presentation (Paragraph 13.e. of Auditing of Auditing Standard No. 16)

Similar to AU sec. 380.11, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth. This communication requirement relates to the auditor's evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, as required by Auditing Standard No. 14.[53/]

Some commenters suggested that the standard should retain the requirement in AU sec. 380 for the auditor to discuss with the audit committee the auditor's views about the clarity and completeness of the company's financial statements and disclosures. However, commenters on the original proposed standard indicated it was not clear what was meant by the clarity and completeness of the company's financial statements and related disclosures. Commenters also expressed concern as to what should be included in the communications to the audit committee. The communication requirement in Auditing Standard No. 16 avoids possible confusion regarding the meaning of the phrase "clarity and completeness" by linking it to the auditor performance requirements included in Auditing Standard No. 14 for the auditor to evaluate the presentation of the financial statements, including disclosures. The performance

---

Unusual Transactions, *and Other Proposed Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2012-001 (Feb. 28, 2012).

[53/] See paragraphs 30-31 of Auditing Standard No. 14, which describe the auditor's responsibility relating to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

requirements in Auditing Standard No. 14[54/] provide context regarding the matters to be communicated under Auditing Standard No. 16.

F. New Accounting Pronouncements (Paragraph 13.f. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. This requirement is based on the situations in which, as a result of the auditor’s procedures, the auditor has identified a concern regarding the anticipated application of a new accounting pronouncement. Auditing Standard No. 16 does not require the auditor to perform additional procedures to identify such concerns.

Some commenters noted that management generally discloses in the financial statements the potential effects of adoption of new accounting standards and that this auditor communication to the audit committee should be related to the auditor's evaluation of management's disclosures related to new accounting pronouncements. The intent of the required communication to the audit committee is not meant to provide an additional evaluation of management's disclosures. Rather, the intent is to inform the audit committee when the auditor "has identified a concern" regarding the planned implementation of a new accounting pronouncement or whether management has devoted adequate resources to prepare its accounting and disclosure processes, and other financial reporting systems, for the timely implementation of the new accounting pronouncement. This communication might inform the audit committee's oversight of the company's financial reporting process. Requiring the discussion of such matters is intended to allow the audit committee to properly consider the auditor's concerns regarding future financial statements. Accordingly, no change to the standard was made.

G. Alternative Accounting Treatments (Paragraph 13.g. of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate all alternative treatments permissible under the applicable financial reporting

[54/] *Id.*

framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor. This requirement is consistent with Section 10A(k) of the Exchange Act and with SEC Rule 2-07, which requires the auditor to report to the audit committee all alternative treatments that are related to material items, were discussed with management, and are permissible under the applicable financial reporting framework.[55/]

IX. Other Information in Documents Containing Audited Financial Statements (Paragraph 14 of Auditing Standard No. 16)

Auditing Standard No. 16 retains the requirement from AU sec. 380.12 for the auditor to communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for other information presented in documents containing audited financial statements, any related procedures performed, and the results of such procedures. Such other information would include documents described in AU sec. 550, AU sec. 558, *Required Supplementary Information,* and AU sec. 711, *Filings Under Federal Securities Statutes*.

The auditor’s responsibility under AU sec. 550 requires the auditor to read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, in the financial statements.[56/] One commenter suggested that Auditing Standard No. 16 should also include a requirement to communicate any identified material inconsistencies or misstatements of facts, including the auditor's response to such matters.

Auditing Standard No. 16 requires the auditor to communicate the results of the auditor's procedures related to other information in documents containing audited financial statements, which would require the auditor to communicate identified inconsistencies or misstatements of facts to the audit committee. The

---

55/ *See* SEC Rule 2-07, Section 10A(k) of the Exchange Act, 15 U.S.C. § 78j-1(k), and Securities Act Release No. 8183.

56/ *See generally*, AU secs. 550.04-.07, which require that the auditor read the information and consider whether it is materially inconsistent with information in the financial statements or whether it contains any material misstatements of fact.

Board is amending AU sec. 550 to require the auditor to communicate to the audit committee the material inconsistency between the other information and the financial statements in situations in which the information is not revised to eliminate the material inconsistency. The Board also is amending AU sec. 550 to require the auditor to communicate to the client and the audit committee, in writing, a material misstatement of fact in the other information. Thus, it was not necessary to revise the standard in response to commenters. Appendix 3 of the release provides the amendments to PCAOB standards as a result of the adoption of Auditing Standard No. 16.

X. Difficult or Contentious Matters for which the Auditor Consulted (Paragraph 15 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process. The required communications of difficult or contentious matters are based on the results of the procedures the auditor performed regarding such matters during the course of the audit and do not require the performance of new or additional procedures.

Many matters that arise during an audit can be complex or unusual, and the auditor might consult on such matters with the firm's national office, industry specialists, or external parties. Difficult or contentious issues can arise in various stages of the audit, including in the auditor's evaluation of management's judgments, estimates, accounting policies, or assessment of identified control deficiencies. Difficult or contentious issues generally are the critical matters that concern the auditor when he or she is making the final assessment of whether the financial statements are presented fairly.

A difficult issue might not always be synonymous with a contentious issue. Rather, a difficult issue might be a matter that requires consultation. A contentious issue might be a matter that not only requires consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management. Audit committees might better appreciate the importance of difficult or contentious matters if they are aware that such consultations took place.

During the course of the audit difficult or contentious issues might arise for which the auditor did not consult, but which the auditor believes are relevant to the audit committee's oversight of the financial reporting process. Auditing

Standard No. 16 does not preclude the auditor from communicating to the audit committee difficult or contentious matters for which the auditor did not consult outside the engagement team.

Some commenters suggested that the standard should define difficult or contentious matters. The term "difficult or contentious matter" is used in Auditing Standard No. 7, *Engagement Quality Review.* Therefore, the term "difficult or contentious matter" is not defined in this standard.

Some commenters suggested that the standard should exclude the discussions between the auditor and the engagement quality reviewer from communications to the audit committee regarding consultation outside the engagement team on difficult or contentious matters. The communication to the audit committee in Auditing Standard No. 16 focuses on the difficult or contentious matters on which the auditor consulted, not on the parties involved in the consultation. Therefore, the standard was not revised.

XI. Management Consultation with Other Accountants (Paragraph 16 of Auditing Standard No. 16)

When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's views about such matters that were the subject of such consultation. This requirement is similar to a requirement in AU sec. 380.[57/] Communicating matters that were the subject of consultations only when the auditor has identified a concern about those matters should allow the audit committee to focus its efforts on important accounting and auditing issues.

Some commenters suggested that communicating management consultations with other accountants should be management's responsibility and that the standard should clarify that the auditor should comment only on what management has communicated regarding such consultations. The standard does not impose a communication requirement on management. The requirement in Auditing Standard No. 16 is specifically related to the auditor's responsibilities when management has consulted with other accountants and only when the auditor has a concern regarding the accounting and auditing

57/ AU sec. 380.14.

matters that were the subject of management's consultations. Therefore, Auditing Standard No. 16 was not revised.

As part of the comment process, the Board asked whether the requirement to communicate about consultations should be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms. Some commenters suggested that communication regarding management's consultations with non-accountants should be required, while others suggested that communication about these consultations should be made at the auditor's discretion depending on the facts or circumstances and the significance of the consultation to the financial statements. However, many commenters indicated that this communication should not be expanded to include consultations with non-accountants, as the auditors would not be in position to know about all management consultations with non-accountants. Some commenters indicated that this requirement could result in the auditor expending significant effort to identify and evaluate management's consultations with non-accountants. After consideration of these comments, the standard was not revised to require the auditor to communicate management's consultation with non-accountants.

XII. Going Concern (Paragraph 17 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the auditor's evaluation of the company's ability to continue as a going concern. The communication requirements in Auditing Standard No. 16 are based on the auditor's performance requirements under AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, which requires the auditor to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.[58/] The auditor's communication to the audit committee regarding the auditor's evaluation of the company's ability to continue as a going concern can serve to further inform the audit committee, in certain circumstances, regarding difficult conditions and events that the company is encountering.

[58/] *See* AU sec. 341.06, which provides examples of such conditions and events and AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

Auditing Standard No. 16 requires the auditor to communicate the conditions and events the auditor identified that, when considered in the aggregate, lead the auditor to believe that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. Information about such conditions and events is obtained from the application of auditing procedures planned and performed to achieve audit objectives that are related to management's assertions in the financial statements.[59/] Examples of such conditions and events include, but are not limited to, negative trends, other indications of possible financial difficulties, internal matters, or external matters that have occurred.[60/]

Under AU sec. 341, if after considering the identified conditions and events, in the aggregate, the auditor believes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider management's plans for dealing with the adverse effects of the conditions and events.[61/] Additionally, the auditor should obtain information about the plans and consider whether it is likely that the adverse effects will be mitigated for a reasonable period of time, and that such plans can be effectively implemented.[62/] Auditing Standard No. 16 requires that if the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the auditor should communicate to the audit committee the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events.[63/]

[59/] *See* AU sec. 341.02.

[60/] *See* AU sec. 341.06, which provides examples of such conditions and events.

[61/] *See* AU sec. 341.07, which discusses the auditor's procedures if the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

[62/] *See* AU sec. 341.03b.

[63/] *See* AU sec. 341.08, which discusses the auditor's responsibilities related to the auditor's evaluation of management's plans.

Under AU sec. 341, if the auditor concludes that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph to reflect the auditor's conclusion that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.[64/] Additionally, Auditing Standard No. 16 requires that if the auditor concludes that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains,[65/] the auditor should communicate to the audit committee: (1) the effects, if any, on the financial statements and the adequacy of the related disclosure;[66/] and (2) the effects on the auditor's report.[67/]

The reproposed standard required the auditor to communicate the conditions and events the auditor identified that, when considered in the aggregate, indicate that there "could be" substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. Some commenters suggested that the threshold for communication to the audit committee should be when the auditor believes there "is" substantial doubt about the company's ability to continue as a going concern, rather than when there "could be" substantial doubt. Those commenters suggested that threshold because, under AU sec. 341, the auditor is required to consider management's plans for addressing the adverse effects of the events and conditions when the auditor believes there "is" substantial doubt.

Auditing Standard No. 16 was revised to require the threshold for the auditor's initial communication to the audit committee to be when the auditor

---

[64/] *See* AU sec. 341.12.

[65/] *See* AU sec. 341.03c, which discusses the auditor's evaluation of factors that indicate there is substantial doubt about the company's ability to continue as a going concern.

[66/] *See* AU sec. 341.10, which discusses the possible effects on the financial statements and the adequacy of the related disclosure.

[67/] *See* AU secs. 341.12-.16, which discuss the auditor's consideration of the effects on the auditor's report when the auditor concludes that substantial doubt exists about the company's ability to continue as a going concern for a reasonable period of time.

"believes there is" substantial doubt about the company's ability to continue as a going concern. This aligns more closely the communication requirement about the conditions and events with the other communication requirements in paragraph 17 of Auditing Standard No. 16. Under paragraph 17 of Auditing Standard No. 16 the auditor is required to communicate conditions and events, along with the auditor's conclusion regarding whether either management's plans alleviate the adverse effects of the conditions and events (item b) or substantial doubt remains (item c).

XIII. Uncorrected and Corrected Misstatements (Paragraphs 18-19 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to provide the audit committee with the schedule of uncorrected misstatements[68/] relating to accounts and disclosures that was presented to management. Several commenters indicated that audit committees would not find value in information presented at the same level of detail as presented to management, and that the auditor, therefore, should provide a summary of misstatements to the audit committee.

The Board decided to retain the requirement because presenting a schedule that shows only a summary of the uncorrected misstatements rather than the individual misstatements might not be informative for the audit committee. In addition, the requirement in Auditing Standard No. 16 is not a significant change from AU sec. 380.10, which required the presentation to the audit committee of a schedule of uncorrected misstatements.

The schedule of uncorrected misstatements required by Auditing Standard No. 16 is similar to the summary of uncorrected misstatements included in or attached to the management representation letter.[69/] Additionally, the Exchange Act and SEC Rule 2-07 require the auditor to provide to the audit committee other material written communications between the auditor and management,

---

[68/] Footnote 13 to paragraph 20 of Auditing Standard No. 14 indicates that misstatements include both omissions and the presentation of inaccurate or incomplete disclosures.

