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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. 2009-007, Rule Making Docket Matter No. 026,
Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB 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 Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards* (the "new proposed standards"). Overall, we believe that the new proposed standards have enhanced the clarity of the original proposed risk assessment standards, such that they more clearly set out the Board's expectations with respect to planning and performing an audit using risk assessment principles. Additionally, we appreciate the efforts made by the Board to promote transparency into the standards-setting process by re-exposing these standards and providing enhanced discussion within the release regarding the Board's rationale for the more significant decisions made.

As set out in our comment letter on the original proposed standards, we support the Board's objective to update its extant interim standards to more fully incorporate guidance about the risk assessment process, including gathering information, evaluating that information to assess risks at the assertion level, designing and performing further audit procedures, and evaluating results and reaching an appropriate conclusion. We believe the new proposed standards largely achieve that goal.

Our comments are organized such that our overall comments are provided first, followed by our responses to the specific questions posed in the release, which include additional commentary on certain matters specific to an individual Appendix.

Overall Comments

Structure and Organization of the New Proposed Standards

To assist practitioners in understanding and effectively implementing the PCAOB's standards, we encourage the Board to continue to apply a consistent structure in developing its standards, including (1) the use of objectives that provide the context within which the requirements of the standard are to be performed, and (2) the use of appendices that



include definitions of technical terms and expand upon special topics. A consistent framework in developing standards promotes a clear understanding of the requirements within a standard and the methods to implement those requirements.

Two areas where we believe the structure of the proposed standards may be improved include the use of notes and appendices within the standards. We understand that notes and appendices are integral parts of the standards and as such, they carry the same authoritative weight as other portions of the standards; however, we believe that setting requirements in notes and appendices may obscure essential guidance. We believe the structure of the standards would be enhanced by organizing the standards such that notes only provide further clarification and do not introduce additional requirements. Further, we believe that the guidance included within appendices should not include requirements not otherwise mentioned in the body of the standard, but rather should provide supplementary or explanatory material on a special topic. This would be similar to the manner in which appendices are used in the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB) standards, where appendices are also considered an integral part of the standards.

Convergence

We understand that the PCAOB, in developing these new proposed standards, has taken into account the risk assessment standards of the IAASB, and we support this convergence effort. In describing the rationale for the differences that exist between the IAASB standards and the new proposed standards, Appendix 9 to the release explains that since the Board's standards must be appropriate for audits of issuers and consistent with the Boards' statutory mandate to oversee the audit of public companies that are subject to the securities laws, its standards will necessarily differ in some respects from IAASB standards. While we agree that certain differences will necessarily exist to reflect the PCAOB's mandate to oversee audits of public companies, these differences are not always specific to auditing in a public company environment.

For example, the International Standards on Auditing (ISAs) use the term "performance materiality" when referring to the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. The PCAOB standards use the term "tolerable misstatement" for the same concept. We strongly recommend that the PCAOB eliminate these types of differences, such that the remaining differences between the standards reflect only differences necessary as a result of aspects unique to the U.S. public company environment and/or for which auditor performance is expected to differ. This is particularly important for those firms that audit both public and private companies and those that audit companies with operations in multiple countries, which as a matter of practicality, therefore, use the ISAs as the basis for their uniform methodologies for the worldwide network.



Additionally, we suggest listing differences from the ISAs that are expected to result in significant differences in practice, such that if a difference were not listed, it could be presumed not to be a significant difference that would require a different auditor response than under the ISA.

Collaboration with Other Audit Standards-Setters

We acknowledge the steps the PCAOB has taken to participate with other standards-setters in the development of auditing standards, for example, through attending IAASB meetings, inviting the IAASB and ASB Chairmen to join the SAG meetings, and participating in joint meetings of standards-setters. We support these efforts and encourage the PCAOB to work more collaboratively with the IAASB and ASB, through participation on IAASB and ASB task forces to benefit from the discussions held at this level in formulating the public company perspective.

Additionally, we believe the Board could enhance its standards-setting process by establishing external task forces to participate in developing and updating its own auditing standards. Such an approach was used previously by the PCAOB in developing the PCAOB's *Staff Views of An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies*. This guidance was developed, under the oversight of the PCAOB, by a working group of auditors with experience in this subject matter. In developing this guidance, the PCAOB also consulted with financial executives from smaller public companies.

Transparency of Standards-Setting Process

We encourage the PCAOB to continue to engage the various stakeholders in the standards-setting process through the use of concept releases, re-exposing proposed standards when necessary, and discussions at the open Standing Advisory Group meetings. Also, as mentioned above, an important aspect of transparency is providing a complete and clear analysis of differences between the PCAOB's standards and the ISAs and, in particular, where such differences are expected to result in a different auditor action, we urge the PCAOB to provide such an analysis.

