

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

March 2, 2010

Dear Mr. Baumann,

**Re.: PCAOB Rulemaking Docket Matter No. 026
PCAOB Release No. 2009-007, December 17, 2009
Proposed Auditing Standards Related to the Auditor's Assessment
of and Response to Risk
And Related Amendments to PCAOB Standards**

We would like to thank you for the renewed opportunity to comment on the PCAOB's Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk And Related Amendments to PCAOB Standards (hereinafter collectively referred to as the "proposed standards"). We are commenting for the second time on these proposed standards because they are 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).

As we had previously commented in our letter dated February 18, 2009, we welcome the updating of the PCAOB's interim standards that deal with audit risk and introduce the "risk assessment" and "risk response" paradigm currently effective in the International Standards on Auditing (ISAs), and many other national 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. However,

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

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamann, RA

Page 2 of 17 to the comment letter dated March 2, 2010, to the PCAOB

we were disappointed that, in re-exposing these standards the Board had not made more effort to minimize differences between its standards and the ISAs wherever possible, given the comments we had made in our afore-mentioned letter. For example, the statement in the second paragraph on page A9-6, that “the organization and style of the new proposed standards ... will provide a template generally to be followed in the future standards issued by the Board”, does not follow the IAASB’s example in terms of placement structure and wording of requirements. We also refer to our previous comment letter wherein we had discussed this issue in more detail.

In the enclosed Appendix to this comment letter, we have again addressed a number of what, in our view, are the more important differences between the proposed standards and the ISAs that have come to our attention through the review of the proposed standards, that remain unaddressed; commented on certain changes made that we view as problematical; and, where appropriate, responded to the questions posed by the Board.

If you have any further questions about our comments, we would be pleased to discuss them with you.

Yours very truly,



Klaus-Peter Feld
Executive Director



Wolfgang Böhm
Director International Affairs

494/584

Appendix

Page 3 of 17 to the comment letter dated March 2, 2010, to the PCAOB

APPENDIX

Q.1 Are the objectives in the new proposed standards useful in providing context for the requirements in the standards?

Subject to our comments below relating to the objectives in the individual standards, we agree that introducing objectives is useful.

Proposed Auditing Standard – Audit Risk in an Audit of Financial Statements

Q.2 Does the new proposed standard on audit risk describe clearly the concept of audit risk and its components?

No. We note that the Board has sought to improve the material explaining risk of material misstatement and audit risk, and in this context, support the addition of text in paragraph 6 mirroring part of the material in ISA 315.A105, as this will help auditors to better understand the nature of risks of material misstatement that may exist at the financial statement level. However, we are concerned that in citing three very different specific examples without further explanation may not be helpful; particularly as to the relationship between business risks and audit risk is likely to confuse readers of the standard, which may increase the expectations gap. ISA 315.A30, A31 and A33 do provide further explanation of the relationship between these risks. We believe that the standard needs to provide further explanation of this complex issue.

Q.3 Does the new proposed standard on audit risk describe clearly the relationship between detection risk and substantive procedures?

We do not provide comments on this matter.

Proposed Auditing Standard – Audit Planning and Supervision

Matters not covered by the questions posed

As we had commented previously, many of the issues addressed in paragraph 7 may be better placed in the risk assessment standard (as in the ISAs), rather than as part of the planning, since these matters relate to the obtaining of an understanding of the business aspect of risk assessment.

Page 4 of 17 to the comment letter dated March 2, 2010, to the PCAOB

Paragraph 10 requires the auditor to develop and document an audit plan, specifying certain content. We would like to point out that in practice, and as is recognized in the ISAs, planning is an iterative process. It is not entirely clear to us whether this standard recognizes the practicalities of this, although the use of the term “develop” together with the clarification in paragraph 5 does seem to indicate this intention. It would be helpful if the PCAOB would clarify, within the standard, that as long as the matters listed in paragraph 10 are documented, it is not necessary that they be recorded within one document or that they are in the form of a single plan. For example, requiring an auditor to subsequently document a “plan” to reflect procedures performed for the sole purpose of ensuring that PCAOB inspectors will have a neat plan to review would be ineffective from both a cost perspective and an audit quality perspective – rather a running planning memo or similar could be developed during the course of the audit and as the audit progresses.