[69/] *See* paragraph .06g of AU sec. 333, *Management Representation*.

which would include the schedule of unadjusted audit differences and a listing of adjustments and reclassifications not recorded, if any.[70/]

Auditing Standard No. 14 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial, and to communicate those to management on a timely basis.[71/] According to Auditing Standard No. 14, a misstatement may relate to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that should be reported in conformity with the applicable financial reporting framework.[72/] The requirement in Auditing Standard No. 16 to communicate misstatements related to accounts and disclosures relates only to those misstatements that the auditor has accumulated throughout the audit that are not clearly trivial and have been reported to management.

Auditing Standard No. 16 also requires the auditor to discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors[73/] considered. In addition, the auditor also should communicate to the audit committee that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

Auditing Standard No. 16 also requires the auditor to communicate those corrected misstatements, other than those that are clearly trivial, related to accounts and disclosures that might not have been detected except through the auditing procedures performed and discuss with the audit committee the

---

[70/] *See* Section 10A(k)(3) of the Exchange Act, 15 U.S.C. § 78j-1(k)(3), SEC Rule 2-07(a)(3) and Securities Act Release No. 8183.

[71/] *See* paragraphs 10 and 15 of Auditing Standard No. 14.

[72/] *See* paragraph A2 of Auditing Standard No. 14.

[73/] *See* Appendix B of Auditing Standard No. 14, which discusses the qualitative factors related to the evaluation of the materiality of uncorrected misstatements.

implications that such corrected misstatements might have on the financial reporting process.

One commenter suggested that the standard should require the auditor to communicate management's adjusting entries recorded at the end of the period or other entries to reconcile accounts. The release accompanying the original proposed standard included a question that asked whether all corrected misstatements, including those detected by management, should be communicated to the audit committee. Many commenters responding to the question were not supportive of the auditor communicating misstatements detected by management or management's period-end adjusting entries, because the auditor may not have knowledge of all such adjustments due to the nature of a company’s financial statement close process and the timing of the auditor’s procedures. Commenters suggested that such a requirement would likely result in the auditor expending significant effort to identify misstatements or adjusting entries that the company’s internal controls previously identified in the financial close process. Accordingly, the standard does not include a requirement for the auditor to communicate misstatements detected by management.

Some commenters suggested that the standard should be revised to require the auditor to communicate only corrected misstatements that individually or in the aggregate could be significant to the company's financial statements. As noted previously, Auditing Standard No. 14 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial. The misstatements the auditor accumulated and management corrected are those that are other than clearly trivial and could be significant to the company's financial statements, either quantitatively or qualitatively. Auditing Standard No. 16 also requires the auditor to communicate those corrected misstatements that might not have been detected except through the auditing procedures performed. The intent of this requirement is to inform the audit committee of misstatements, which might have certain implications on the company's financial reporting process, that were detected only through audit procedures. Therefore, Auditing Standard No. 16 was not revised.

Another commenter suggested that the standard should specifically require the auditor to request management to correct the uncorrected misstatements. The Board did not make this change because management has its own legal responsibilities in relation to the preparation and maintenance of the company’s books, records, and financial statements. Section 13(i) of the

Exchange Act requires the financial statements filed with the SEC to reflect all material correcting adjustments identified by the auditor.[74/]

XIV. Material Written Communication (Paragraph 20 of Auditing Standard No. 16)

Auditing Standard No. 16 incorporates the Exchange Act's requirement for the auditor to communicate other material written communications between the auditor and management to the audit committee.[75/] This requirement is intended to capture other possible material written communications that might occur but are not addressed by requirements in the standard or by other PCAOB standards, such as the management representation letter.[76/]

XV. Departure from the Auditor's Standard Report (Paragraph 21 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee when the auditor expects to modify the opinion in the auditor's report or include explanatory language or an explanatory paragraph in the auditor's report.[77/] The auditor is required to communicate the reasons for and the wording of the modification, explanatory language, or explanatory paragraph. The requirement is intended to provide the basis for a discussion between the auditor and the audit committee in those circumstances in which the auditor expects to add explanatory language or modify the opinion in the auditor's standard report.

As part of overseeing the audit and the financial reporting process, it might be important for the audit committee to understand the reasons an auditor adds explanatory language or modifies the opinion in the auditor's standard report.

[74/] Section 13(i) of the Exchange Act, 15 U.S.C. § 78j-1(m)(i).

[75/] Section 10A(k)(3) of the Exchange Act, 15 U.S.C. § 78j-1(k)(3), requires the auditor to report this information to the audit committee; *see also* SEC Rule 2-07.

[76/] *See* Securities Act Release No. 8183 for a discussion of the substance of other material written communications.

[77/] *See* paragraphs .11-.74 and .76 of AU sec. 508, *Reports on Audited Financial Statements*.

Such communication enables the audit committee to be aware of the nature of any specific matters that the auditor expects to highlight in the auditor's report. In addition, these communications provide the audit committee with an opportunity to obtain further clarification from the auditor about the modification. This communication also provides the audit committee with an opportunity to provide the auditor with further information and explanations regarding the matters that are expected to be included in the auditor's report.

XVI. Disagreements with Management (Paragraph 22 of Auditing Standard No. 16)

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. This requirement is retained from AU sec. 380.13.

Examples of disagreements might include disagreements with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report. For purposes of Auditing Standard No. 16, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional, relevant facts or information prior to the issuance of the auditor's report.

One commenter suggested that disagreements that are satisfactorily resolved should not be communicated to the audit committee unless the auditor determines that these matters warrant the audit committee's attention. As noted previously, this communication requirement is not new. As part of conducting the oversight of the audit and the financial reporting process, it might be important for the audit committee to know the areas of tension between the auditor and management regarding matters that could be significant to the company's financial statements, such as accounting principles and practices, financial statement disclosures, auditing scope or procedures, or similar matters. Accordingly, no change was made in response to this comment. Additionally, SEC Form 8-K requires that a registrant report certain disagreements between management and the auditor, whether or not such disagreements are satisfactorily resolved, when there is a change in the auditor.[78/] The requirement in Auditing Standard No. 16 provides the audit committee with information regarding important matters that might need to be reported subsequently in an SEC filing.

XVII. Difficulties Encountered in Performing the Audit (Paragraph 23 of Auditing Standard No. 16)

Auditing Standard No. 16 includes the requirement from AU sec. 380.16 for the auditor to communicate to the audit committee any significant difficulties encountered during the audit. Significant difficulties encountered during the audit include, but are not limited to:

- Significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures;
- An unreasonably brief time within which to complete the audit;
- Unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence;
- Unreasonable management restrictions encountered by the auditor on the conduct of the audit; and
- Management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor.

XVIII. Other Matters (Paragraph 24 of Auditing Standard No. 16)

Auditing Standard No. 16 requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight

---

[78/] *See e.g.,* Exchange Act Form 8-K, Item 4.01. *See also* Item 304(a)(1)(iv) of Regulation S-K, 17 C.F.R. § 229.304(a)(1)(iv), and Instructions 4 and 5 to that item, which require disclosure of disagreements, or differences of opinion, at the "decision-making level," that, if not resolved to the auditor's satisfaction, would have caused the auditor to make reference to the subject matter of the disagreement in connection with his or her report.

of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters. Communication of the other matters is based on the results of audit procedures or the conduct of the audit and does not require the auditor to perform new or additional procedures beyond the communication itself.

The Act requires that audit committees of listed companies establish procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting control, or auditing matters, and for the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.[79/]

Auditing Standard No. 12 requires the auditor to inquire of the audit committee regarding tips or complaints received by the audit committee regarding financial reporting matters. The auditor might become aware of complaints or concerns regarding financial reporting matters that were not received through the audit committee's process, and, therefore, are unknown to the audit committee. The audit committee might be better able to exercise its oversight activities if the auditor informed the audit committee of these matters. Paragraph 24 of Auditing Standard No. 16 requires the auditor to communicate these matters to the audit committee.

AU sec. 380 required the auditor to ensure that the audit committee receives additional information regarding the scope and results of the audit that may assist the audit committee in overseeing the financial reporting and disclosure process. Auditing Standard No. 16 enhances the requirement in AU sec. 380 for the auditor to communicate to the audit committee the results of the audit procedures regarding the accounting or auditing matters that have been the subject of complaints or concerns.

The standard acknowledges that there might be other matters known to the auditor that may be beneficial to the audit committee's oversight of the financial reporting process. This communication could provide the audit committee with an opportunity to better understand management’s intentions regarding such matters.

[79/] *See* Section 301 of the Act, and Section 10A(m)(4) of the Exchange Act, 15 U.S.C. § 78j-1(m)(4).

Several commenters suggested that Auditing Standard No. 16 should require the auditor to communicate to the audit committee the results of PCAOB inspection findings and any necessary remediation by the audit firm. With respect to inspections, the Act restricts what the Board may publicly disclose,[80/] and the Act makes no exception for disclosure to an audit committee even if a Board inspection has reviewed an audit of the financial statements overseen by that audit committee. The Board cannot compel a firm to disclose nonpublic inspection information to an audit committee. This need not prevent an audit committee from discussing inspection results with its auditor. The Board encourages firms to communicate effectively with audit committees about inspection matters. The Act does not restrict a firm from disclosing to an audit committee nonpublic information regarding PCAOB inspections (including quality control deficiencies and the firm's remediation of those deficiencies) or PCAOB disciplinary matters.[81/]

XIX. Form and Documentation of Communications (Paragraph 25 of Auditing Standard No. 16)

Auditing Standard No. 16 retains from AU sec. 380 the ability for auditors to communicate to the audit committee either orally or in writing, unless otherwise specified in the standard. Some commenters suggested that the standard should require all communications to be in writing, while other commenters indicated that the standard should continue to provide flexibility in the manner of communication.

Auditing Standard No. 16 was not revised to require all communications to be in writing. The Board's intention is to promote effective two-way communication between the auditor and the audit committee, whether through presentations, written reports, or interactive discussions. Written communications might provide the auditor with a basis to lead an active two-way discussion with the audit committee.

In addition, the form of communication may depend on the nature of the matter to be communicated. For example, written information often makes it

---

80/ *See* Section 104(g)(2) of the Act (providing that the Board shall make inspection reports available to the public in appropriate detail "subject to," among other things, the broad disclosure restrictions of Section 105(b)(5)(A)).

81/ *See Information for Audit Committees About the PCAOB Inspection Process*, PCAOB Release No. 2012-003 (Aug. 1, 2012).

easier for the audit committee to understand highly complex information (for example, information about critical accounting estimates). However, having a dialogue on key matters often is an important factor in effective communications between the auditor and the audit committee.

Auditing Standard No. 16 also requires the auditor to document the communications in the work papers, whether such communication took place orally or in writing. The standard further requires the auditor to include a copy of or a summary of management's communications provided to the audit committee in the audit documentation if, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management.

XX. Timing (Paragraph 26 of Auditing Standard No. 16)

The Board considers communications with audit committees to be an integral part of the audit process. AU sec. 380 stated that audit committee communications are incidental to the audit and are not required to occur before the issuance of the auditor's report on the entity's financial statements so long as the communications occur on a timely basis.[82/] Auditing Standard No. 16 requires the auditor to communicate the matters required by the standard in a timely manner and prior to the issuance of the auditor's report. This requirement aligns the timing of communications with SEC Rule 2-07, which requires the auditor to communicate matters to the audit committee prior to the filing of the auditor's report with the SEC.[83/] The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up actions needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.

The reproposed standard specified that all communications be made in a timely manner and prior to the issuance of the auditor's report, unless other timing requirements are specified by PCAOB rules or standards or the rules or regulations of the SEC. One commenter suggested that the "rules and regulations of the SEC" should be modified to the "federal securities laws," since

---

82/ AU sec. 380.04.

83/ *See* SEC Rule 2-07.

timing of certain communications to the audit committee also is specified in securities laws. The standard was updated to reference "securities laws."[84/]

Commenters generally agreed that audit committee communications should occur in a timely manner and prior to the issuance of the auditor's report. Some commenters suggested that the standard should specify the timing of the communication about certain matters, such as during planning or prior to the earnings release.

