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February 18, 2009

SENT VIA EMAIL TO COMMENTS@PCAOB.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 Conforming Amendments to PCAOB Standards*, PCAOB Rulemaking Docket Matter No. 026

Dear Office of the Secretary:

We appreciate the opportunity to share our views on the Public Company Accounting Oversight Board's (the Board or PCAOB) *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (the proposal or proposed standards).

Moss Adams LLP is the 11th largest accounting and consulting firm in the United States, and the largest headquartered in the West. Founded in 1913 and headquartered in Seattle, Washington, Moss Adams has 20 locations in Washington, Oregon, California, Arizona, and New Mexico. Our staff of over 1,900 includes more than 250 partners. Our audit practice emphasizes middle market, domestic and foreign-owned, public and private companies, as well as not-for-profit organizations.

In general, 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 proposed rules. We believe the approach described in the proposal is scalable, which is important to our varied client base of middle market public companies.

Further, we support the integration of fraud considerations as part and parcel of an audit risk assessment, and see advantages of retaining in a separate audit standard the specific required responses to fraud risk. This has the benefit of promoting integrated consideration of risk of material misstatement whether from fraud or error, while not diminishing the importance of specific fraud procedures and responses.

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After reviewing the Board's proposal we believe additional clarification is needed in certain places. In other areas we see opportunities for more streamlined guidance that will assist the practitioner in the application of these proposed standards. Specifically, there are areas where we believe the benefits of divergence of the proposal from existing or proposed standards of other standard setters do not outweigh the costs of application. Our comments focus on:

- Convergence with other standards setters
- Integration with Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5)
- Style of the proposed standards
- Codification of PCAOB standards

We also have observations about the PCAOB's standards-setting process and the effective date of the proposed standards.

Convergence with Other Standards Setters

While we support the incorporation of more clearly defined risk assessment principles into a public company audit, we encourage the Board to leverage as much as possible from existing standards adopted by other standard setting bodies, namely the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants' Auditing Standards Board (ASB). While we agree there are areas in which the differences of a U.S. public company audit would warrant divergence from the standards adopted by the IAASB or the ASB, a higher degree of convergence than the PCAOB proposes would lead to higher quality and more efficient audits for all, including public company audits.

In a firm our size or smaller, the public company audit practice often represents a smaller part of the firm's client base, and as such the audit approach for the entire firm is not strictly designed around PCAOB standards. Rather, the requirements of PCAOB standards that are applicable only to public company audits are an addition to the firm's standard audit approach. It is difficult for a firm and practitioners to incorporate into their audit approach multiple sets of standards that vary from each other either slightly or completely, without a full understanding of the reasoning for the differences.

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The Securities and Exchange Commission's (SEC) use of other standards setters (i.e., the Financial Accounting Standards Board) to establish the basis of public company accounting and the SEC's identification of areas where additional interpretation for public companies is warranted creates a common base of accounting principles, with clear identification of where public companies might diverge from private companies. We urge the PCAOB to consider a model similar to this. The result would be audit standards that are as similar as possible across all audits, with clear identification of what is different in a public company audit (whether an audit of financial statements only or an integrated audit). This would enhance auditors' understanding, implementation, and consistent execution of standards on all audits they perform, not just those subject to the PCAOB's oversight. This method also would allow the PCAOB to focus its efforts and resources providing guidance on the elements of an audit that are uniquely different for a public company audit, rather than re-creating the applicable elements of core audit standards.

There appear to be more similarities than differences between a risk-based audit as described by the proposed standards and that described by the ASB and IAASB standards. We suggest the Board use the International Standards on Auditing (ISAs) as a common base for current and future standards-setting, modifying them as it sees fit for a public company audit. The PCAOB indicated in its release of the proposal that it reviewed the application and other material in the ISAs, adapted those provisions that the Board believed are necessary for audits of issuers, and included them in the proposed standards. We recommend the Board be more transparent in that approach, clearly delineating what guidance it believes needs to be different for a U.S public company audit and the reasons. This explanation should encompass the Board's expectations for auditor actions that would be different than those required by the ISAs, particularly in areas where the PCAOB has specifically adopted mandatory or presumptively mandatory language where the ASB or IAASB has not. This would help the auditor understand whether a fundamentally different mindset is expected in performing a public company audit as opposed to one performed under Statements on Auditing Standards or ISAs.