Effective Date

We note that the effective date set out in the release is expected to be for audits of fiscal years beginning on or after December 15, 2010. In setting an effective date, we encourage the Board to consider the time required for SEC approval, in addition to the time required by firms to incorporate the standards into their audit methodologies and provide for training prior to implementation. As such, we suggest revising the anticipated effective date if these new proposed standards are not approved by the SEC prior to June 2010.



Specific Questions Posed in the Release

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

Yes. We support the use of objectives in the new proposed standards and believe objectives should be established for all PCAOB Auditing Standards. The use of objectives in each auditing standard establishes a useful context for the auditor to evaluate whether the procedures performed were sufficient to meet the stated objective. Such a construct strengthens the standard and, as a result, audit quality is enhanced.

Appendix 1 - Audit Risk

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

While the discussion in the new proposed standard appropriately defines audit risk as a function of the risks of material misstatement and detection risk, it does not include a discussion that explains that the assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit, and that the assessment of such risks is a matter of professional judgment. Accordingly, we recommend including such a discussion.

Further, we suggest clarifying that in assessing risk the auditor must evaluate both control risks and inherent risks, but that a separate conclusion (e.g. high, medium, low) is not necessary for each of these separately in reaching the conclusion as to the risk of material misstatement for any assertion. We believe that the current discussion of risk may inappropriately imply that a conclusion for each aspect of risk is necessary to determine the overall risk of material misstatement for an assertion.

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

No. We do not believe that the relationship between detection risk and substantive procedures is clearly described. While the new proposed standard appropriately explains that the level of detection risk is reduced by performing substantive procedures, it does not describe the interaction between detection risk and other procedures the auditor performs, such as tests of controls, which impact the level of detection risk.

Appendix 2 - Audit Planning and Supervision

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



Overall, we believe the proposed requirements for multi-location engagements are appropriately aligned with Auditing Standard No. 5. We have one suggestion, however, related to the unpredictability of auditing procedures. Paragraph 14 of the new proposed standard explains that the “auditor should vary the nature, timing, and extent of audit procedures at locations or business units from year to year.” In addition to this guidance, we believe it would be appropriate, within the context of multi-location engagements, to include as an example of such unpredictability the concept of varying the location where audit procedures are to be performed from year to year.

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

Yes. We believe that the proposed requirements for multi-location engagements, which align with Auditing Standard No. 5, clearly describe how such requirements would be applied in audits of financial statements only.

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

Overall, we believe the differences between the responsibilities for supervision of engagement team members and oversight of specialists are appropriate. However, we suggest enhancing the guidance by emphasizing the need to communicate the nature, scope, and objectives of the work to be performed by the specialist with engagement team members. Further, we support the Board’s current standards-setting project on this topic, to consolidate into one standard all relevant guidance relating to using the work of an auditor’s specialist, whether employed or engaged by the auditor.

Appendix 3 - Consideration of Materiality in Planning and Performing an Audit

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?

Yes. We agree that the provisions regarding consideration of materiality in multi-location engagements are appropriate.



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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?

Yes. We agree with the revisions made to the original proposed standard, such that the auditor's reassessment of materiality and tolerable misstatement is made in light of whether changes in circumstances or additional information that the auditor becomes aware of would influence the judgment of a reasonable investor. The discussion in Appendix 9 explains that this revision is intended to encompass situations such as when:

- Changes in laws, regulations, or the applicable financial reporting framework affect investor's expectations about the measurement or disclosure of certain items.
- Significant new contractual arrangements have attracted attention on a particular aspect of a company's business that is separately disclosed in the financial statements.

We believe that these examples are important to the auditor's understanding about how to apply the requirement to reassess established materiality to reflect the broader principal that materiality and tolerable misstatement should be reassessed not only as a result of changes in amounts upon which materiality levels were first based but also on changes in circumstances or information that may affect judgments of a reasonable investor. For this reason, we suggest including these examples in the new proposed standard rather than in an appendix to the release.

Additional Comment

We understand that the Board has considered the comments received on the original proposed standard relating to the use of the term "performance materiality" and decided to retain the term tolerable misstatement because it is well understood by practitioners. We do not agree with the Board's conclusion for two reasons:

1. Both the ISA's and the ASB's clarified risk standards refer to performance materiality in reference to amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. As auditors begin implementing these standards, (the clarified ISAs are effective for periods beginning on or after December 15, 2009 and the effective date for the ASB's clarified Statements on Auditing Standards (SAS), while not yet set, is anticipated to be effective shortly thereafter), this term will become well understood.

Since almost every registered audit firm will have both public and private company engagements, and since many will also encompass international engagements using



foreign auditors, having two terms to describe exactly the same concept makes it unnecessarily cumbersome for audit firms to maintain in policies, procedures and training materials, and will likely result in confusion as to the meaning of the two terms.

2. The term performance materiality is distinguished from tolerable misstatement in both the clarified ISAs and SASs in that performance materiality is used with respect to assessing risks of material misstatement and determining the nature, timing, and extent of further audit procedures, whereas tolerable misstatement is used in the application of performance materiality to a particular sampling procedure.