Auditing Standard No. 16 does not emphasize the specific timing of certain communications because the appropriate timing might vary depending on the circumstances. As noted in the standard, the appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and any corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws. However, in all events, the timing of the communication should be prior to the issuance of the auditor's report.

Providing communications required by Auditing Standard No. 16 to the audit committee in a timely manner and prior to the issuance of the auditor's report will allow the audit committee and the auditor the opportunity to take any action they may deem appropriate to address the matters communicated prior to the issuance of the auditor's report.

The reproposed standard noted that an auditor may communicate to only the audit committee chair if done in order to communicate matters in a timely manner during the audit; however, the auditor should communicate such matters to the full audit committee prior to the issuance of the auditor's report. Several commenters suggested that the auditor's responsibility to subsequently communicate to the "full" audit committee was an unnecessary burden and that the word "full" should be deleted to allow the auditor to communicate to the audit committee when a quorum is present. The standard was revised accordingly to eliminate the word "full."

[84/] The term "securities laws" is defined in section 2(a)(15) of the Act, 15 U.S.C. § 7201, to mean the provisions of law referred to section 3(a)(47) of the Exchange Act, 15 U.S.C. § 78c(a)(47), as amended by the Act, and includes the rules, regulations, and orders issued by the SEC thereunder.

XXI. Adequacy of the Two-Way Communication Process

The original proposed standard included a requirement for the auditor to evaluate whether the two-way communication between the auditor and the audit committee was adequate to support the objectives of the audit. The requirement was included to emphasize that effective two-way communication is beneficial to achieving the objectives of the audit.

Many commenters on the original proposed standard noted that an evaluation of the adequacy of the two-way communications can only be effective if both parties are involved in the evaluation. These commenters also suggested that if only the auditor evaluates the effectiveness based on his or her understanding of what was communicated, that evaluation would not provide information about the audit committee's understanding of that communication. In response to commenters, the Board removed this requirement in the reproposed standard.

Some commenters on the reproposed standard indicated that the Board should reinstate the requirement for the auditor to evaluate the adequacy of the two-way communication between the auditor and the audit committee to encourage the auditor to determine whether there is effective two-way communication. Additionally, some commenters suggested that the standard should be revised to change certain requirements for the auditor to communicate "with" the audit committee instead of "to" the audit committee in situations in which two-way discussion would be appropriate for the auditor to obtain information on particular matters relevant to the audit.

The note in paragraph 3 of Auditing Standard No. 16 states that the requirement for the auditor to "communicate to" the audit committee is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit. The importance of effective two-way communications remains in the standard; therefore, no change was considered necessary.

In addition, as part of understanding the company's control environment in Auditing Standard No. 12, the auditor assesses whether the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control.[85/] Other PCAOB standards require that, in an audit

[85/] *See* paragraphs 23-24 of Auditing Standard No. 12.

of financial statements, if the auditor becomes aware, or in an integrated audit, if the auditor concludes that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that information in writing to the board of directors.[86/] Not including a requirement for the auditor to evaluate the adequacy of a two-way communication in this standard does not change the auditor's responsibility for assessing the audit committee's effectiveness under existing PCAOB standards.

XXII. Audits of Brokers and Dealers

The release accompanying the reproposed standard posed a question about whether the standard should apply to the audits of all brokers and dealers. Many commenters supported the requirement for the standard to apply to the audits of all brokers and dealers. However, some commenters suggested that it may not be practicable to communicate the matters in the standard because they may not be applicable to all brokers and dealers due to the varying size and nature of the brokers and dealers as well as the difference in their governance structures. Some commenters suggested that these brokers and dealers may not have an audit committee, board of directors, or equivalent body, or that the individual designated to oversee the financial reporting process and audits of the company might be the same person preparing the financial statements. They suggested, therefore, that the standard should apply only to certain types of brokers and dealers, such as carrying brokers or dealers. Other commenters suggested that the standard should not be applicable to the audits of brokers and dealers.

The Board acknowledges that there are smaller, less complex brokers and dealers that do not have an audit committee, board of directors, or equivalent body, but that communicating matters about the audit and the financial statements to those overseeing the financial reporting process is important. The governance structure of brokers and dealers does not change the value of the information regarding the audit or the company's financial statements.

Therefore, as discussed in Section I of this appendix, the definition of audit committee was revised for audits of nonissuers to recognize that if no such committee or board of directors (or equivalent body) exists with respect to the company, the communication should be made to the person(s) who oversee the

---

[86/] *See* paragraph 79 of Auditing Standard No. 5 and paragraph 5 of AU sec. 325.

accounting and financial reporting processes of the company and audits of the financial statements of the company.

The release accompanying the reproposed standard posed a question about whether there are any communication requirements specific to the audits of all brokers and dealers that should be added to the standard. Some commenters suggested that the standard should require additional communication to the audit committee related to the additional attestation reporting to be required for brokers and dealers as proposed in pending SEC amendments to its Rule 17a-5.[87/] Once the amendments to Rule 17a-5 are adopted in final form, the Board may consider adding requirements for communication to the audit committee pertaining to such matters.

XXIII. Amendments to PCAOB Standards

With the adoption of Auditing Standard No. 16, the Board adopted related communication requirements to other PCAOB standards. These amendments were made to the following standards, among others:

- Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*;
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*;
- AU sec. 317, *Illegal Acts by Clients*;
- AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*; and
- AU sec. 722, *Interim Financial Information*.

The Board is amending AU sec. 722 to be consistent with Auditing Standard No. 16. Some commenters suggested that the amendments to AU sec. 722 should clarify that the accountant ("accountant" is the term used in AU sec. 722) is not required to repeat communications that were made as part of the

---

87/ SEC, *Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers*, Exchange Act Release No. 62991 (Sept. 24, 2010).

annual audit. Other commenters suggested that the amendments to AU sec. 722 should become effective for interim periods following the first annual period in which Auditing Standard No. 16 becomes effective and that, otherwise, implementing the amendments prior to the first annual communication under Auditing Standard No. 16 would likely result in unnecessarily expanding the communication requirements related to the auditor's review of interim information.

The objective of a review of interim financial information pursuant to AU sec. 722 is to provide the accountant with a basis for communicating whether the accountant is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.[88/] Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information to be reported.[89/] A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit.[90/]

AU sec. 722.18 requires the accountant to make inquiries of members of management who have responsibility for financial and accounting matters, including but not limited to, matters concerning unusual or complex situations that may have an effect on the interim financial information. Examples of situations about which the accountant would ordinarily inquire of management include, among other things, significant, unusual, or infrequently occurring transactions; application of new accounting principles; changes in accounting principles or the methods of applying them; and trends and developments affecting accounting estimates.[91/]

88/ AU sec. 722.07.

89/ AU sec. 722.15.

90/ AU sec. 722.07.

91/ AU sec. 722.55.

An amendment to AU sec. 722 states that when conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Auditing Standard No. 16, as they relate to interim financial information, have been identified.[92/] This requirement is similar to the current requirement for the accountant to refer to AU sec. 380 for matters to communicate to the audit committee when conducting an interim review.[93/]

Additionally, the amendments to AU sec. 722 recognize that management might communicate some or all of the matters related to the company's accounting policies, practices, estimates, and significant unusual transactions described in paragraph 12 of Auditing Standard No. 16. If management communicates any of these matters, the accountant does not need to communicate them at the same level of detail as management, as long as certain criteria are met. However, any omitted or inadequately described matters should be communicated to the audit committee.

The amendment to AU sec. 722.35 also indicates that any communication the accountant may make about the entity's accounting policies, practices, estimates, and significant unusual transactions as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. The amendments to AU sec. 722 do not require that the communications to the audit committee repeat the annual communications but, rather, that the communication be related to the accountant's findings while performing the interim review procedures.

The Board determined not to defer the effective date for quarterly reviews as suggested by some commenters. Deferral of the effective date would result in AU sec. 380 continuing to apply to communications relevant to quarterly reviews, while Auditing Standard No. 16 simultaneously would require communications relating to the annual audit. Auditing Standard No. 16 requires timely communications of matters in connection with the annual audit to be made throughout the year under audit. These communications would, therefore, be made at or near the time that related communications are required in connection with quarterly reviews. Applying Auditing Standard No. 16 for the annual audit

---

92/ Amendment to AU sec. 722.34.

93/ *Id*.

and AU sec. 380 for quarterly reviews could cause some degree of complexity because auditors would be required to apply two different standards when communicating important information to the audit committee. Therefore, the Board is making Auditing Standard No. 16 effective for quarterly reviews of fiscal years beginning on or after December 15, 2012.

In addition to avoiding having two co-existing and differing standards, implementing Auditing Standard No. 16 in the first quarter of 2013 should benefit audit committees by providing for the communication of significant information during the most current period. Also, and as discussed above, the objective of a review of interim financial information differs significantly from that of an audit, and any communication the accountant would make pertaining to interim financial reporting would be limited, as discussed in AU sec. 722, to matters the accountant considered when conducting the review of interim financial information.

The proposed amendments to other PCAOB standards accompanying the reproposed standard included an amendment to AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents.* This amendment would have required the auditor to communicate to the audit committee material misstatements if the client did not agree to revise the accompanying information. This amendment was removed from the amendments accompanying Auditing Standard No. 16 because the Board has proposed to supersede AU sec. 551 as part of its standard-setting project related to auditing supplemental information.[94/]

QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice,* states that to minimize the risk of misunderstandings regarding the nature, scope, and limitations of services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services.[95/] To align with Auditing Standard No. 16, the reproposed standard proposed an amendment to QC sec. 20 to change "client" to "audit committee." One commenter indicated that QC sec. 20 applies to attest

---

[94/] *See Proposed Auditing Standard, Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards.* PCAOB Release No. 2011-005 (July 12, 2011).

[95/] QC sec. 20.16.

engagements as well as to audit engagements. This commenter suggested that instead of replacing "client" with "audit committee," a clarifying footnote be added to the word "client" to indicate that with respect to a financial statement audit or an audit of internal control over financial reporting, the auditor is required to establish an understanding of the terms of the audit engagement with the audit committee. The Board considered this comment and decided not to amend QC sec. 20 at this time. Changes to the Board's quality control standards will be considered as part of the Board's quality control standard-setting project.

APPENDIX 5

Comparison of the Objectives and Requirements of Auditing Standard No. 16, Communications with Audit Committees*, to the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants*

Introduction

This appendix compares certain significant differences between the objectives and requirements of Auditing Standard No. 16, *Communications with Audit Committees,* and the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants.

The analogous IAASB standards are:

- International Standard on Auditing ("ISA") 210, *Agreeing the Terms of Audit Engagements*, and
- ISA 260, *Communication with Those Charged with Governance*.

The analogous ASB standards[1/] are:

- AU-C Section 210, *Terms of Engagement*, and
- AU-C Section 260, *The Auditor's Communication With Those Charged with Governance*.

[1/] In October 2011, the ASB issued Statement on Auditing Standards ("SAS") No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which contains the Preface to Codification of Statements on Auditing Standards, *Principles Underlying an Audit Conducted in Accordance with Generally Accepted Auditing Standards*, and 39 clarified SASs. SAS 122 identifies the section within the AICPA codification with "AU-C" section numbers. *See* http://www.aicpa.org/RESEARCH/STANDARDS/AUDITATTEST/Pages/audit%20and%20attest%20standards.aspx

Other standards of the IAASB and the ASB, respectively, were considered in this comparison to the extent that they include comparable requirements, including:

- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*,
- ISA 450, *Evaluation of Misstatements Identified during the Audit*,
- ISA 570, *Going Concern,*
- ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),*
- ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements,*
- AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*,
- AU-C Section 450, *Evaluation of Misstatements Identified During the Audit,*
- AU-C Section 600, *Using the Work of Others – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors),*
- SAS 118, *Other Information in Documents Containing Audited Financial Statements*, and
- SAS 126, *The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern* (Redrafted).

The information presented does not cover the application and explanatory material in the IAASB standards or ASB standards.[2/]

[2/] Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards*

This appendix is provided for informational purposes only. It is not a summary of or a substitute for Auditing Standard No. 16 itself, which is presented in Appendix 1 of this release. This comparison may not represent the views of the IAASB or ASB regarding the interpretation of their standards.