Integration With AS 5

The proposed standards seem to imply there are separate risk assessment processes that would occur in an integrated audit – one for the audit of the financial statements and one for the audit of internal control over financial reporting. We believe the risk assessment process is fundamentally the same whether performing an audit of the financial statements only or an integrated audit. While the audit objectives and audit responses of

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each type of audit differ, the process to identify risks should be similar. The common element is the audit of the financial statements.

In that regard, we believe it is appropriate to create audit standards that comprehensively address risk assessment for a financial statement audit, and identify the incremental considerations, required procedures, and action steps for an audit of internal control. To increase the usefulness of the standards to practitioners we encourage the PCAOB to reconsider ways to better integrate into the proposed standards the relevant elements of existing guidance for performing an integrated audit.

We find that the Board's approach to combining content of the proposed standards with content of AS 5 is inconsistent and in some cases confusing. Our observations are summarized in three themes described below. The examples we provide are not intended to be an exhaustive list of the corrections we believe are needed, but we hope they will illustrate our observations and recommendations.

First, some **guidance from AS 5 that has relevance to an audit of financial statements (whether an audit of financial statements only or an audit of financial statements that is part of an integrated audit) is not incorporated into the proposed standards.** We recommend that this guidance be incorporated into the proposed standards. To the extent this incorporation creates redundancy, in keeping with our second observed theme below, we recommend that a conforming amendment eliminate the guidance from AS 5, or limit the guidance in AS 5 to only that which is incremental guidance applicable to an audit of internal control over financial reporting. Examples of this observation include:

- The notion of using a top-down approach is prevalent in AS 5, but is not incorporated into the proposed standards. We believe the top-down approach is equally relevant to identifying and responding to risk in a risk-based audit of the financial statements, and should be encouraged in the proposed standards to promote more efficient and effective audits of financial statements.
- Paragraph 11 of the proposed standard *Audit Planning and Supervision* provides guidance for multi-location engagements. Appendix B of AS 5 also contains multiple location scoping guidance, which we believe can be helpful in an audit of financial statements as well as an audit of internal control.

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- Paragraph 6(b) of the proposed standard *Identifying and Assessing Risks of Material Misstatement* states that the auditor's risk assessment procedures should include obtaining an understanding of internal control over financial reporting. Understanding internal control is a focal point of the proposed standard, yet the auditor is referred to paragraph A5 of AS 5 for the very definition of "internal control over financial reporting" and a discussion of the inherent limitations of internal control over financial reporting. This important concept should be included within the proposed standard itself, not by reference to AS 5.
- AS 5 paragraphs 23-27, "Identifying Entity-Level Controls" include information on entity-level controls that we believe is also relevant in obtaining an understanding of internal control over financial reporting in an audit of financial statements only. We recognize the wording in AS 5 requires auditor action that would not be required in an audit of financial statements only, and that it is based on the underlying assumption that the operating effectiveness of internal controls will be tested to support the auditor's opinion on the effectiveness of internal control, which is a different audit objective than an audit of financial statements only. However, we believe much of the guidance in these paragraphs would be beneficial to an auditor of financial statements only as he or she obtains an understanding of the company's internal control over financial reporting. We recommend the Board incorporate the information in paragraphs 23-27 of AS 5 into the proposed standard *Identifying and Assessing Risks of Material Misstatement*, with modifications as appropriate, to fit the audit objective of an audit of financial statements only while not adding requirements for an audit of financial statements only.
- AS 5 paragraphs 34-36, "Understanding Likely Sources of Misstatement," present additional objectives the auditor should achieve in an integrated audit. As noted above, we believe the risk assessment process is fundamentally the same whether performing an audit of the financial statements only or an integrated audit. With respect to these paragraphs in AS 5, it is unclear what the Board intends to be different in a risk assessment performed in an integrated audit. We recommend the Board clarify what it intends to be different, or to appropriately incorporate the concepts in paragraphs 34-36 of AS 5 into the proposed standard *Identifying and Assessing Risks of Material Misstatement*.
- Paragraphs 37-38 of AS 5 discuss performing walkthroughs as a method of obtaining an understanding of controls. We believe this is equally beneficial guidance for the audit of financial statements only, and that the concept of

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walkthroughs should be added to the “Obtaining an Understanding of Internal Control Over Financial Reporting” section of the proposed standard *Identifying and Assessing Risks of Material Misstatement*.

