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March 2, 2010

**SENT VIA EMAIL TO 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: *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards*, PCAOB Rulemaking Docket Matter No. 026**

Dear Office of the Secretary:

We appreciate the Public Company Accounting Oversight Board's (the Board or PCAOB) willingness to expose its revised *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards* (the reproposal or repropose standards). We acknowledge the Board's careful consideration of the comments it received on the original proposal, and we appreciate the continued opportunity to share our views on the subject reproposal. We believe the Board's efforts to gather and incorporate input from a variety of interested parties, including public accounting firms our size, benefits the standards-setting process and contributes to advancing the Board's mission to improve audit quality. As a result, we look forward to additional opportunities for involvement in the Board's future standards-setting activities.

We believe significant improvements have been made in the repropose standards as compared with the original proposal. In particular, the Board's efforts to better align and integrate the repropose standards with Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and AU 316, *Consideration of Fraud in a Financial Statement Audit*, have had the desired effect of clarifying the auditor's responsibilities when performing a financial statement audit only, while continuing an emphasis on fraud-related audit procedures.

As stated in our comment letter related to the original proposal, we support the Board's direction in updating public company auditing standards to reflect a more risk-based approach, and we agree with the basic principles of the repropose standards. While we generally support the changes made by the Board, we believe additional clarification is needed for the successful and consistent understanding and application of the

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reproposed standards. Our comments and recommendations are provided in the following sections in the remainder of this letter:

- Style of the reproposed standards: Use of notes and appendices
- Organization and codification of PCAOB standards
- Effective date
- Differences between PCAOB and other standards-setters' standards
- Observations related to PCAOB's standards-setting process
- Comments on individual standards

### **Style of the Reproposed Standards: Use of Notes and Appendices**

Similar to the original proposal and as we noted in our previous comment letter, the reproposed standards represent a third "style" of PCAOB standards that is inconsistent with many of the Board's other standards (i.e., interim standards and AS No. 1-6). This style includes the drafting convention that makes more extensive use of notes and appendices and places requirements within them.

We note that the Board stated in its release<sup>1</sup> with the reproposed standards that the notes and appendices in the Board's auditing standards are considered integral parts of the standards and accordingly, carry the same authoritative weight as the other portions of the reproposed standards. While we do not dispute this, we believe the inclusion of requirements in notes and appendices serves to devalue the requirements and may increase the likelihood that auditors could overlook those particular requirements. Similar to the Board's rationale for incorporating the guidance from the Board's interim standards related to fraud into the respective auditing standards to emphasize the auditor's responsibilities for consideration of fraud at various stages of the audit, we recommend the Board consider incorporating requirements currently located in appendices into the body of the applicable standards.

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<sup>1</sup> We noted the reference in footnote 6 of Appendix 9 of the reproposal refers to Questions No. 1 and 2 of *Staff Questions and Answers: Auditing Internal Control Over Financial Reporting* (June 23, 2004 and revised July 27, 2004). However, this guidance has been superseded according to the PCAOB website.

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This drafting convention also may create more complexity than necessary in referring to the requirements. Specifically, the existence of requirements within notes may make it difficult for the PCAOB and auditors to easily identify and refer to all requirements within the PCAOB standards. We recommend the PCAOB consider utilizing paragraphs, as opposed to notes, in all situations where it is establishing a requirement.

### **Organization and Codification of PCAOB standards**

The multiple “styles” of PCAOB standards, as described above, result in a set of PCAOB auditing standards that is increasingly cumbersome to navigate. While the Board indicated in the release that the style of the repropoed standards will provide a template for future standards issued by the Board, there does not appear to be a clearly stated plan for updating existing standards in the future, nor for clearly codifying all auditing standards adopted by the PCAOB. Given the PCAOB’s current extensive standards-setting agenda, we are concerned that new standards may exacerbate the difficulty of navigating and applying new standards with the remaining interim standards without a consistent style, a plan for updating existing standards, as well as codification of all Board auditing standards. Therefore, we recommend that the PCAOB consider undertaking a project, similar to that undertaken by the AICPA Auditing Standards Board (ASB) and the International Auditing and Assurance Standards Board (IAASB), to redraft all of its auditing standards in a consistent manner (e.g., consistent use of objectives), with the intent of encouraging greater understanding and more consistent application, and to fully codify the standards by subject matter. While we recognize that the PCAOB’s resources are limited, we believe such projects, and the potential benefits to auditor understanding and performance, merits priority on the Board’s agenda.