Objectives

PCAOB

Auditing Standard No. 16 supersedes AU sec. 310, *Appointment of the Independent Auditor*, and AU sec. 380, *Communication With Audit Committees*. Given the responsibility of many audit committees for the appointment and retention of the auditor, Auditing Standard No. 16 combines the requirements from the Board's standards, AU secs. 310 and 380, into one auditing standard.

Auditing Standard No. 16 includes four objectives for the auditor, which reflect both the appointment and retention of the auditor as well as the overall communication responsibilities. The objectives of the auditor are to:

a. Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee;

b. Obtain information from the audit committee relevant to the audit;

c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and

d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

---

on Auditing, indicates that the application and other explanatory material section of the ISAs "does not in itself impose a requirement," but "is relevant to the proper application of the requirements of an ISA." Paragraph A63 of AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards,* states that although application and other explanatory material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

IAASB and ASB

ISA 210 and AU-C Section 210 both include an objective to establish whether the preconditions for an audit are present. Auditing Standard No. 16 does not include this objective, because some of the related requirements in the ISA and SAS are not applicable to audits performed under PCAOB standards, such as determining whether the financial reporting framework is acceptable. For audits performed under PCAOB standards, 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.

Both ISA 260 and AU-C Section 260 include an objective for the auditor to promote effective two-way communication between the auditor and those charged with governance. Although Auditing Standard No. 16 does not include a similar objective, the standard encourages effective two-way communication between the auditor and the audit committee. As stated in Auditing Standard No. 16, "communicate to," is meant to encourage effective two-way communication between the auditor and the audit committee throughout the audit to assist in understanding matters relevant to the audit.

Appointment and Retention

Significant Issues Discussed with Management In Connection with the Auditor's Appointment or Retention

PCAOB

Auditing Standard No. 16 requires the auditor to discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment or retention of the auditor, including significant discussions regarding the application of accounting principles and auditing standards.

IAASB and ASB

ISA 210 and AU-C Section 210 do not include a similar requirement.

PCAOB
Public Company Accounting Oversight Board

Establish an Understanding of the Terms of the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee the objective of the audit, the responsibilities of the auditor, and the responsibilities of management. Paragraph 6 of Auditing Standard No. 16 requires the auditor to record the understanding of the terms in an engagement letter and provide the engagement letter to the audit committee annually. In addition, paragraph 6 of Auditing Standard No. 16 includes a requirement for the auditor to have the engagement letter executed by the appropriate party or parties on behalf of the company. If the appropriate party or parties are other than the audit committee, or its chair on behalf of the audit committee, the auditor should determine that the audit committee has acknowledged and agreed to the terms of the engagement.

Additionally, Auditing Standard No. 16 requires the auditor to decline to accept, continue, or perform the engagement if the auditor cannot establish an understanding of the terms of the audit engagement with the audit committee.

IAASB and ASB

ISA 210 and AU-C Section 210 require the auditor to agree on the terms of the audit engagement with management and, where appropriate, those charged with governance.

ISA 210 and AU-C Section 210 require the engagement letter to be in writing, although there is no requirement that the engagement letter be given to the audit committee or that it be signed by the audit committee, or its chair on behalf of the audit committee, or that it otherwise be acknowledged by the audit committee. Additionally, ISA 210 states that for recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. Accordingly, ISA 210 permits the auditor to not send a new audit engagement letter or other written agreement each period.

AU-C Section 210 requires the auditor to assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented.

Both ISA 210 and AU-C Section 210 also establish requirements for the auditor to determine whether the preconditions for an audit exist. Auditing Standard No. 16 does not include similar requirements, as these requirements were either not applicable to audits performed under PCAOB standards or were addressed through the requirements in Auditing Standard No. 16 for establishing an understanding of the terms of the audit engagement with the audit committee.

ISA 210 requires the auditor to determine whether there are any conflicts between the financial reporting standards and additional requirements supplemented by law or regulation. AU-C Section 210 does not include similar requirements. Auditing Standard No. 16 also does not include similar requirements as they are not relevant to the audits performed under PCAOB standards.

ISA 210 and AU-C Section 210 also include requirements regarding limitation of scope prior to audit engagement acceptance, other factors affecting audit engagement acceptance, and acceptance of a change in the terms of the audit engagement. Auditing Standard No. 16 does not include such requirements as they are not applicable to audits performed under PCAOB standards.

AU-C Section 210 also includes requirements regarding initial audits and re-audits. Auditing Standard No. 16 does not include similar requirements, although similar requirements are included in the Board's standard, AU sec. 315, *Communications Between Predecessor and Successor Auditors*.

Additionally, ISA 260 and AU-C Section 260 include a requirement for the auditor to communicate with those charged with governance the form, timing, and expected general content of communications. Auditing Standard No. 16 does not include this requirement; however, Auditing Standard No. 16 does not preclude the auditor from communicating these matters to the audit committee.

Obtaining Information and Communicating the Audit Strategy

Obtaining Information Relevant to the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to inquire of the audit committee about whether it is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations. This requirement complements the requirement in Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* for the auditor to make inquiries of the audit committee, or equivalent (or its chair) about risks of material misstatement, including inquiries related to fraud risks.[3/]

IAASB and ASB

ISA 260 and the AU-C Section 260 do not contain a similar requirement for the auditor to inquire of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations. However, ISA 240 and AU-C Section 240 require the auditor to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity.

Overall Audit Strategy, Significant Risks, and Timing of the Audit

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures. As part of communicating the overall audit strategy, paragraph 10 of Auditing Standard No. 16 requires the auditor to communicate the following matters to the audit committee, if applicable:

a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;

[3/] Paragraphs 5.f. and 54-57 of Auditing Standard No. 12.

b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;

c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;

d. The names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit; and

e. The basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.

In addition, Auditing Standard No. 16 requires the auditor to communicate to the audit committee significant changes to the planned audit strategy or the significant risks initially identified and the reasons for such changes.

IAASB and ASB

ISA 260 and AU-C Section 260 require the auditor to communicate an overview of the planned scope and timing of the audit. However, ISA 260 and AU-C Section 260 do not require the auditor to communicate significant changes to the planned scope and timing of the audit. Further, ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks, the auditor's use of the work of internal auditors, or the auditor's use of the work of other company personnel and third parties working under the direction of management or the audit committee.

ISA 260 and AU-C Section 260 do not include requirements for the auditor to communicate information about the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current period audit.

However, ISA 600 and AU-C Section 600, include requirements for the auditor to communicate certain matters to those charged with governance including: an overview of the type of work to be performed on the financial information of the components; an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components; instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work; any limitation on the group audit; and fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or other where the fraud resulted in a material misstatement of the group financial statements. In addition, AU-C Section 600 also includes a requirement for the auditor to communicate the basis for the decision to make reference to the audit of a component auditor in the auditor's report on the group financial statements.

Results of the Audit

Accounting Policies and Practices, Estimates, and Significant Unusual Transactions

PCAOB

Auditing Standard No. 16 requires the auditor to communicate certain matters relating to accounting policies and practices, estimates, and significant unusual transactions. However, Auditing Standard No. 16 acknowledges that if management communicates matters related to accounting policies and practices, estimates, and significant unusual transactions to the audit committee, the auditor does not need to communicate these matters at the same level of detail as management as long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) with respect to critical accounting policies and practices, identified for the audit committee those accounting policies and practices that the auditor considers critical. In addition, the auditor is required to communicate any omitted or inadequately described matters to the audit committee.

Matters to be communicated include:

a. Significant accounting policies and practices – (1) management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period; and (2) the effect on financial statements or disclosures of significant accounting policies in (i) controversial areas or (ii) areas for which there is a lack of authoritative guidance or consensus, or diversity in practice.

b. All critical accounting policies and practices to be used, including: (1) the reasons certain policies and practices are considered critical; and (2) how current and anticipated future events might affect the determination of whether certain policies and practices are considered critical.

c. Critical accounting estimates – (1) a description of the process management used to develop critical accounting estimates; (2) management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity; and (3) any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements.

d. Significant unusual transactions – (1) significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature; and (2) the policies and practices management used to account for significant unusual transactions.

IAASB

ISA 260 requires the auditor to communicate the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. AU-C Section 260 also provides that, when applicable, the auditor should determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The ISAs and the AU-Cs do not include a similar requirement for communicating significant unusual transactions.

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

PCAOB

Auditing Standard No. 16 requires the auditor to communicate the following matters to the audit committee:

a. Qualitative aspects of significant accounting policies and practices.

   1) The results of the auditor's evaluation of, and conclusions about, the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments about the amounts and disclosures in the financial statements; and

   2) The results of the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management.

b. Assessment of critical accounting policies and practices. The auditor's assessment of management's disclosures related to the critical accounting policies and practices, along with any significant modifications to the disclosure of those policies and practices proposed by the auditor that management did not make.

c. Conclusions regarding critical accounting estimates. The basis for the auditor’s conclusions regarding the reasonableness of the critical accounting estimates.

d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.

e. Financial statement presentation. The results of the auditor's evaluation of whether the presentation of the financial statements and related disclosures are in conformity with the applicable financial reporting framework, including the auditor's 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, and the bases of amounts set forth.

f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.

g. Alternative accounting treatments. All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.

IAASB

ISA 260 requires the auditor to communicate the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. The ISA provides that, when applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity.

The ISAs do not include a similar requirement for communicating the auditor's understanding of the business rationale for significant unusual transactions.

ASB

AU-C Section 260 requires the auditor to communicate the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable the auditor should:

a. Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity, and

b. Determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The AU-Cs do not include a similar requirement for communicating the auditor's understanding of the business rationale for significant unusual transactions.

Other Information in Documents Containing Audited Financial Statements

PCAOB

When other information is presented in documents containing audited financial statements, Auditing Standard No. 16 requires the auditor to communicate to the audit committee the auditor's responsibility under PCAOB rules and standards for such information, any related procedures performed, and the results of such procedures.

AU sec. 550, *Other Information in Documents Containing Audited Financial Statements,* requires that if the auditor identifies a material inconsistency in the other information presented in documents containing audited financial statements, and the other information is not revised by management to eliminate the material inconsistency, the auditor should communicate the material inconsistency to the audit committee. The auditor should also consider other actions, such as revising the audit report to include an explanatory paragraph describing the material inconsistency, as described in paragraph .11 of AU sec. 508, *Reports on Audited Financial Statements*, withholding the use of the report in the document, and withdrawing from the engagement. The auditor should also communicate a material misstatement of fact to the client and the audit committee, if the material misstatement of fact is not corrected.

IAASB

ISA 720 requires that if the auditor identifies a material inconsistency in the other information in documents containing audited financial statements and revision of the other information is necessary and management refuses to make the revision, then the auditor shall communicate this matter to those charged with governance and (a) include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; or (b) withhold the auditor's report; or (c) withdraw from the engagement, where withdrawal is possible under applicable law or regulation. ISA 720 also requires the auditor to notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action if there is a material misstatement of fact in the other information which management refuses to correct.

ASB

SAS 118 contains similar requirements to those in Auditing Standard No. 16.

Difficult or Contentious Matters for which the Auditor Consulted

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

IAASB and ASB

ISA 260 and AU-C Section 260 do not include a similar requirement.

Management Consultation with Other Accountants

PCAOB

When the auditor is aware that management consulted with other accountants about significant auditing or accounting matters and the auditor has identified a concern regarding such matters, Auditing Standard No. 16 requires the auditor to communicate to the audit committee his or her views about such matters that were the subject of such consultation.

IAASB

ISA 260 does not include a similar requirement.

ASB

AU-C Section 260 requires the auditor to communicate to those charged with governance the auditor's views about matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultations occurred.

Going Concern

PCAOB

Paragraph 17 of Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee, when applicable, certain matters relating to the auditor's evaluation of the company's ability to continue as a going concern. These matters include (a) If the auditor believes there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, the conditions and events that the auditor identified that, when considered in the aggregate, indicate that there is substantial doubt; (b) If the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern is alleviated, the basis for the auditor's conclusion, including elements the auditor identified within management's plans that are significant to overcoming the adverse effects of the conditions and events; (c) if the auditor concludes, after consideration of management's plans, that substantial doubt about the company's ability to continue as a going concern for a reasonable period of time remains, the effects, if any, on the financial statements and the adequacy of the related disclosure and the effects on the auditor's report.