- Paragraph 30 of AS 5 discusses the auditor’s identification of significant accounts and disclosures and their relevant assertions, and suggests the auditor might ask “what could go wrong” with a given significant account or disclosure. We believe this is equally beneficial guidance for the audit of financial statements only, and that the concept of “what could go wrong” should be added to paragraph 56(c) of the proposed standard *Identifying and Assessing Risks of Material Misstatement*.
- Paragraph 37 of the proposed standard *The Auditor’s Responses to the Risks of Material Misstatement* lists factors “the auditor should take into account” when determining the evidence needed in the current year audit to support the auditor’s control risk assessments when controls have been tested in past audits. Paragraph 47 of AS 5 provides guidance on this topic for integrated audits. Paragraph 47 of AS 5 includes additional considerations we believe are equally relevant to an audit of financial statements only, and therefore should be included in the proposed standards. For instance, the complexity of the control, the significance of the judgments that must be made in its operation, the competence of the personnel performing the control from year to year, and the nature and materiality of the misstatements the control is intended to prevent or detect are important considerations in determining the extent of use of prior year audit evidence in an audit of financial statements only.

Second, we observed several instances of **unnecessary redundancy between the proposed standards and AS 5**. In these instances, guidance from AS 5 is repeated entirely or almost verbatim in the proposed standards, therefore duplicating guidance to be followed when performing an integrated audit. We believe such redundancy should be eliminated, as follows:

- Guidance from AS 5 that has been repeated in its entirety and is relevant to an audit of financial statements, whether or not that audit is part of an integrated audit, should be incorporated into the proposed standards and, through a conforming amendment, removed from AS 5 and replaced with a cross-reference to the proposed standards. An example of this observation is as follows:

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- Paragraphs 21-24, 26-28 and 35 of the proposed standard *The Auditor's Responses to the Risks of Material Misstatement* are entirely copied from paragraphs 42-45, 50-51, 54, and 56, respectively, of AS 5. (In addition, paragraphs 25 and 32-34 of the proposed standard are modified slightly to accommodate a financial statement audit not integrated with an audit of internal control over financial reporting, but otherwise duplicate paragraphs 49, 53 and 55 in AS 5.)
- Guidance from AS 5 that has been incorporated into the proposed standards partially or with slight modifications to fit an audit of financial statements only should be retained in the proposed standards, and the duplicative parts removed from AS 5 through conforming amendments. In other words, the elements of the guidance that are common to audits of financial statements should be retained in the proposed standards, and AS 5 should be modified so that what is left in AS 5 is only the incremental guidance relevant to an integrated audit beyond what is considered necessary for an audit of financial statements only. Examples include:
 - The bullet points in paragraph 7 of the proposed standard *Audit Planning and Supervision* are incorporated, with very slight modification to broaden their scope to an audit of financial statements, from paragraph 9 of AS 5. There is very little difference in the two sources of guidance, so we recommend that a conforming amendment to AS 5 eliminate the redundancies. To the extent the Board intended there to be differences in the considerations applied in an integrated audit, those incremental differences should be clearly delineated and retained in AS 5.
 - AS 5 paragraph 9 states that “the auditor should properly plan the audit of internal control over financial reporting and properly supervise any assistants,” but paragraph 3 of the proposed standard *Audit Planning and Supervision* states that “the auditor must adequately plan the audit and properly supervise the members of the engagement team.” There is inconsistent use of “must” versus “should” and references to the engagement team. We believe the requirements embedded in the cited paragraphs for planning the audit and supervising members of the engagement team should be the same for an audit of financial statements only and an integrated audit. If the Board intended there to be differences, the common elements should be included in the proposed standards and the incremental requirements should be clearly delineated and retained in AS 5.