Q.4 Are the proposed requirements for multi-location engagements appropriately aligned with Auditing Standard No. 5?

We do not provide comments on this matter.

Q.5 Is it clear how the proposed requirements for multi-location engagements would be applied in audits of financial statements only?

In considering the risk of material misstatement associated with a location or business unit, sections c. and d. of paragraph 11 introduce the concept of reasonable possibility of material misstatement to a company’s consolidated financial statements, cross referencing this term to FASB’s use in relation to contingencies: Our views on the definition of “reasonable possibility” and its relationship to the FASB’s use of the term in relation to contingencies (see the IDW comment letter of February 26, 2007) and the technical difficulties resulting from such use have been made known to you. These sections of paragraph 11 would be more appropriately placed in the standards on risk assessment, since this is to what these sections refer.

Q.6 Are the differences between the responsibilities for supervision of engagement team members and oversight of specialists in accordance with AU sec. 336 appropriate in light of the auditor’s responsibilities to opine with reasonable assurance on whether the financial statements are fairly presented, in

Page 5 of 17 to the comment letter dated March 2, 2010, to the PCAOB

all material respects, in conformity with the applicable financial reporting framework?

The section entitled persons with specialized skill or knowledge has been significantly improved compared to the previous draft. However, the wording of paragraph 16 ought to be reworded so as to clarify that whilst a person with specialized skill or knowledge may assist the auditor, such a person does not relieve the auditor of the performance of appropriate risk assessments, application of planned audit procedures and evaluation of audit results respectively referred to in that paragraph. In this context, we refer to ISA 620.A4 which refers to the possibility that an auditor's expert may be needed to assist the auditor.

We agree that there needs to be a differentiation between experts in accounting or auditing (paragraph 18) and in other fields (paragraph 19); however, the differentiation should not solely rest upon whether they are experts in accounting and auditing or, when not, are part of the team or are engaged by the auditor, but should concentrate on whether they are performing audit work as opposed to providing solely expert services that assist the auditor in performing the audit. For example, an expert in a field other than accounting and auditing who although engaged by the auditor - but not part of the engagement team and not being an employee of the auditor's firm - nevertheless is hired to perform audit procedures that involve audit decisions, etc., should be supervised in the same manner as all audit team members. Therefore, without having thoroughly reviewed AU sec. 336 (which we note is, in any case, to be the subject of revision in the near future) we do not express an opinion on the adequacy or otherwise of the reference thereto in paragraph 19.

Proposed Auditing Standard – Consideration of Materiality in Planning and Performing an Audit

Matters not covered by the questions posed

We believe that the replacement of paragraph 2 with an explanation of the court's interpretation of federal securities laws is an improvement, as this can guide the auditor in considering how materiality required by the financial reporting framework should be interpreted. However, as we had also previously suggested, the proposed standard would greatly benefit from an explanation of what the PCAOB envisages the term "reasonable shareholder" to mean, similar to the material in ISA 320.04, which forms the basis for an auditor's consideration of materiality and does not appear to be inconsistent with the concept of a reasonable investor under U.S. securities law.

Page 6 of 17 to the comment letter dated March 2, 2010, to the PCAOB

We had previously noted that the proposed standard used the term “tolerable misstatement” from AU §350 *Audit Sampling* rather than the term “performance materiality” used in the ISAs. This has not been changed. Use of this term would be appropriate if “tolerable misstatement” as defined in AU §350 is the same as the meaning of tolerable misstatement in the proposed standard. However, we would like to point out that the two concepts are equivalent for a particular financial statement item only when sampling the entire population of items comprising that financial statement item (i.e., one could select particular items included in that financial statement item for testing and draw a statistical sample for testing on the remaining items). When sampling less than all of the population of items comprising a financial statement item, “tolerable misstatement” for statistical purposes for the sampled population (which would be a portion of the total population of the financial statement item) would be different than the “tolerable misstatement” applied to that entire financial statement item (which may or may not be the same as the “tolerable misstatement” for the financial statements as a whole) to reduce to an appropriately low level the risk that the aggregate of uncorrected and undetected misstatements in that item exceeds the materiality for that item (which may or may not be the same as the materiality for the financial statements as a whole). For these reasons, we again question whether it is appropriate to use the same terms for statistical sampling and for reducing to an appropriately low level the risk that the aggregate of uncorrected and undetected misstatements in an item exceeds materiality for that item.