### **Effective date**

We appreciate that the PCAOB responded to comments received from the original proposal by including a proposed effective date in the release to the repropoed standards. We agree that the effective date should be as of the beginning of an audit period. However, given the time required to consider public comments received and obtain Board and SEC approval, the PCAOB’s expectation that the standards would be effective for audits of fiscal years beginning on or after December 15, 2010, may be aggressive.

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Due to the foundational nature of the proposed standards, the effective date for the standards should consider the time required for firms to incorporate the standards into their audit methodologies and training programs prior to implementation. Therefore, if the final standards are approved by the Board and the SEC after June 30, 2010, we strongly request the Board consider a later effective date.

### **Differences between PCAOB and other standards-setters' standards**

We recognize the improvements the Board has made to reduce differences between the repropoed standards and the IAASB's International Standards on Auditing (ISAs) and the ASB's Statements on Auditing Standards (SASs). For example, there are a number of areas in which the requirements and terminology in the repropoed standards are more closely aligned with the ISAs and SASs and in areas where differences remain, the Board generally provided its rationale for maintaining the differences.

We note that a large number of registered firms conduct audits in accordance with standards from the PCAOB, the ASB and the IAASB. As one of those firms that follow each set of standards, we are concerned with how the PCAOB's standards interact with those of other standards setters. An accurate understanding and consistent application of the requirements and terminology of each set of standards is required to achieve high quality audits. Consistency of each set of standards, to the extent appropriate, allows an auditor and an audit firm to concentrate efforts on conducting a high-quality audit.

As a result, we recommend the PCAOB seek to achieve the following three objectives when drafting its standards:

1. Minimize differences between PCAOB and other standards-setters' standards in terminology and requirements. We recognize that the Board may decide that different procedures are appropriate in the U.S. public company audit context. However, we encourage the Board to continue to minimize the differences in its standards to only those matters that are unique to audits of issuers in the U.S. Minimizing differences also allows firms to cultivate synergies related to training, implementation, and the development and maintenance of quality control systems that accommodate the standards of the various standards-setting bodies—all factors that we believe contribute to enhanced audit quality.
2. Clearly articulate the rationale for any differences. For those differences from other standards-setters that do exist, we encourage the Board to continue to

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clearly and publicly explain the reasoning. We do not intend to put the PCAOB in a position of defending its choices. Rather, a public dialogue and communication about the Board's thought process would improve the understanding of the PCAOB's standards and the Board's intent for the differences.

3. Explain the desired auditor actions as a result of the differences. In situations where the underlying objectives and requirements between PCAOB standards and those of other standards-setters are similar, firms may generally presume that the PCAOB does not intend there to be a different auditor action unless it is specifically highlighted by the PCAOB (or otherwise clearly apparent within the context of the standard). As such, we continue to encourage the PCAOB to highlight the different procedures required in the U.S. public company audit context, being as comprehensive as possible in its explanations of the desired auditor actions as a result of the differences to assist firms in recognizing and implementing any intended differences.