Therefore, to avoid any confusion about the use of these terms, we strongly recommend that the PCOAB replace the term “tolerable misstatement” with “performance materiality” in the new proposed standard on materiality.

Appendix 4 - Identifying and Assessing Risks of Material Misstatement

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?

Generally, we believe the new proposed standard adequately describes 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.

However, we believe that a fundamental aspect of the objective is missing. To adequately describe the auditor’s responsibility, it is essential to describe how such an assessment is to be performed, which is primarily through obtaining an understanding of the entity and its environment, including the entity’s internal control. Including this reference within the objective emphasizes its importance in the risk assessment process and corresponds to the prominence of this concept within the standard itself.

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

No. We believe that the auditor’s responsibilities regarding all the procedures for understanding the company and its environment, as set out in paragraph 11, should be clarified by including a reference to paragraph 7 regarding the auditor’s responsibility to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement. Without such a



link, the connection between the auditor's responsibilities and the requirement to consider performing the listed procedures may not be clearly evident and the effectiveness of such procedures may be diminished.

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?

Overall, the proposed requirements regarding obtaining an understanding of internal control over financial reporting are appropriate. However, to strengthen the proposed standard, we suggest including a more robust discussion of entity level controls, similar to the discussion in Auditing Standard No. 5, paragraphs 23-24. While we agree with the discussion in Appendix 9 that explains that the objective of an audit of only the financial statements differs from an audit performed under Auditing Standard No. 5, we believe that the auditor's understanding of entity level controls, which add to or potentially mitigate risks of material misstatement, is an essential component of the top-down approach to risk and controls assessment and is essential to the effective performance of any audit, whether or not integrated with an audit of internal control over financial reporting.

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?

Yes. We believe the proposed requirements regarding the discussion among engagement team members about the risks of material misstatement are appropriate.

Appendix 5 - The Auditor's Responses to the Risks of Material Misstatement

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?

Generally, we agree that the proposed requirements for overall responses and responses involving the nature, timing, and extent of audit procedures are appropriate. One area where we believe additional clarity is needed, however, is with respect to the factors that may affect the extent of testing a control. Paragraph 31 of the new proposed standard provides a list of factors the auditor should take into account when controls have been tested in past audits, but it is unclear why some of these factors should only be taken into account in these circumstances.



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We believe that the following factors listed in paragraph 31 are unique to circumstances when controls have been tested in past audits:

- The nature, timing, and extent of procedures performed in past audits
- The results of the previous years' testing of the control
- Whether there have been changes in the control or the process in which it operates since the previous audit

However, we believe that the other factors listed are not necessarily unique to this circumstance and suggest that the Board reconsider whether such factors should instead be considered in all or many circumstances.

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

We believe the new proposed standard clearly describes when tests of controls are necessary in an audit of financial statements only.

Additional Comment

The objective as set out in paragraph 2 of the new proposed standard appears to be inconsistent with the discussion in paragraph 3. Paragraph 3 explains that to meet the objective of the standard, the auditor must address the risks that are identified and *assessed* in accordance with the new proposed standard, *Identifying and Assessing Risks of Material Misstatement*, whereas the objective in paragraph 2 does not include the notion of addressing the risks "assessed" by the auditor. To address this inconsistency, we recommend that the Board add the clarifying word "assessed" to the objective paragraph.

Appendix 6 - Evaluating Audit Results

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

We believe the new proposed standard clearly describes the auditor's responsibilities for accumulating and evaluating misstatements. However, we do not believe the new proposed standard sufficiently describes the auditor's responsibility for communicating accumulated misstatements to management on a timely basis to provide them with an opportunity to correct them.

Paragraph 15 of the new proposed standard includes guidance for the auditor to communicate accumulated misstatements to management on a timely basis to provide them with an opportunity to correct them, but the guidance does not require the auditor to request that management correct the misstatements. We believe that the requirement to request management to correct the misstatement is significant and should be included to



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improve the likelihood that such corrections will be made. Such a requirement is included in paragraph 12 of ISA 450, *Evaluation of Misstatements Identified during the Audit*, and paragraph 7 of the ASB clarified risk standards, *Evaluation of Misstatements Identified During the Audit*.

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?

Yes. We believe the new proposed standard appropriately describes the auditor's responsibilities for evaluating the presentation of the financial statements. In particular, we believe the guidance provided in paragraph 26 of the new proposed standard provides clarity around the impact that bias has on the auditor's evaluation of the effect of uncorrected misstatements and the auditor's assessment of risks.

Appendix 7 - Audit Evidence

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?

Yes. The financial statement assertions are clearly described in the new proposed standard.

Proposed Amendments to PCAOB Standards

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

We did not note any provisions in the to-be superseded standards that should be retained.

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

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