The insertion of wording in the first sentence of paragraph 8 to now require the auditor determine tolerable misstatement for the purpose of assessing risks of material misstatement and planning and performing audit procedures *at the account or disclosure level* represents a significant change. This change also introduces a significant difference in an auditor’s approach to performance materiality to that of the ISAs that will involve potentially considerably more work on the part of the auditor without necessarily adding much benefit. ISA 320.11 requires the auditor to “determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures”. ISA 320.A12 provides a further explanation as to the nature and purpose of performance materiality as an audit tool and explains that performance materiality relates to the materiality level for financial statements as a whole and, where applicable, to the materiality level for a particular class of transactions, account balance or disclosure. An additional performance materiality at the account or disclosure level would only be necessary when the aggregation risks of risks of not detecting a misstatement are such that the level of performance materiality for the financial statements as a whole

Page 7 of 17 to the comment letter dated March 2, 2010, to the PCAOB

is not adequate for such account or disclosure (i.e., too high), or when an additional performance materiality is required because the particular account and disclosure requires its own materiality based upon users' needs.

In general, certain changes made are not particularly helpful. For example, the sentence added in paragraph 6 (previously paragraph 5) to the effect that establishing a materiality level for the financial statements as a whole "includes consideration of the company's earnings and other relevant factors" is, without any practical explanation of what such other relevant factors may be or of their inter-relationship with earnings, not helpful. Also, in both the new notes following paragraph 7 and paragraph 11, it is not easy to understand how the "judgment" of a reasonable investor might be interpreted in the context of materiality for a particular account or disclosure given the explanation in paragraph 2 of the court's interpretation of materiality referring to a reasonable investor's perception relevant to the "total mix" of information made available in financial statements. Guidance as to what this judgment is meant to mean in practical terms is needed.

Q.7 Are the provisions in the new proposed standard regarding consideration of materiality in multi-location engagements appropriate in light of the auditor's responsibility to plan and perform audit procedures to detect misstatements that, individually or in combination, would result in material misstatement of the financial statements?

The basic requirement appears in line with ISA 600, where materiality at a component (PCAOB term = location) is set by the group engagement partner. However, it is not clear that the auditor performing the work at/on that component's financial information is required to set a performance materiality (PCAOB term tolerable misstatement). The standard should clarify this.

Q.8 Are the revised provisions regarding reassessment of materiality appropriate in light of the auditor's responsibility to plan and perform audit procedures to detect misstatements that, individually or in combination, would result in material misstatement of the financial statements?

These need to be amended to follow ISA 320.12, since a change in overall materiality may not necessarily affect the performance materiality (PCAOB term tolerable misstatement) depending on the reasons causing to set that level. For example, if materiality itself has to be revised downwards, but tolerable misstatement was already quite low to take account of detection risk, there may not

Page 8 of 17 to the comment letter dated March 2, 2010, to the PCAOB

be a case to amend tolerable misstatement further; in other cases it may need amending. Therefore the auditor should first be required to determine whether it is necessary to revise tolerable misstatement, and whether the nature, timing and extent of further audit procedures remain appropriate.

Proposed Auditing Standard – Identifying and Assessing Risks of Material Misstatement

Matters not covered by the questions posed

We were disappointed to note that the definition of significant risk remains the same as that in the previous draft. In defining a significant risk for this standard as “a risk of material misstatement that requires special audit consideration” deviates from the definition used by the ISAs because the PCAOB definition does not clarify that only those risks that the auditor has identified and assessed as such can be given special audit consideration. In this context, we refer to our second comment on the Proposed Auditing Standard – The Auditor’s Response to the Risks of Material Misstatement in our previous letter, which explained that by requiring an appropriate response to actual misstatement risks, rather than to those assessed, the PCAOB is setting a standard that is impossible to meet in practice or theory. We are pleased to note that the PCAOB has recognized and attempted to address this matter within the requirements of that particular standard, but were disappointed that this has not been rectified throughout the set of risk standards in a consistent manner. We suggest this definition be amended accordingly.