IAASB

ISA 570 requires the auditor to communicate events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. This communication includes whether the events or conditions constitute a material uncertainty; whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and the adequacy of related disclosures in the financial statements.

ASB

SAS 126 requires the auditor to communicate with those charged with governance the nature of the conditions or events identified, the possible effects on the financial statements and the adequacy of related disclosures in the financial statements, and the effects on the auditor's report if, after considering identified conditions or events in the aggregate and after considering management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains.

Uncorrected and Corrected Misstatements

PCAOB

Auditing Standard No. 16 requires the auditor to provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that the auditor presented to management. Auditing Standard No. 16 also requires the auditor to discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors considered. Additionally, Auditing Standard No. 16 requires the auditor to communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated. Auditing Standard No. 16 also requires the auditor to communicate to the audit committee those corrected misstatements, other than those that are clearly trivial, related to accounts and disclosures that might not have been detected except through the auditing procedures performed, and discuss with the audit committee the implications that such corrected misstatements might have on the company's financial reporting process.

IAASB and ASB

ISA 450 and AU-C Section 260 include requirements for the auditor to communicate uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. The auditor's communication shall identify the material uncorrected misstatements individually. Additionally, under ISA 450 and the AU-C Section 260, the auditor is required to communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

ISA 450 and AU-C Section 450 require the auditor to request that uncorrected misstatements be corrected. Auditing Standard No. 16 does not require the auditor to make this request, because under SEC rules the financial statements are required to reflect all material correcting adjustments identified by the auditor.

ISA 450 does not include a requirement for the auditor to communicate corrected misstatements to those charged with governance. AU-C Section 260 requires the auditor to communicate material, corrected misstatements that were brought to the attention of management as a result of audit procedures.

Material Written Communication

PCAOB

Auditing Standard No. 16 requires the auditor to communicate to the audit committee other material written communications between the auditor and management.

IAASB and ASB

ISA 260 and AU-C Section 260 require the auditor to communicate to those charged with governance written representations the auditor is requesting.

Disagreements with Management

PCAOB

Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report. Auditing Standard No. 16 also states that disagreements with management do not include differences of opinion based on incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information prior to the issuance of the auditor's report.

IAASB

The ISAs do not include a similar requirement.

ASB

AU-C Section 260 requires the auditor to communicate disagreements with management, if any.

Other Matters

PCAOB

Auditing Standard No. 16 includes a requirement for 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. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.

IAASB and ASB

ISA 260 and AU-C Section 260 include a similar requirement for the auditor to communicate other matters to those charged with governance that, in the auditor's professional judgment, are significant and relevant to the oversight of the financial reporting process.

Form and Documentation of Communications

PCAOB

Auditing Standard No. 16 requires the auditor to communicate the matters in the standard to the audit committee, either orally or in writing, unless otherwise specified in Auditing Standard No. 16. In addition, the standard also requires the auditor to document the communications in the work papers whether such communications took place orally or in writing. Auditing Standard No. 16 also requires the auditor to include a copy of or a summary of management's communication provided to the audit committee in the audit documentation, if as part of its communications to the audit committee, management communicated some or all of the matters related to accounting policies and practices, estimates, significant unusual transactions, or uncorrected misstatements to the audit committee, and, as a result, the auditor did not communicate these matters at the same level of detail as management.

IAASB

ISA 260 requires the auditor to communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate. Written communication need not include all matters that arose during the course of the audit.

ASB

AU-C Section 260 requires the auditor to communicate in writing with those charged with governance significant findings or issues from the audit if, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved.

Timing

PCAOB

Auditing Standard No. 16 requires the communications to the audit committee to be made in a timely manner and prior to the issuance of the auditor's report.[4/]

IAASB and ASB

ISA 260 and AU-C Section 260 require that the auditor should communicate with those charged with governance on a timely basis.

[4/] Auditing Standard No. 16 includes the following exception for registered investment companies – Consistent with SEC Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07, in the case of a registered investment company, audit committee communication should occur annually, and if the annual communication is not within 90 days prior to the filing of the auditor's report, the auditor should provide an update, in the 90-day period prior to the filing of the auditor's report, of any changes to the previously reported information.

Exhibit 4 - Request to Apply Auditing Standard No. 16 to Audits of Emerging Growth Companies

Introduction and Statutory Background

On August 15, 2012, the Public Company Accounting Oversight Board ("PCAOB" or "Board") adopted Auditing Standard No. 16, *Communications with Audit Committees,* and related amendments ("Auditing Standard No. 16" or "the new standard")[1/] pursuant to the Board's authority under the Sarbanes-Oxley Act of 2002 ("Act").[2/]

Auditing Standard No. 16 requires auditors to communicate certain significant audit and financial statement matters to the audit committee of the company[3/] under audit. Among other things, the required communications include such matters as: (i) the company's critical accounting practices; (ii) significant

---

1/ *Communications with Audit Committees*, PCAOB Release No. 2012-004 (Aug. 15, 2012).

2/ Pub. L. No. 107-204. Pursuant to Section 101 of the Act, the mission of the Board is to oversee the audit of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. Section 103 of the Act authorizes the Board to adopt auditing standards for use in public company audits "as required by this Act or the rules of the [Securities and Exchange] Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." In addition, Section 982 of the Dodd-Frank Act of 2010 expanded the authority of the PCAOB to oversee the audits of registered brokers and dealers, as defined in the Securities Exchange Act of 1934 ("Exchange Act"). *See* Pub. L. No. 111-203.

3/ The term "company" as used in this submission is intended to refer to companies whose audits are required to be performed in accordance with PCAOB standards.

risks identified by the auditor's risk assessment procedures; (iii) the company's significant unusual transactions; and (iv) when applicable, the auditor's evaluation of the company's ability to continue as a going concern. Communications may be made orally or in writing, but should be made in a timely manner and prior to the issuance of the auditor's report.

In the Board's view, the adoption of Auditing Standard No. 16 is in the public interest and contributes to investor protection because it establishes requirements that enhance the relevance, timeliness, and quality of communications between auditors and audit committees. The enhanced relevance, timeliness, and quality of communications should improve the audit and facilitate audit committees' financial reporting oversight, fostering improved financial reporting. The Board's adopting release dated August 15, 2012, discusses the record developed by the Board in adopting Auditing Standard No. 16 in greater detail.

The Board filed Auditing Standard No. 16 for approval by the Securities and Exchange Commission ("SEC" or "Commission") on August 28, 2012. Pursuant to Section 107(b)(3) of the Act, the Commission shall approve a proposed standard if it finds that the standard is "consistent with the requirements of [the] Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors."

In addition, the Act was recently amended by Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act")[4/] to provide that any additional rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of "emerging growth companies" ("EGCs")[5/] unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation."[6/] As a result, Auditing Standard No. 16, which was adopted by the Board after April 5, 2012, is subject to a separate determination by the SEC regarding its applicability to audits of EGCs.

The Board is thus requesting that the Commission also take action to apply Auditing Standard No. 16 to audits of EGCs, pursuant to Section 104 of the JOBS Act. In this submission, the Board is providing information to assist the SEC in its consideration of whether it is "necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation," to apply Auditing Standard No. 16 to audits of EGCs.

4/ Pub. L. No. 112-106.

5/ Section 3(a)(80) of the Exchange Act defines the term "emerging growth company."

6/ *See* Section 103(a)(3)(C) of the Act, as added by Section 104 of the JOBS Act.

The information provided in this submission summarizes the Board's record in adopting Auditing Standard No. 16 and includes a discussion of the following areas to assist the SEC in its consideration pursuant to Section 104 of the JOBS Act: (i) the background of and reasons for the new standard; (ii) the Board's approach to developing the new standard, including consideration of alternatives; (iii) key changes and improvements from existing audit committee communication requirements; and (iv) characteristics of EGCs and economic considerations.

Background and Reasons for the New Standard

The following discussion provides summary information regarding the background and reasons for Auditing Standard No. 16. These matters are also discussed in greater detail in the Board's adopting release.

Auditing Standard No. 16 would replace PCAOB interim standards AU sec. 380, *Communication With Audit Committees* ("AU sec. 380"), and AU sec. 310, *Appointment of the Independent Auditor* ("AU sec. 310").[7/] The existing PCAOB requirements regarding auditor communications with audit committees are primarily in AU sec. 380, while AU sec. 310 discusses establishing an

---

[7/] Shortly after its inception, the Board adopted the existing standards of the American Institute of Certified Public Accountants ("AICPA"), as in existence on April 16, 2003, on an initial, transitional basis. *See* PCAOB Release No. 2003-006 (Apr. 18, 2003). References to AU sections ("AU secs.") throughout this document are to these PCAOB interim auditing standards, which consist of generally accepted auditing standards, as described in the AICPA Auditing Standards Board's Statement on Auditing Standards No. 95, as in existence on April 16, 2003, to the extent not superseded or amended by the Board.

understanding between the auditor and the client regarding the audit engagement.

AU sec. 380 became effective in January 1989, at a time when management typically hired and retained the auditor and had oversight of the work of the auditor. AU sec. 380 indicates that audit committee communications are "incidental to the audit" and are not required to occur prior to the issuance of the auditor's report. AU sec. 380 includes a variety of specified communication requirements.

Subsequently, changes to the federal securities laws and related SEC rules imposed additional communication requirements that are not currently reflected in AU sec. 380. Most significantly, in 2002, the Act changed the role of the audit committee and the interaction between the audit committee and the auditor, requiring the auditor of a listed company to report directly to the audit committee. Section 301 of the Act made changes to the federal securities laws to require the audit committee of a listed company to be directly responsible for the appointment, compensation, and oversight of the work of the external auditors, including the resolution of disagreements between management and the auditor regarding financial reporting. In addition, Section 204 of the Act made other changes to the federal securities laws to require the auditor to report the following matters to the audit committee on a timely basis:

- All critical accounting policies and practices to be used;

- All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
- Other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

Since the adoption of AU sec. 380, certain PCAOB auditing standards also have changed as a result of the Board's ongoing efforts to revise its interim standards. For example, in 2010 the Board adopted eight standards on assessing and responding to risk in an audit (the "risk assessment" standards), which cover the entire audit process, from initial planning activities to evaluating audit evidence to forming the opinion to be expressed in the auditor's report.[8/] The risk assessment standards address, among other things, requirements for the auditor in the areas of audit planning, audit strategy, and risk assessment, including requirements for the auditor to identify significant risks of material misstatement. As one of the PCAOB's interim auditing standards, AU sec. 380's communication requirements are not aligned with the procedures performed pursuant to the PCAOB's risk assessment standards, which became effective for audits for fiscal years beginning after December 15, 2010.

[8/] *See* PCAOB Release 2010-004 (Aug. 5, 2010).

Additionally, observations from the Board's oversight activities raised matters for consideration. For example, some inspection observations indicate that auditors have not made all required audit committee communications, possibly because they are not aware of the varying sources of communication requirements contained throughout the Board's standards and rules. Currently, thirteen auditing standards and rules require the auditor to communicate with the audit committee, and other additional communication requirements are located in the federal securities laws and SEC rules.

In light of these changes and considerations, the Board adopted Auditing Standard No. 16 with the goal of improving the audit by enhancing communications between auditors and audit committees. With the passage of the Act and the establishment of the PCAOB, Congress acknowledged that auditors play an important role in protecting the interests of investors by preparing and issuing informative, accurate, and independent audit reports.[9/] The audit committee also plays an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to a company's shareholders and others to oversee the integrity of a company's accounting and financial reporting processes and audits.

In the Board's view, both the auditor and the audit committee benefit from a meaningful and timely exchange of information regarding significant risks of material misstatement in the financial statements and other matters that may

---

[9/] *See* Section 101(a) of the Act; Senate Report No. 107-206, at 5-6 (July 3, 2002).

affect the integrity of the company's financial reports. Communications with the audit committee improve the audit by providing auditors with the audit committee's insights about the company as well as providing auditors with a forum separate from management to discuss complex and significant matters about the audit and the company's financial reporting process. Communications between the auditor and the audit committee allow the audit committee to be well-informed about accounting, auditing, and disclosure matters, including the auditor's evaluation of matters that are significant to the financial statements, and to be better able to carry out its oversight role.