We noted the following two areas in particular in the repropoed standards for which we strongly encourage the Board to reconsider whether the remaining differences in terminology and requirements are truly necessary, and if so, more clearly articulate the rationale and explain the desired auditor action as a result of the differences:

- The repropoed standard *Consideration of Materiality in Planning and Performing an Audit* uses the term "tolerable misstatement" (e.g., paragraphs 8 and 9). This is different from the term "performance materiality" used in ISA 320 (Revised and Redrafted), *Materiality in Planning and Performing an Audit*, and in the clarified issued SAS, *Materiality in Planning and Performing an Audit*, for essentially the same concept. For the reasons described in our comment on Appendix 3 below, we recommend that the PCAOB replace the term "tolerable misstatement" in the repropoed standard with "performance materiality."
- Paragraph 15 of the repropoed standard *Evaluating Audit Results* includes guidance for the auditor to communicate accumulated misstatements to management on a timely basis to provide them with an opportunity to correct them. Both the ISAs and SASs include a requirement that the auditor request management to correct those misstatements. We believe this requirement should also exist in the PCAOB standards. Requiring the auditor to make such a direct and specific request of management may improve the likelihood that such corrections will be made in the current period.

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### Observations related to PCAOB's standards-setting process

We request the Board consider further enhancements to its standards-setting process in the areas described below that would improve the clarity of its standards, provide additional visibility to the Board's rationale and desired changes to practice, and increase the consistency of implementing its auditing standards.

#### *Release Text*

We appreciate the Board providing insight into its thought process on certain aspects of the reproposal by including its consideration of the comments received on the original proposal. 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. The following two instances provide examples:

- Paragraphs 11-14 of the reproposed standard *Audit Planning and Supervision* outline the auditor's responsibilities with respect to multi-location engagements. The Board states in Appendix 10 that these provisions "are applicable to all multi-location audits, not just group audits." However, we note that the Board's standards do not currently contain a definition of a "group audit," nor do the standards or the Board's release to the reproposed standards contain any discussion of what the similarities and/or differences between multi-location audits and group audits might be. Therefore, we request the Board to clarify its intent with respect to the application of these paragraphs.
- With respect to the proposed amendments to paragraphs 23 and 38 of AU 350, *Audit Sampling*, the Board clarified its view in Appendix 9 of the reproposal that "the proposed amendments are not intended to require auditors to compute sample sizes using statistical methods in all instances to demonstrate compliance with the requirements." Although we appreciate that the Board has attempted to address the concern expressed by commenters to the original proposal, we recommend the Board include this guidance within the standard itself to avoid potential confusion or misinterpretation. The potential guidance could leverage the language used in the release or, alternatively, language similar to paragraph A11 of redrafted ISA 530 or footnote 5 from paragraph 23 of the ASB's revised AU 350, *Audit Sampling*.

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Interpreting standards through release text can result in potential 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. This may create the need for supplemental staff interpretations on certain aspects of the standards, adding further complexity for the auditor implementing the standards. As a result, we encourage the Board to consider providing such interpretive guidance within its final standards as opposed to the accompanying release.

### ***Highlight Desired Changes to Practice***

We believe that providing specific descriptions of the Board's desired changes to current audit practice as a result of a proposal, final standard, or rule would assist auditors and other interested parties in understanding the changes expected from the relevant proposals or standards. We note that the Board could consider the approach utilized by the Financial Accounting Standards Board to provide this information.

### **Comments on individual standards**

In addition to the comments provided above as examples, we observed the following opportunities to improve the clarity of several of the repropoed standards.

#### *Appendix 2, Audit Planning and Supervision*

Paragraph 7 – As in the original proposed standard, this paragraph includes a list of matters that auditors should evaluate to determine whether or not they are important to the company's financial statements and internal control over financial reporting and if so, how they will affect the auditor's procedures. The ninth bullet in the list requires the auditor to consider "preliminary judgments about the effectiveness of internal control over financial reporting." However, unlike the fifth bullet point related to the auditor's preliminary judgments of materiality, the ninth bullet is not clear that it refers to the auditor's judgments about effectiveness of controls. We recommend that the PCAOB modify the ninth bullet point to clarify that it pertains to the auditor's preliminary judgments or consider clarifying within the standard the intent behind the omission.