Paragraph 42 (previously 41) requires that, in identifying risks of material misstatement, the auditor should take into account information relevant to identifying risks obtained by the auditor through other engagements performed for the company. We are concerned to note that both concerns we had mentioned in our previous letter remain unaddressed, as the PCAOB believes that the suggested changes would weaken the standard. First the word “auditor” could mean the audit firm. It is unlikely that audit firms will be in a position to convey only relevant information from one team performing an unrelated non-assurance engagement at the company to another performing the audit without developing very costly reporting systems between engagement teams; there may even be confidentiality barriers. The ISAs resolve this problem by addressing the engagement partner only. Second, even if the engagement partner becomes privy to information from another completely unrelated engagement, it remains unclear to us how the relevance of this information to identifying risks of material misstatement would be established in this context. We had previously sug-

Page 9 of 17 to the comment letter dated March 2, 2010, to the PCAOB

gested that, similar to the requirement of ISA 315.08, the engagement partner need only consider whether it may be relevant at that stage. We again suggest that the proposed standard be aligned to the ISAs.

Paragraph 51 (previously 50) retains the requirement that auditors make inquiries of those within the company that “might reasonably be expected to have information...”. This remains a very open-ended requirement that begs the question: reasonably expected by whom? The auditor? The PCAOB? The courts? We would like to reiterate that, in our view, this is unreasonable, because with hindsight any third party will always be able to claim that the auditor should have made an inquiry of someone that he hadn’t. As described in ISA 315.06(a), it is the auditor’s judgment that is paramount in this situation: no one else was there at the time and there shouldn’t be any second-guessing with hindsight unless the auditor’s judgment was clearly unreasonable in the circumstances. This has not been addressed in redrafting. In contrast, we note that the wording of the requirement in paragraph 54 has been amended in response to our previous comment on the same issue. This now requires the auditor “...to identify...by considering whether others...might have additional information or be able to corroborate...” Thus, it is the auditor’s consideration as to what others might have (i.e., professional judgment) that is the deciding factor. We suggest this requirement in paragraph 51 be amended accordingly.

Certain changes made to this standard stem from the PCAOB’s intent stated on page 6 of the release to enhance the requirements for evaluating disclosures, as a result of observations from its oversight activities. However, the Board has identified only two areas for singling out consideration of disclosures alone: First, by including in the discussion among key team members how fraud might be perpetrated or concealed by omitting or presenting incomplete disclosures in paragraph 49, and second, by requiring in paragraph 68 an evaluation of how fraud could be perpetrated or concealed through omitting or presenting incomplete disclosures. Assuming the PCAOB’s aim is to strengthen audit work on disclosures, we wondered why both these passages do not also include reference to incorrect or inaccurate disclosures – as disclosure misstatement is not restricted to omission or partial omission but also ought to foresee that incorrect information may be presented within a disclosure.

Q.9 Does the new proposed standard adequately describe the auditor's responsibilities for performing risk assessment procedures that are sufficient to provide a reasonable basis for the identification and assessment of risks of material misstatement due to error or fraud and to design further audit procedures?

Page 10 of 17 to the comment letter dated March 2, 2010, to the PCAOB

In our view, the addition of new explanatory text in paragraph 5 explaining some possible sources of risks of material misstatement, whilst helpful, needs to mention fraud as well, as the potential for fraud varies from entity to entity and is a major aspect that needs to be considered in risk identification and assessment.

As we had previously pointed out, the use of the words “should consider” in what is in the new draft paragraph 11 will have the effect of requiring the auditor to justify for each bullet point why a certain procedure was not performed, rather than having auditors take a top-down approach to determining which audit procedures they ought to be performing in the circumstances. This leads to a checklist approach to the issues identified, which is not conducive to audit quality.

Paragraph 39 (previously 38) of the proposed standard specifically requires the auditor to incorporate knowledge obtained in past audits in the risk assessment of subsequent audits. Whilst we agree that information from past audits should not be ignored, as we had previously commented, the real issue for auditors is whether this information is still relevant. We suggest that the PCAOB follow the ISAs (see ISA 315.09) in being more cautious in this regard, and consider aligning this requirement with that of ISA 315.09.