Auditing Standard No. 16 also updates the auditing standards to reflect the communication requirements mandated by the federal securities laws and aligns the audit committee communication requirements with auditor performance requirements, including those in the risk assessment standards. Bringing these requirements together in one place should promote the auditor's compliance with relevant statutory and regulatory requirements (as well as facilitating audit planning and informing audit scope). Updating auditing standards to incorporate new statutory and regulatory requirements can help ensure that audit firms update their audit methodologies to include all required and relevant procedures. Such updating is particularly critical with respect to AU sec. 380 because, as noted earlier, AU sec. 380 treats audit committee communications as "incidental," and does not focus on the important role of the audit committee in the current regulatory environment.

The Board's Approach to Development of Auditing Standard No. 16, including Consideration of Alternatives

Auditing Standard No. 16 was adopted by the Board after several years of consideration and public outreach. For example, the issue of auditor communications with the audit committee was discussed with the Board's Standing Advisory Group ("SAG") on several occasions prior to the Board’s decision to propose a new standard.[10/]

The Board proposed a new standard on March 29, 2010, which was open for comment until May 28, 2010. The comment period reopened on September 7, 2010 and was extended until October 21, 2010, to accommodate comments received in connection with a public roundtable held by the Board on September 21, 2010.

The standard was then reproposed on December 20, 2011, and open for comment until February 29, 2012. The Board adopted the new standard on August 15, 2012.

The Board received and considered 44 comment letters on the original proposal, which included the reopened comment period, and 39 comment letters on the reproposed standard. Most commenters were supportive of the Board's efforts to enhance communications between the auditor and the audit committee. Those commenters agreed that fuller and more relevant communications

---

[10/] The SAG discussed the audit committee communications standard at a number of its meetings, including meetings prior to proposing a new standard on: June 21-22, 2004, June 8, 2005, Oct. 5-6, 2005, and Oct. 14-15, 2009.

between the auditor and audit committee would allow the auditor to perform a more informed, and thus more effective, audit and also would enable the audit committee to more effectively fulfill its oversight responsibilities regarding the financial reporting process.

The Board's adopting release explains in greater detail the Board's consideration of significant comments received and the reasons for making the changes reflected in the new standard. In general, as discussed below, the Board made a number of decisions as it developed Auditing Standard No. 16 that make the new standard more efficient and effective to apply, and avoid unnecessary costs. The following summary describes the Board's overall approach and highlights some of the choices made, and alternatives considered.

- Auditing Standard No. 16 is scalable, based on a company's size and complexity. In developing the new standard, the Board sought to promote high-quality audits, while considering the standard's overall effect on current audit practice and on audit committees and companies. In doing so, the Board sought to achieve the standard's intended benefits, without imposing unnecessary costs, and to create a standard that is scalable based on the company's size and complexity. A company's size and complexity can affect the risks of material misstatement, create auditing challenges, and involve other significant matters that warrant bringing to the attention of the audit committee. Thus, an auditor of a smaller, less complex company with fewer difficult auditing or financial reporting issues may have fewer matters to communicate than for an audit of a larger, more complex company. Accordingly, under Auditing Standard No. 16, in an audit of a small, less complex company, an auditor may make less extensive audit committee communications than in an audit of a larger, more complex company. The original proposal asked for comment on whether any of the requirements of the proposed standard were inappropriate based on the size or industry of the company. Commenters considered the proposed requirements to be applicable and appropriate to companies of different sizes and industries.

- Auditing Standard No. 16 has been carefully designed to: (i) retain the pre-existing communication requirements in auditing standards; (ii) incorporate the communication requirements already imposed by the Act and related SEC rules; and (iii) link new communications to related performance requirements arising out of the Board's existing auditing standards. As a result of this approach, the auditor's communications under the new standard are limited to *communicating* the results of the audit or specific audit procedures already required under the existing standards. Auditing Standard No. 16 does not impose new performance obligations on the auditor, other than the standard’s required communications.

- <u>Auditing Standard No. 16 organizes and compiles information regarding other PCAOB auditor communication requirements.</u> Auditing Standard No. 16 contains an appendix that lists in one place other PCAOB standards and rules that require the auditor to communicate specific matters to the audit committee. This aspect of the new standard responds to observations from the Board's oversight activities that suggest that auditors may not make all required audit committee communications because they might not be aware of the varying sources of such requirements. This convenient list facilitates auditors' identification of other PCAOB standards and rules that contain communication requirements.
- <u>Auditing Standard No. 16 focuses on the communication of significant matters relating to the audit.</u> In developing the new standard, the Board sought to focus on communication of significant matters relating to the audit. In response to comments, the requirements in Auditing Standard No. 16 were changed from the original proposal to focus the auditor on communicating matters that are significant to the audit committee's oversight of the financial reporting process. For example, changes were made to limit communications regarding the need for specialized skill or knowledge in the audit to only those relevant to significant audit risks. Similarly, the standard was narrowed to require

communications relating to matters on which the auditor consulted to only those 'difficult or contentious' matters that are relevant to the audit committee's oversight of the financial reporting process.

- Auditing Standard No. 16 provides the auditor with flexibility to communicate orally or in writing. AU sec. 380 provides the auditor with the flexibility to communicate orally or in writing. Several commenters to both the original proposal and the reproposal suggested that the communications to the audit committee should be required to be in writing. The Board considered this approach, but determined that requiring all communications to be in writing could reduce the effectiveness of the communication process. The Board's goal is to promote effective two-way communication between the auditor and the audit committee, whether through presentations, written reports, or interactive discussions. Allowing different forms of communication also makes the communication requirement more flexible for companies of all sizes and natures.
- Auditing Standard No. 16 recognizes that management, as well as the auditor, may discuss issues relating to the company's financial statements with the audit committee, and that it would not be cost-effective or practical for the audit committee to receive the same communication twice. With respect to certain auditor communications, the new standard provides that the auditor need

not duplicate communications made by management at the same level of detail, so long as certain conditions specified in Auditing Standard No. 16 are met.[11/] These changes allow for better use of auditor, management, and audit committee time and resources while, at the same time, help to ensure that the audit committee is informed of important accounting issues.

- Auditing Standard No. 16 reflects practical considerations. The scope of the new standard was narrowed in response to practical concerns raised during the comment process. For example, the original proposed standard included a requirement for the auditor to evaluate whether the two-way communications between the auditor and the audit committee were adequate to support the objectives of the audit. Commenters were concerned that the evaluation might not be effective, as it would reflect only the auditor's evaluation of the communications, and would not provide information about the audit committee's understanding of the nature of the communications. The Board agreed and did not adopt the requirement.

[11/] *See* note to Paragraph 12 of Auditing Standard No. 16 and discussion in PCAOB Release No. 2012-004 (Aug. 15, 2012) at pages A4-24 to A4-25.

Key Changes and Improvements from Existing Standards

The following discussion provides a summary of the existing standards relating to auditor communications. The summary also includes a discussion of improvements that have been made in the new standard that should benefit audit quality. These matters also are discussed in greater detail in the Board's adopting release.

Existing Requirements. As previously noted, the existing requirements for communications with the audit committee are primarily in AU sec. 380. In addition, AU sec. 310 requires the auditor to establish an understanding with the client regarding the audit engagement.

Requirements Retained from Existing Standard. The new standard retains from AU sec. 380 the following audit committee communication requirements:

- Major issues discussed with management prior to the retention of the auditor;
- The company's significant accounting policies and practices;
- The auditor's responsibility related to other information in documents containing audited financial statements;
- Difficulties encountered in performing the audit; and
- Disagreements with management.

Incorporation of Statutory Communication Requirements. Auditing Standard No. 16 also incorporates the following specific auditor communication requirements contained in Exchange Act Section 10A(k) and SEC Rule 2-07 of Regulation S-X ("SEC Rule 2-07"):

- All critical accounting policies and practices to be used;
- All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
- Other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.[12/]

Improvements Made to Existing Communication Requirements. While Auditing Standard No. 16 retains many of the communication requirements in AU sec. 380, it also revises certain requirements to be consistent with existing audit performance requirements or to respond to other requirements in the Act as well as SEC Rule 2-07. The new standard improves current communication requirements in the following areas:

[12/] *See* Section 10A(k) of the Exchange Act, 15 U.S.C. §78j-1(k), and implementing changes in Rule 2-07(a)(1)-(3) of Regulation S-X, 17 C.F.R. § 210.2-07(a)(1)-(3).

- Timing/Shift in Approach to Audit Committee Communications. AU sec. 380 provides that audit committee communications are "incidental to the audit." While AU sec. 380 requires auditors to "discuss" or determine that the audit committee is "informed" regarding a range of matters on a timely basis, AU sec. 380 also provides that communications are not required to occur prior to the issuance of the auditor's report. The new standard indicates that communications between the auditor and the audit committee are integral to the audit and that communications should occur in a timely manner and prior to the issuance of the auditor's report. By requiring communications prior to the issuance of the auditor's report, Auditing Standard No. 16 makes a significant difference in the standard regarding the timing of communications by giving auditors and audit committees the ability to take appropriate action to address the matters communicated, including any effect on the company's financial statements. This timing requirement aligns with the timing of communications required by Exchange Act Section 10A(k) and SEC Rule 2-07.
- Understanding the Terms of the Audit and the Engagement Letter. AU sec. 310 requires the auditor to establish an understanding with the "client" regarding the terms of the audit and services to be performed. Auditing Standard No. 16 retains the requirement for the

auditor to establish an understanding of the terms of the audit engagement and the services to be performed, but requires the understanding to be with the audit committee. The new standard also requires that the understanding be recorded in an engagement letter. These changes align the new standard with the audit committee's oversight of the work of the external auditor.[13/] These new requirements also build on the requirement in AU sec. 310 for the auditor to document the understanding in the working papers, preferably through a written communication with the client. Having a mutually clear understanding of the terms of the engagement, including the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management in connection with the audit, should benefit both the auditor and the audit committee.

- Definition of "Audit Committee." AU sec. 380 does not have a formal definition of audit committee, but describes the audit committee as "those that have responsibility for oversight of the financial reporting process." Auditing Standard No. 16 incorporates the definition of audit committee used in the Act and modifies the Act's definition for companies that are nonissuers, such as brokers and dealers.

[13/] *See* Section 301 of the Act, and Section 10A(m)(2) of the Exchange Act, 15 U.S.C. § 78j-1(m)(2).

- Qualitative Aspects of the Company's Financial Reporting. AU sec. 380 requires the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles, including the consistency of the entity's accounting policies and their application, and the clarity and completeness of the entity's financial statements and related disclosures. Many commenters indicated that it was unclear what was meant by the quality, clarity, and completeness of the company's financial statements and related disclosures. Auditing Standard No. 16 aligns the communication requirement with an underlying performance requirement in Auditing Standard No. 14, *Evaluating Audit Results.* Under this approach, the auditor communicates, among other things: (i) the results of the auditor's evaluation of and conclusions about the qualitative aspects of the company's significant accounting policies and practices, including situations in which the auditor identified bias in management's judgments and (ii) the results of the auditor's evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including such matters as consideration of the form, arrangement, and content of the financial statements. This approach aligns with existing performance requirements and was favored by most commenters.

- Critical Accounting Estimates. AU sec. 380 requires the auditor to determine that the audit committee is informed about the process used by management in formulating "particularly sensitive" accounting estimates. Auditing Standard No. 16 largely retains the auditor communication requirement from AU sec. 380, but uses the term "critical accounting estimates," which conforms to the term used by the SEC.[14/] Auditing Standard No. 16 adds related requirements to communicate matters pertaining to management's significant assumptions and changes to the process or assumptions used to develop critical accounting estimates. These additional requirements address communication of the results of the auditor's procedures performed under AU sec. 342, *Auditing Accounting Estimates.* The purpose of this communication is to focus the audit committee's attention on the estimates that might be subject to higher risk of material misstatement.

- *Uncorrected and Corrected Misstatements.* Auditing Standard No. 16 incorporates the communication requirements from AU sec. 380 related to uncorrected and corrected misstatements. In addition,

[14/] *See* SEC, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (Dec. 19, 2003).

Auditing Standard No. 16 incorporates the requirement from the Act and SEC Rule 2-07 for the auditor to report to the audit committee other material written communications between the auditor and management, such as a schedule of unadjusted differences.