Paragraph 14 – This paragraph appears to create a narrower or more prescriptive requirement than the requirement set forth in paragraph 5c of the repropoed standard, *The Auditor's Responses to the Risks of Material Misstatement*, relating to introducing an

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element of unpredictability in the auditing procedures performed in multi-location engagements. Paragraph 14 appears to require auditors to change the nature, timing and extent of audit procedures performed at various locations each year, whereas paragraph 5c requires that auditors incorporate unpredictability, providing the varying of locations where procedures are performed as an example of how that might be achieved.

We do not believe it is necessary or recommended that risk-based auditing standards dictate the specific manner in which the element of unpredictability is to be introduced. Given that the requirement in paragraph 5 is intended to impact the auditor's overall response to the assessed risks of misstatement, including the risk of fraud, we recommend deleting paragraph 14 from this repropoed standard or including this paragraph only as an example to paragraph 5 of repropoed standard, *The Auditor's Responses to the Risks of Material Misstatement*.

*Appendix 3, Consideration of Materiality in Planning and Performing an Audit*

As in the original proposal, the repropoed standard uses the term "tolerable misstatement" (e.g., paragraphs 8 and 9), which is different from the term "performance materiality" used in ISA 320 (Revised and Redrafted), *Materiality in Planning and Performing an Audit*, and in the clarified issued SAS, *Materiality in Planning and Performing an Audit*, for essentially the same concept. As described by the Board in Appendix 9 of the repropoal, we recognize that the term is well understood by auditors and that the Board is not seeking to change the concept as described in existing PCAOB standards. However, the term is defined and largely understood by auditors in the context of audit sampling (as defined in AU 350, *Audit Sampling*, in the PCAOB's interim standards). Using the same term in two separate fashions – to both assist auditors in assessing risks of material misstatement for the purpose of determining an appropriate audit response and to plan a sample – could result in confusion for auditors and result in misapplication of the concepts, which in turn, could have adverse impacts on audit quality. Further, upon adoption of the revised and redrafted ISAs and SASs, auditors will become more familiar with the term "performance materiality". If the PCAOB persists in its proposed use of "tolerable misstatement", audit firms would be faced with incorporating into their audit methodologies and training programs different terminology for the same concepts among standards-setters. Therefore, to avoid potential confusion and unnecessary complexity, we recommend that the PCAOB replace the term "tolerable misstatement" in the repropoed standard with "performance materiality," which is the equivalent term used in the revised and redrafted ISAs and SASs to distinguish the term's meaning when used in separate aspects of the audit.



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*Appendix 4, Identifying and Assessing Risks of Material Misstatement*

Paragraph 11 – This paragraph contains procedures an auditor should consider performing as part of obtaining an understanding of the company. We agree that information from such procedures, in many instances, would provide the auditor with meaningful insights into the company and therefore, enhance the assessment of risks. However, we note that the broad nature of the procedures, combined with the presumptively mandatory requirement, may result in auditors expending significant efforts to identify such information and/or documenting the considerations regarding the importance of such information to the auditor’s understanding of the company. Such excess efforts may not result in a commensurate increase in audit quality. As such, we recommend the PCAOB consider amending the requirement to indicate that the auditor “might consider” the procedures outlined within the paragraph.

Paragraphs 13 and 68 – Paragraph 13 requires the auditor to identify the “necessary disclosures for the company’s financial statements” in order to identify and assess the risks of material misstatement related to omitted or incomplete disclosures. Paragraph 68 states that the “auditor’s evaluation of fraud risk factors...should include evaluation of how fraud could be perpetrated or concealed through omitting or presenting incomplete disclosures.” We recommend that the PCAOB clarify in both of these instances that the auditor’s identification, assessment, and evaluation of the risk of material misstatement related to omitted or incomplete disclosures is conducted in consideration of the company’s financial reporting framework.

Appendix A5 – The definition of “significant risk” should make it clear that the auditor makes a determination of the areas that are deemed significant risk and thus require special audit consideration based on the auditor’s assessment of the entity’s risks. This concept is excluded from the definition in Appendix A. We believe the definition of significant risk would be improved by including the following language: “*Significant risk* – A risk of material misstatement that the auditor determines requires special audit consideration.”