The use of the phrase “analytical procedures designed to” in paragraph 43 (previously 42) suggests that such analytical procedures are more effective than they actually are in covering items (a) and (b). As pointed out in the ISAs (ISA 315.6(b) together with ISA 315.A7), analytical procedures contribute to an auditor’s understanding of (a) and (b), but only in conjunction with other procedures.

Q.10 Are the auditor's responsibilities regarding the additional procedures for understanding the company and its environment in paragraph 11 clear?

The examples given in paragraph 11 are useful; however the first bullet point in the requirement could be interpreted more broadly than we believe reasonable. Given the myriad of information that may be available to the public on the internet it would be useful to clarify that the requirement does not mean that the auditor would be expected to read each and every mention of the company made public (e.g., it would not include comments by individuals on networking sites or blogs, etc., critical of the company’s products or business practices, etc., or even all of a company’s website, which may be extensive and subject to continual change).

Page 11 of 17 to the comment letter dated March 2, 2010, to the PCAOB

Q.11 Are the proposed requirements regarding obtaining an understanding of internal control over financial reporting appropriate in light of the auditor's responsibilities for identifying and assessing the risks of material misstatement?

As we had previously pointed out, paragraph 18 (previously 20) states that the auditor should obtain a sufficient understanding of each component of internal control over financial reporting to (a) identify the types of potential misstatements, (b) assess the factors that affect the risks of material misstatement and (c) design further audit procedures. We still have a number of difficulties with this requirement. First, we would like to point out that, unless the auditor does a combined inherent risk and control risk assessment (a misstatement risk assessment), an auditor identifies types of potential misstatements by examining inherent risks without including the effect of control risk. This is in fact required by the ISA 315.26 for significant risks. Second, some components of internal control only affect the misstatement risk at the financial statement, rather than assertion level. Consequently, obtaining an understanding of these components will not lead to the ability to identify types of potential misstatements, which is an assertion-level concept. Third, the only factors that affect the risks of material misstatement are inherent and control risk: does this mean that by requiring an assessment of the factors that affect the risks of material misstatement, the PCAOB is requiring a separate, rather than a combined risk assessment for all cases, including risks that are not significant risks? This seems to be at odds with other requirements in the standards. Furthermore, what is left (sufficient understanding of internal control to design further audit procedures) is now covered by the objective of the standard, since we note that the objective used in ISA 315.03 has now been applied. It is therefore redundant. On the whole, therefore, there is no need for this requirement, which only confuses a number of issues and therefore causes more harm than good.

Q.12 Are the proposed requirements regarding the discussion among engagement team members about risks of material misstatement appropriate given the auditor's responsibilities for identifying and assessing the risks of material misstatement?

It still seems to us that the requirement in paragraph 47 (previously 46) provides a gratuitous definition of who "key engagement members" are without adding any real guidance because it interprets the word "key" by using the term "significant engagement responsibilities", which is not particularly helpful. Furthermore, one would presume that the discussion would cover only important matters, which makes the following requirement to communicate important matters to the

Page 12 of 17 to the comment letter dated March 2, 2010, to the PCAOB

other engagement team members too restrictive. On the other hand, it begs the question of “important to whom”? The solution in ISA 315.10.02 is more practical in that the engagement partner makes the determination of what needs to be reported to whom on a “need to know” basis.

We had also commented that paragraph 49 (previously 48) represents a rules-based approach to audits by including a “checklist” of matters that should be covered in the discussion among team members about potential misstatements due to fraud. Whilst we agree that the addition of a discussion as to the susceptibility of the financial statements to a material misstatement through related party transactions mirrors ISA 550.11, it would also need to refer to relationships as well as transactions given the potential not to disclose such relationships irrespective of whether there had been any transactions or not. We continue to believe that not all of these matters may be relevant to all audits, and there may be matters that are relevant that are not on the list (see ISA 240.A11). We had therefore suggested that the PCAOB consider whether guidance on this matter may be more helpful than a list of requirements and repeat this suggestion.

Paragraph 50 (previously 49) requires specific communication of items that are required of auditors on all audits. We continue to view this as a rather strange and even redundant requirement. Once having communicated these matters to all audit staff at a firm, why would they need to be communicated again on every engagement? This is a matter that ought to be addressed as part of the fraud standard in terms of the overall stance taken by team members on all audits, not as part of risk assessment for each audit.