- *Significant Unusual Transactions.* AU sec. 380 requires the auditor to determine that the audit committee is informed about the methods used to account for significant unusual transactions. Auditing Standard No. 16 revises the requirement by adding requirements based on the auditor's procedures under AU sec. 316, *Consideration of Fraud in a Financial Statement Audit,* for the auditor to communicate: (i) significant transactions that are outside the normal course of business for the company or otherwise appear to be unusual due to their timing, size, or nature and (ii) the auditor's understanding of the business rationale for significant unusual transactions. Communications of significant unusual transactions by the auditor will improve audit quality by promoting discussion of such transactions. It will also allow the audit committee to gain insight into such transactions and take appropriate actions, if necessary, to address the financial statement or disclosure impact of such transactions.
- Management Consultations with Other Accountants. When the auditor is aware that management consulted with other accountants

about auditing and accounting matters, AU sec. 380 requires the auditor to discuss with the audit committee the auditor's views about significant matters that were the subject of such consultation. Auditing Standard No. 16 modified this requirement. The new standard requires the auditor to communicate to the audit committee only when the auditor has identified a concern regarding such consultations. Commenters viewed this change as an improvement as they noted that it may be good practice for management to consult with other accountants as experts to assist them regarding complex accounting matters, but that the audit committee need not be informed of all such consultations, rather just those matters for which the auditor identified a concern.

- Obtaining Information Relevant to the Audit*.* Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement,* requires the auditor to inquire of the audit committee regarding the matters important to the identification and assessment of risks of material misstatement, including fraud risks. Pursuant to Auditing Standard No. 16, the auditor also inquires about whether the audit committee is aware of additional matters relevant to the audit. As a result, the auditor has an opportunity to focus on any additional matters relevant to the audit, such as possible violations of laws or regulations. This inquiry requirement might enable the auditor to learn from the audit committee about a possible previously unidentified risk.

New Communication Requirements. Auditing Standard No. 16 also contains new communication requirements that improve the audit by promoting discussion about significant aspects of the audit, while also providing valuable information to the audit committee. These new communications relate to audit procedures that already will be performed under existing PCAOB standards, with the auditor communicating the results of such procedures to the audit committee. The new communication requirements include:

- <u>Overall Audit Strategy and Significant Risks.</u> Auditing Standard No. 16 includes a requirement for the auditor to communicate to the audit committee an overview of the overall audit strategy, including the timing of the audit, and to discuss with the audit committee significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks. These changes are aligned with the results of the audit procedures performed under the PCAOB's risk assessment standards, in particular, Auditing Standard No. 9, *Audit Planning,* and Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement.*
- <u>Other Participants in the Audit.</u> Auditing Standard No. 16 requires the auditor to communicate, as applicable, information about specialized skill or knowledge needed for the audit. In addition, the

auditor is required to communicate: (i) information regarding other participants in the audit, such as the extent of the use of internal auditors, company personnel, other third parties (including other independent public accounting firms), or other persons not employed by the auditor that are involved in the audit and (ii) the basis for the auditor's determination that the auditor can serve as the audit engagement's principal auditor, if significant parts of the audit are performed by other auditors. The communications related to others involved in the audit, including the nature and extent of their involvement, could be important for an audit committee to understand in its oversight of the audit. These communications should reflect the results of other audit procedures that the auditor is currently required to perform in accordance with PCAOB standards.

- Difficult or Contentious Matters for which the Auditor Consulted. Auditing Standard No. 16 requires the auditor to communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process. Audit committees might better appreciate the importance of difficult or contentious matters, benefiting their governance responsibility, if they are aware that such consultations took place. Communications are based on the results of the procedures the auditor performed regarding difficult or contentious matters.

- Going Concern. Auditing Standard No. 16 requires the auditor to communicate to the audit committee certain matters related to the auditor's evaluation of the company's ability to continue as a going concern. The communication requirements in Auditing Standard No. 16 are based on the auditor's performance requirements under AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.* This communication enables the auditor to improve the audit by facilitating discussion between the auditor and the audit committee about the company's ability to continue as a going concern. This communication also can serve to further inform the audit committee, by focusing attention on financial difficulties the company is encountering. Through this communication, the auditor can benefit from the audit committee's views of the concerns identified by the auditor. Such communications also could be significant in terms of the audit committee's role in overseeing the company's financial reporting process to ensure that the company's financial statements contain the necessary disclosures.

- Other Matters. Auditing Standard No. 16 requires the auditor to communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process, such as complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit. The auditor benefits from a robust discussion of such complaints or concerns with the audit committee. Also, the audit committee should be better able to exercise its oversight activities if the auditor informs the audit committee of these matters. Communication to the audit committee is based on the results of the auditor's procedures relating to such other matters.
- New Accounting Pronouncements. Auditing Standard No. 16 requires the auditor to communicate to the audit committee situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. This communication informs the audit committee of situations relevant to the audit committee's oversight of the company's financial reporting process. Auditing Standard No. 16 requires only that the auditor communicate concerns identified

as a result of existing audit performance requirements and does not require the auditor to perform additional procedures to identify such concerns.

- Departure from the Auditor's Standard Report. Auditing Standard No. 16 requires the auditor to communicate to the audit committee when the auditor expects to: (i) modify the opinion in the auditor's report or (ii) include explanatory language or an explanatory paragraph in the auditor's report. The requirement is intended to provide the basis for a discussion between the auditor and the audit committee in those circumstances in which the auditor expects to change the auditor's standard report. This requirement is limited to the communication of changes to the audit report determined by the auditor during the course of the audit and does not require the performance of new audit procedures.

Other Considerations Relating to Changes to the Standard. As part of the Board's regular standard-setting process, the Board takes into account costs related to its proposed changes based on, among other things, the Board's general knowledge of audit firm practice based on the Board's oversight activities. The Board did not specifically seek or receive comment that attempted to quantify costs related to the new standard.[15/]

[15/] The discussion in this section reflects the Board's qualitative assessment of the new standard's impact based on the overall design of the new standard, and the changes made by the Board in response to comments, both of

The Board has sought to devise an overall framework for auditor communications that is sensitive to the new standard's overall effect. The Board has sought to avoid unnecessary costs in developing the new standard. To the extent that the new standard changes existing or imposes new communication requirements, however, the Board recognizes that those requirements will impose some incremental costs.

To avoid unnecessary costs:

- Auditing Standard No. 16 incorporates significant existing and new communication requirements into one standard. Bringing these requirements together in one place should promote the auditor's compliance with relevant statutory and regulatory requirements, as well as potentially reducing auditor time searching for requirements. Similarly, an appendix to the new standard lists and identifies the location of other auditor communication requirements contained in other PCAOB rules and standards; and
- The new standard does not impose new auditor performance requirements, other than the required communications themselves. In other words, the new audit committee communication requirements in Auditing Standard No. 16 are based on the results of audit procedures performed under existing standards.

---

which are discussed throughout this submission and in the record for Auditing Standard No. 16.

In considering costs, as a threshold matter, the Board notes that auditors and audit committees already engage in audit committee communications under the federal securities laws and existing auditing standards and thus registered firms and companies already incur some costs in complying with existing requirements.

Registered firms will need to incur the one-time cost to update their audit methodologies to reflect the new requirements and conduct initial training of their personnel on the new requirements.[16/] In addition, registered firms will incur the recurring costs of the additional time required to prepare and make the communications in each audit in which they are required and to document that those communications were made. The Board also recognizes that audit committees will need to receive or read, and potentially discuss and act upon, the new required communications, which might result in the ongoing cost of increased time required for audit committee meetings. The Board sought to ensure that the recurring communication requirements are scalable – that is, they vary based on the size and complexity of the company – in part to avoid unnecessary costs.

For all the reasons discussed above and in the Board's adopting release, the Board does not anticipate the incremental costs imposed by the new standard would be significant.

[16/] Those firms that in the past did not use an engagement letter for audits subject to the standard will now have to develop one. In the Board's experience, most firms currently use an engagement letter for such audits.

Characteristics of EGCs and Economic Considerations

The PCAOB has begun to monitor implementation of the JOBS Act in order to understand the characteristics of EGCs and inform the Board's request to apply Auditing Standard No. 16 to audits of EGCs.[17/]

To obtain data regarding EGCs, the PCAOB's Office of Research and Analysis has reviewed registration statements and Exchange Act reports filed with the SEC with filing dates between April 5, 2012, and June 4, 2012, for disclosures by entities related to their EGC status. Only those entities that have voluntarily disclosed their EGC status have been identified.[18/]

[17/] Pursuant to the JOBS Act, an "emerging growth company" is defined in Section 3(a)(80) of the Exchange Act. In general terms, an issuer qualifies as an EGC if it has total annual gross revenue of less than $1 billion during its most recently competed fiscal year (and its first sale of common equity securities pursuant to an effective Securities Act registration statement did not occur on or before December 8, 2011). *See* JOBS Act Section 101(a), (b), and (d). Once an issuer is an EGC, the entity retains its EGC status until the earliest of: (i) the first year after it has total annual gross revenue of $1 billion or more (as indexed for inflation every five years by the SEC); (ii) the end of the fiscal year after the fifth anniversary of its first sale of common equity securities under an effective Securities Act registration statement; (iii) the date on which the company issues more than $1 billion in non-convertible debt during the prior three year period; or (iv) the date on which it is deemed to be a "large accelerated filer" under the Exchange Act (generally, an entity that has been public for at least one year and has an equity float of at least $700 million).

[18/] The PCAOB has not validated these entities' self-identification as EGCs. The information presented in this submission also does not include data for entities that have confidentially submitted draft registration statements to the SEC for confidential non-public review in accordance with the JOBS Act. Thus, the data and analysis are not based on the complete population of EGCs. The Board recognizes that its initial analysis of self-identified EGCs does not include all entities that may be EGCs and that, after the JOBS Act has been in effect for a longer period of time, additional analysis of the characteristics of EGCs may be possible.

Characteristics of Self-Identified EGCs. As of June 4, 2012, based on the PCAOB's research, 196 entities have voluntarily identified themselves as EGCs in SEC filings. These 196 entities operate in diverse industries. The five most common Standard Industrial Classification (SIC) codes applicable to these entities are for: blank checks; pharmaceutical preparations; prepackaged software services; computer processing/data preparations services; and crude petroleum/natural gas.

Of the 196 entities, approximately 78% are companies that were identified in a registration statement filed to conduct an initial public offering. The other 22% were identified through Exchange Act filings. Forty-one entities have securities listed on a national securities exchange.

The reported assets for the 196 entities ranged from zero to approximately $13 billion, based on filings for the period reported. The average and median reported assets of the 196 entities were approximately $260.6 million and approximately $24.9 million, respectively.[19/] The reported revenue for the 196 entities, based on filings for the period reported, ranged from zero to approximately $958.1 million. The average and median reported revenue of the

---

[19/] For purposes of comparison, the PCAOB compared the data compiled with respect to the 196 entities with companies listed in the Russell 3000 Index in order to compare the EGC population with the broader issuer population. The Russell 3000 was chosen for comparative purposes because it is intended to measure the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market (as marketed on the Russell website). The average and median reported assets of issuers in the Russell 3000 was approximately $11.5 billion and approximately $1.4 billion, respectively. The average and median reported revenue of issuers in the Russell 3000 was approximately $4.6 billion and $742.8 million, respectively.

196 entities was approximately $106.9 million and approximately $6.7 million, respectively. Seventy-eight of the 196 entities identified themselves as "development stage entities" in their financial statements.[20] Of the 196 entities, 103 were audited by firms that are annually inspected by the PCAOB (i.e., firms that have issued audit reports for more than 100 public company audit clients). The remaining 93 were audited by triennially inspected firms (i.e., firms that have issued audit reports for 100 or fewer public company audit clients).

Based on the Board's initial analysis of EGCs, these entities appear to represent diverse industries and are audited by a diverse group of firms. Although these entities range in size, approximately 61% or 119 have reported revenue of less than $50 million. Given the December 8, 2011, initial starting point for EGC eligibility, one key difference between EGCs and other entities appears to be the length of time an EGC has been subject to the reporting requirements under the Exchange Act.[21]

Economic Considerations and Application of Auditing Standard No. 16 to Audits of EGCs. The Board adopted Auditing Standard No. 16 to "further the

---

[20] According to Financial Accounting Standards Board ("FASB") guidance, development stage entities are entities devoting substantially all of their efforts to establishing a new business and for which *either* of the following conditions exists: (a) planned principal operations have not commenced or (b) planned principal operations have commenced, but there has been no significant revenue from operations.) *See* FASB Accounting Standards Codification, Subtopic 915-10, *Development Stage Entities – Overall*.