Paragraph 54 – This paragraph requires auditors to identify other individuals within the company to whom inquiries about their views regarding fraud risks should be directed. We recommend that certain deleted words from paragraph 24 of the PCAOB’s extant AU 316, the source for paragraph 54, be reinstated. Specifically, we recommend making the following changes to the second sentence, “The auditor should identify other individuals within the company to whom inquiries should be directed and determine the extent of such inquiries by considering whether others in the company might have

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additional knowledge that will be helpful to the auditor in identifying risks of material misstatement due to about fraud, alleged or suspected fraud ...” Retaining the extant language will make clear that the auditor is to make a determination about the extent of such inquiries and explicitly relates the need for these inquiries to the risks of material misstatement.

*Appendix 5, The Auditor’s Responses to the Risks of Material Misstatement*

Paragraph 2 – The objective in paragraph 2 could be clarified to reflect the additional perspective provided by the discussion in paragraph 3. Paragraph 3 clarifies that to meet the objective of the standard, the auditor must address the risks that are identified and assessed in accordance with the repropoed standard, *Identifying and Assessing Risks of Material Misstatement*. As currently drafted, the objective in paragraph 2 does not include the notion of addressing the risks “assessed” by the auditor. We recommend that the Board add the word “assessed” before the phrase “risks of material misstatement” in the objective to clarify the auditor’s responsibilities. While we support the Board’s changes to include the concept of “assessed risk” to create a better linkage to audit responses, we believe that the objective of the standard should include “assessed risk” to make this same linkage.

*Appendix 6, Evaluating Audit Results*

Paragraphs 28 and C1 – Paragraph 28 provides that when evaluating the results of the audit, the auditor should evaluate whether the accumulated results of audit procedures and other observations affect the assessment of fraud risks made throughout the audit and whether audit procedures need to be modified to respond to those risks. Paragraph 28 also references Appendix C, which is titled “Matters That Might Affect the Assessment of Fraud Risks.” Paragraph C1 lists matters, if identified during the audit, for which “...the auditor should determine whether the assessment of fraud risks remain appropriate or needs to be revised.” This seems to indicate that the auditor is required to determine if each listed item identified during the audit individually affects the assessment of fraud risks, and appears to be inconsistent with paragraph 28. This may lead to confusion about the level of consideration and documentation expected in these situations. We recommend the following sentence replace the first sentence of paragraph C1 to be consistent with paragraph 28 and the title of Appendix C: “The following matters might affect the auditor’s assessment of fraud risks, including the auditor’s evaluation of whether that assessment remains appropriate or needs to be revised.”

*Appendix 7, Audit Evidence*

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Paragraph 18 – The original proposed standard included a description that “[w]ritten confirmations might be received in paper form, or by electronic or other medium.” We note that this description is excluded from the repropoed standard. While we understand the PCAOB is in the process of considering amendments to its interim standard, AU 330, *The Confirmation Process*, we are concerned that the removal of the expectation that confirmations be “written,” could have an effect on the auditor’s evaluation of information provided from third parties as part of the audit. For example, the paragraph as currently drafted could be interpreted to pertain equally to oral responses to oral requests for information, which we do not believe is the Board’s intent. As such, we recommend that the Board consider re-inserting the word “written” in the first sentence so it refers to a “direct written response.” We believe such language would better maintain the existing guidance until the completion of the Board’s current project on confirmations.

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In summary, we appreciate the effort and time the Board and its staff have devoted to this proposal, and its careful consideration of our comments. While we believe the repropoed standards represent a significant improvement over the original proposal, we believe they require more consideration with respect to the areas outlined above.

We appreciate the opportunity to comment on the repropoed standards and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations. If you have any questions on our response please contact Erica Forhan in our Professional Practice Group at 206-302-6826 or Erica.Forhan@mossadams.com.

Very truly yours,

A handwritten signature in blue ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Moss Adams LLP