Proposed Auditing Standard – The Auditor’s Response to the Risks of Material Misstatement

Q.13 Are the proposed requirements for overall responses and responses involving the nature, timing, and extent of audit procedures appropriate given the auditor’s responsibility to opine with reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework?

We are pleased to note that the requirements section has been changed along the lines we had suggested in our previous letter, such that the requirements now relate to the assessed risks of material misstatement responses rather than to the risks of material misstatement, as was the case in the PCAOB’s previous draft. However, we do not agree with the Board that neither the wording of the objective nor of the title of the standard should have been amended to reflect

Page 13 of 17 to the comment letter dated March 2, 2010, to the PCAOB

this change. The proposed Standard “Identifying and Assessing Risks of Material Misstatement” is the correct place to address this issue, as the overall objective of an audit can only be achieved using a risk-based approach, if the audit risks are firstly identified and then subsequently appropriately assessed. An auditor can only respond to the risks of which he or she is aware and for which he or she has made an appropriate assessment. Unless the objective is amended to be in line with the requirements of the standard, no auditor complying with the requirements of this standard will be in a position to fulfill its objective. This is not an appropriate method for standard setting. We therefore suggest the objective and title be amended accordingly, as we had previously proposed, in line with the very precisely worded objective used in ISA 330.03.

We continue to believe that it is important for auditors to implement overall responses to risks at the financial statement level because these risks are pervasive to the financial statements and also that they would be difficult to address only at the assertion level. For this reason, we do not share the view of the PCAOB that an auditor need not match overall responses to misstatement risks at the financial statement level. Such a requirement does not lead to the auditor being able to avoid performing audit procedures to address risks of material misstatement at the assertion level at all and therefore such a requirement ought to be included in the proposed standard. We suggest the wording of paragraph 5 be amended accordingly.

We do not understand why the requirement of paragraph 19, to test design effectiveness, is included in this standard, when it is already covered in the standard on risk assessment. We note that on page A4-10, paragraph no. 20 requires an evaluation of the design of controls. This potential double counting begs the question whether the Board intends the testing design effectiveness in this standard to be different from the afore-mentioned evaluation, and, if so, in what way?

Q.14 Does the new proposed standard clearly describe when tests of controls are necessary in an audit of financial statements only?

We note that certain changes have been made to paragraphs 30 and 31, but do not understand why they were not based more on the relevant ISAs, for example, we would have expected the control environment to have been added within paragraph 30 (from ISA 330.A 233).

One particular more stringent requirement is that in the previous draft paragraph 37 stated: “For audits of financial statements, the auditor should obtain evidence

Page 14 of 17 to the comment letter dated March 2, 2010, to the PCAOB

about the design and operating effectiveness of *controls selected for testing in the current year audit* [italics added for emphasis]. This has been changed such that the new draft paragraph 31 reads: “For audits of financial statements, the auditor should obtain evidence during the current year audit about the design and operating effectiveness of *controls upon which the auditor relies*.” This is far more onerous and does not follow the equivalent ISA, as ISA 330. A 35 states

“In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance “, and further in A37: “The auditor’s decision on whether to rely on audit evidence obtained in previous audits for controls that:

- (a) have not changed since they were last tested; and
- (b) are not controls that mitigate a significant risk,

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment, but is required by paragraph 14 (b) to be at least once in every third year.“

We note that Page A9 – 48 states “One commenter expressed a concern that eliminating the auditor’s ability to use rotational testing of controls in audits of issuers differs from the ISAs and would be a significant, unnecessary change from current practice. The Board continues to believe that auditors should support their control risk assessments each year with current evidence. When the auditor has tested controls in past audits, the new proposed standard allows the auditor significant flexibility to adjust the amount of evidence needed based on the relevant factors.” However, other than footnote no. 12 which permits the auditor to use a benchmarking strategy solely for automated application controls, there is no guidance either in the proposed standard or the additional discussion as to what this purported “flexibility” might mean in practice. Yet other than stating its belief that auditors should support their control risk assessments each year with current evidence, the Board does not give any reasons for this requirement being more stringent than that of ISA 330.