[21] The Board notes that its initial analysis is generally consistent with the legislative history of the JOBS Act, which anticipated that EGCs will be somewhat smaller entities that may have less experience in complying with some aspects of the federal securities laws. *See* House Report No. 112-406, at 5-7.

public interest in informative, accurate, and independent audit reports." Auditing Standard No. 16 is intended to improve the relevance, timeliness, and quality of communications between auditors and audit committees. The Board's determination to adopt Auditing Standard No. 16 is based on a record developed over several years that includes extensive public outreach and comment.

As discussed above and in the Board's release, improved communications should result in both auditors and audit committees becoming better informed and, therefore, better equipped to fulfill their respective roles in the company's financial reporting. Through this communication, the auditor may obtain more complete information about the company, enabling the auditor to be more effective in identifying and assessing risks of material misstatement in the company's financial statements and designing and performing audit procedures to address those risks. Similarly, a better informed audit committee should contribute to management oversight, which may also improve the company's financial reporting as well as its oversight of management more generally.

The Board believes the standard will enhance the quality of the audit and the quality of the financial reporting process. In attempting to obtain these benefits through the new standard, the Board sought to avoid imposing unnecessary costs. The approach used by the Board was to consider the new standard's overall effect on current audit practice and on audit committees and companies. This approach was used to develop a standard that is scalable based on a company's size and complexity, thereby avoiding unnecessary costs for audits of smaller or less complex companies, including smaller or less complex companies that are EGCs.

The benefits of the standard, which are summarized throughout this submission and described more fully in the Board's adopting release, should also be applicable to companies of various types and natures. For example, auditors and audit committees of all types of companies should benefit from a meaningful exchange of information regarding significant matters that may affect the integrity of a company's financial reports. Communications with the audit committee should improve the audit by providing auditors with the audit committee's insights about the company, as well as providing auditors with a forum that is separate from management to discuss complex and significant matters about the audit and the company's financial reporting process. Communications between the auditor and the audit committee should allow the audit committee to be well-informed about accounting, auditing, and disclosure matters that are significant to the company's financial statements, and to be better able to carry out its oversight role. These general benefits of the new standard should accrue to audits of all companies, including EGCs.

Moreover, enhanced audit committee communications may be of particular benefit to EGCs. Based on the Board's preliminary analysis of EGC data, EGCs generally appear to be companies that are relatively new to the SEC reporting process. Such companies may have new audit committee members and may be relatively less familiar with SEC reporting requirements, and have relatively more questions regarding how to present their financial statements for SEC reporting purposes. Similarly, some EGCs may be considering for the first time initial choices in their accounting policies and practices that could have implications for their financial reporting.

Another benefit of the new standard is that it provides for communications regarding significant matters on a timely basis. Timely communications with the audit committee help improve the audit by, among other things: (i) informing the audit committee, which has responsibility for the oversight of financial reporting, about significant matters related to the audit and the financial statements; (ii) enabling the auditor to obtain the audit committee's insights and information about transactions and events; (iii) enabling the auditor to learn from the audit committee about additional matters relevant to the audit, including possible violations of laws or regulations; and (iv) assisting the auditor in gaining a better understanding of the company and its environment. Timely communications also permit both the auditor and the audit committee to take appropriate action to address the matters communicated, including any effect on the company's financial statements. Again, these benefits were designed to benefit audits of all companies, including audits of EGCs.

The new standard also promotes communications that are tailored to the circumstances of the company and informative, rather than "boiler-plate" or standardized. Under Auditing Standard No. 16, required communications would vary by the nature and complexity of the company being audited. Effective communication between the auditor and the audit committee also need not be in writing, but may involve many forms of communication, such as presentations, charts, and robust discussions, as well as written reports. Such flexibility in the form of communications is an important element of the new standard and part of what allows the standard to work for audits of companies of varying sizes and complexity, including EGCs.

The Board has also considered other potential economic effects on efficiency and capital formation. The Board's overall approach is designed to: (i) scale the required communications to the size and complexity of the company being audited; (ii) maintain flexibility (for example, with respect to communicating orally or in writing); (iii) minimize duplicative or redundant communications to the audit committee from the auditor and management; (iv) focus the communications on the accounting matters that are significant to the auditor and the audit committee; and (v) reduce auditors' search costs (i.e., the costs associated with researching the federal securities laws' and auditing standards' various communication requirements) by providing a list of other PCAOB standards and rules that contain audit committee communication requirements in one place. Moreover, as previously discussed, the auditor's requirements under the new standard are focused on communicating the results of audit procedures that the auditor is already required to perform.

The Board also considered alternatives to the communication requirements in the final standard. Before commencing this project, the Board considered whether a new standard was necessary, particularly since a number of the standard's requirements were already required by existing auditing standards or provisions of the federal securities laws. The Board also discussed whether to develop a new standard on audit committee communications with its SAG, and had subsequent discussions with the SAG on the nature and extent of communications in a new standard. The Board proposed the standard, extended the proposal's comment period, held a roundtable, and reproposed the standard to obtain additional public input. As a result of the public comment and outreach, through which many commenters were supportive, the Board decided to proceed with a new standard. The Board did so because it believes that establishing the new communication requirements, as well as clarifying, updating and consolidating the other communication requirements, would improve audits and audit committee oversight with respect to all types of companies, including EGCs, without imposing unnecessary costs.

Many now agree that the interaction between the auditor and the audit committee – as mandated by the Act – improves audit quality and the quality of financial reporting.[22/] Research has indicated that improved auditor

---

[22/] For example, research conducted by the Center for Audit Quality and published in its March 2008, *Report on the Survey of Audit Committee Members*, found that increased audit committee oversight was believed to have had a positive impact on the overall quality of audits by 92% of its audit committee member respondents. As recently as June 12, 2012, the United Kingdom's Financial Reporting Council issued its annual report, *Audit Quality Inspections*, which indicate, among other things, that: "Audit committees play an essential role in ensuring the quality of financial reporting. In particular, their work communications with audit committees can enhance the quality of the audit and the quality of the financial reporting process.[23/] Also, most commenters on the new standard generally agreed that fuller and more relevant communications between the auditor and audit committee would allow the auditor to perform a more informed, and thus more effective audit, and would enable the audit committee to more effectively fulfill its oversight responsibilities regarding the financial reporting process.[24/]

Higher quality financial reporting (as a result of better informed auditors, better informed audit committees, or both) improves the quality of information available to the markets and reduces the information asymmetry that exists about the company among investors as well as between investors and the company's

---

with auditors in planning the audit and reviewing its results contributes greatly to the quality of the audit."

[23/] *See, e.g.,* Jeff Cohen, Ganesh Krishnamoorthy, and Arnie Wright, *Views to Strengthen Auditor Independence and Skepticism*, PCAOB meeting (March 22, 2012). Among other things, the statement provides: "Our research has validated the very important role the audit committee plays in enhancing audit and financial reporting quality." *See also* Jeffrey Cohen, Lisa Milici Gaynor, Ganesh Krishnamoorthy, and Arnold M. Wright, *Auditor Communications with the Audit Committee and the Board of Directors: Policy Recommendations and Opportunities for Future Research,* Accounting Horizons, at 183 (June 2007) ("Frequent communications with a well-informed, financially sophisticated audit committee and communications among the audit committee, the auditor and the full board improve financial reporting quality.").

[24/] For a discussion of comments received on the new standards, *see* PCAOB Release No. 2012-004 (Aug. 15, 2012) and PCAOB Release No. 2011-008 (Dec. 20, 2011).

management.[25/] Academic research indicates that improving the quality of financial reporting can reduce investors' uncertainty about the information being provided in companies' financial reports and thus increase efficiency in capital allocation and foster capital formation.[26/] Higher quality financial reporting (and improved corporate governance) can mitigate principal-agent problems and reduce agency costs.[27/]

[25/] Shareholders and other financial statement users possess less information about the company than the company's management. This information asymmetry can provide an opportunity for management to act in ways that are not aligned with the interests of the company's investors. *See, e.g.*, Greenwald, B. C., and J. E. Stiglitz, *Asymmetric Information and the New Theory of the Firm: Financial Constraints and Risk Behavior*, 80 American Economic Review 2, at 160-165 (1990). Also, information asymmetry between informed and uninformed investors makes the latter less willing to trade and require higher risk premiums when they do invest. *See, e.g.*, Easley, D., and M. O'Hara, *Information and the Cost of Capital*, 59 The Journal of Finance 4, at 1553-1583 (2004).

[26/] *See, e.g.*, Lambert R. A., C. Leuz, and R. E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research, at* 385-420 (2007). The authors show that accounting information influences a company's cost of capital directly and indirectly. Improved financial reporting quality can reduce a company's cost of capital by increasing precision of investors' assessments of a company's future cash flows. The lower cost of capital can subsequently affect real investment choices of the company, improving future cash flows and increasing the value of the company. *See also* Easley, D., and M. O'Hara, *Information and the Cost of Capital*, 59 The Journal of Finance 4, at 1553-1583 (2004). Their model suggests that increasing reliable public information about a company reduces the risk premium investors require. Also, Lambert et al. (2012) show that cost of capital decreases with higher average precision of information. *See* Lambert R. A., C. Leuz, and R. E. Verrecchia, *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 Review of Finance, at 1-29 (2012).

[27/] In a principal-agent situation, the goals of principals and agents generally differ and it is expensive for the principals to directly verify the agents' actions. In a corporation, management acts as agent for the shareholders (principals), with the audit committee and the auditor serving as intermediary agents. Well informed intermediary agents can more effectively exercise their

There will be some costs associated with audit committee communications under the new standard, including additional costs incurred by companies. As previously discussed, the costs for a company to operate and maintain an audit committee may increase because of the need for additional meetings and increased audit committee member time demands. However, for the reasons explained above, the Board does not believe these additional costs will significantly expand the time or resources companies spend on audit committees.

With respect to competition, as noted above, the standard is designed to be scalable based on a company's size and complexity. The required communications can be tailored or adjusted to fit the size and nature of the company under audit. By doing so, the Board sought to avoid imposing unnecessary costs that could have a disproportionate effect on, and thereby potentially have an adverse competitive impact on, smaller and less complex public companies. In response to the Board’s solicitation of comment on the appropriateness of the standard’s requirements for audits of companies of different sizes and in different industries, commenters generally considered the requirements of the standard to be applicable and appropriate to companies of varying sizes and industries. Commenters did not raise concerns regarding the standard's impact on competition and the Board has not identified any economic effects on competition.

---

oversight responsibilities to mitigate undesired behaviors of the management and reduce the goal incongruence between management and shareholders.

Conclusion

As discussed throughout this submission, and in the Board's adopting release, the Board believes that Auditing Standard No. 16 will contribute to audit effectiveness. In addition, the new standard should assist the audit committee in its oversight over financial reporting. Moreover, more effective and informed communications between the auditor and the audit committee also should help enhance the quality of a company's financial reporting.

In both its proposing and reproposing releases, the Board sought comment on all aspects of the standard and as part of the process specifically asked questions regarding the appropriateness of the standard for companies of all sizes or industries, which include EGCs. Commenters considered the requirements of the standard to be applicable and appropriate to companies of different sizes and industries. Notably, the Board received comments from a wide spectrum of commenters, including from auditors that represented the interests of both small and large accounting firms and that audit companies of various sizes.

After the enactment of the JOBS Act, the Board compiled data available from entities voluntarily identifying themselves as EGCs in SEC filings. Based on data available to the Board, it appears that a wide range of entities, of differing sizes and industries, identify themselves as EGCs. One key difference between EGCs and other issuers appears to be the length of time that they have been subject to Exchange Act reporting requirements.

The Board believes that Auditing Standard No. 16 is in the public interest, and, for the reasons explained above, after considering the protection of investors and the promotion of efficiency, competition, and capital formation, recommends that the standard should apply to audits of EGCs. Accordingly, the Board requests that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply Auditing Standard No. 16 to audits of emerging growth companies. The Board stands ready to assist the Commission in considering any comments the Commission receives on these matters during the public comment process.