We remain concerned with the requirement for substantive tests of details for all relevant assertions for significant accounts or disclosures. We do not agree with the changes made to the text of paragraph 37 (formerly 41): “As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases”. We would like to point out that in some cases performing substantive tests of details rather than, or in addi-

Page 15 of 17 to the comment letter dated March 2, 2010, to the PCAOB

tion to, tests of control and analytical review procedures may not obtain any additional assurance because the tests of detail may not be relevant. For example, for some cases, as identified in ISA 315.29, for risks for which substantive procedures alone do not provide sufficient appropriate audit evidence (e.g., the completeness assertion or some fraud risks), substantive tests of details may be irrelevant. For this reason, we believe that the requirement to perform such substantive tests of detail for all relevant assertions, as described in paragraph 36 of the proposed standards, is inappropriate and needs to be deleted.

The requirement in paragraph 45 (previously 49) to compare relevant information about the account balance at the interim date with comparable information at the period end presumes that there will always be comparable information. In our view, requirements should not be introduced for situations that may or may not exist on most audits, unless there is an overriding need for a requirement predicated upon such existence, even if it is rare. We do not see such an overriding need when auditors are already required to test the remaining period.

Proposed Auditing Standard – Evaluating Audit Results

Matters not covered by the questions posed

Appendix B is new. This should be useful, but we wonder why it was not more closely aligned with ISA 330. A16; in particular the last items therein.

Q.15 Does the new proposed standard clearly describe the auditor's responsibilities for accumulating and evaluating misstatements?

The new explanation of how the term “clearly trivial” is meant to be applied in practice (second sentence of paragraph 11) is somewhat confusing and in any case, in our view, not needed. This explanation infers that the clearly trivial threshold plays substantially the same role as that of tolerable misstatement. The footnote to paragraph 10 is easier to understand and, subject to the comment in the next paragraph, in our view sufficient. We suggest the second sentence of paragraph 11 be deleted.

Paragraph 20 requires the auditor evaluate whether identified misstatements might be indicative of fraud, irrespective of considerations, e.g., as to their magnitude. In our opinion, it ought to be made clear that where there is such indication, depending on the magnitude of the fraud the auditor uncovers some misstatements that had originally been classified as clearly trivial, which in complying with the requirements of paragraph 10 may need to be reclassified and

Page 16 of 17 to the comment letter dated March 2, 2010, to the PCAOB

therefore added to the auditor's documentation of accumulated misstatements required by that paragraph.

Q.16 Does the new proposed standard appropriately describe the auditor's responsibilities for evaluating the presentation of the financial statements, including evaluating bias, in light of the auditor's responsibility to opine with reasonable assurance on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework?

We agree that the situation depicted in paragraph 25b. is a reasonable example to include however, in our opinion, the term "identified misstatements other than those that are not clearly trivial" ought to be used, as management bias is not fraud, rather its main relevance is to the materiality in misstatement of the financial statements. A lower threshold would result in more audit work not reflected in an increase in audit quality.

Proposed Auditing Standard – Audit Evidence

Q.17 Does the new proposed standard describe clearly how the auditor should determine the financial statement assertions to use for both integrated audits and audits of financial statements only?

We do not provide comments on this matter.

Proposed Amendments to PCAOB Standards

Q.18 Are there provisions in the to-be-superseded standards that should be retained?

Without fully considering the entire text of each of these standards we do not provide comments on this matter with the exception of the following.

As we noted in our previous comment letter, the PCAOB has proposed certain changes to its standard AS-3 "Audit Documentation" despite the fact that only two of seven respondents to the question in PCAOB Release 2008-006 concerning the adequacy of documentation requirements supported adding specific documentation requirements whereas four respondents indicated that the existing requirements were adequate.

Page 17 of 17 to the comment letter dated March 2, 2010, to the PCAOB

Indeed, the proposed amendments to AS-3 “Audit Documentation” represent, in the main, an additional degree of precision being added to the current requirements of that standard, which, as stated on page A9-65, could help reviewers understand the areas of greater risk and the auditor’s responses to those risks. Thus, they appear to us to stem more from the results of inspections than from comments from respondents to the previous proposed standards.

We are concerned that the degree of detail may be overly prescriptive, and refer to our letter to the PCAOB dated January 19, 2004, in which we had cautioned on the possible detrimental effects of overly prescriptive requirements.