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Third, the proposed standards unnecessarily include guidance related only to an audit of internal control over financial reporting (and not to an audit of financial statements). Guidance that has no relevance unless the auditor is performing an audit of internal control should be eliminated from the proposed risk assessment standards and retained only in AS 5. Examples include:

- The Note to paragraph 34 of the proposed standard *Identifying and Assessing Risks of Material Misstatement* describes the auditor's understanding of control activities in an integrated audit in order to contrast it with that in an audit of financial statements only. The description of the nature of the auditor's understanding of controls in an integrated audit is unnecessary to the user of the proposed standard who is not performing an integrated audit, and we recommend the Board remove this Note to paragraph 34 from the proposed standard.
- The following paragraphs in the proposed standard *The Auditor's Responses to the Risks of Material Misstatement* should be removed because they pertain solely to an audit of internal control:
 - Paragraph 10 includes guidance that pertains to addressing fraud risk only in the audit of internal control.
 - Paragraphs 14 and 15 focus on testing controls specific to an audit of internal control. Additionally, paragraph 16 focuses on evidence about the effectiveness of controls in an audit of internal control.
 - Paragraph 31 pertains solely to the timing of tests of controls in an audit of internal control.
- Paragraphs 41 through 44 of the proposed standard *Evaluating Audit Results* unnecessarily repeat requirements and guidance existing in AS 5, and relate only to integrated audits. Because they have no relevance to the user of the proposed standards who is performing an audit of the financial statements only, and this guidance is already included in AS 5, we recommend these paragraphs be deleted from the proposed standards.

Style of the Proposed Standards

We believe that the structure of the proposed standards may unintentionally drive an auditor to use more of a checklist-oriented approach rather than a true assessment of risk and responsiveness to assessed risk. The overuse of presumptively mandatory requirements (i.e., use of the term "should") tends to take the focus away from an

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overarching risk-based audit objective and towards a list of required actions, which may or may not assist the auditor in achieving the overall objective. The reduction of presumptively mandatory requirements would also serve to streamline the proposed standards and direct the auditor to spend time where it is most needed – responding to identified and assessed risks.

We encourage the use of clearly stated objectives which provide the context for performing the requirements of each proposed standard. We also support clear separation of a stated requirement from its related application guidance. We recommend the Board more closely follow the format of the ISAs, which contain objectives, requirements, and related guidance in the form of application and other explanatory material. These components of each audit standard, clearly delineated, make it easier to apply the standards and focus on the overall objective.

We also encourage the Board to find areas of the proposed standards where guidance supporting a stated requirement is unnecessarily stated as a presumptively mandatory requirement using a “should” statement, therefore requiring specific action from the auditor. While in some places the proposed standards provide the appropriate amount of auditor flexibility (such as paragraph 15 of the proposed standard *Identifying and Assessing Risks of Misstatement*), the following are examples of what we believe are unnecessarily or overly prescriptive requirements:

- Paragraph 11 of the proposed standard *Audit Planning and Supervision* lists factors an auditor “should evaluate” regarding the selection of a particular location or business unit when multiple locations exist. We believe the presentation of a specific list of factors the auditor “should evaluate”, requiring specific evaluation of each item, rather than presenting these factors as application guidance, discourages use of professional judgment and identification of other relevant considerations.
- Paragraph 18 of the proposed standard *Audit Planning and Supervision* establishes a requirement by stating “the engagement partner should supervise other engagement team members...” Paragraphs 19 and 20 provide detail on how the requirements stated in paragraph 18 should be fulfilled through additional “should” statements. The initial stated requirement in paragraph 18 is appropriate and sufficient to impose the requirement. We recommend that paragraphs 19 and 20 be presented as application guidance for paragraph 18.
- Paragraph 9 of the proposed standard *Identifying and Assessing Risks of Misstatement* is very prescriptive regarding how the auditor is to achieve the objective stated in

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paragraph 8. The detailed presumptively mandatory requirements may limit the auditor's appropriate use of his or her professional judgment. We recommend the items in paragraph 9 be presented as factors the auditor may consider in understanding the company.

- Paragraph 52(d) of the proposed standard *Identifying and Assessing Risks of Material Misstatement* requires the auditor to make specific inquiries about fraud of "accounting and financial reporting personnel, including, in particular, employees involved in initiating, authorizing, processing, or recording complex or unusual transactions." We agree that the inquiries that are required in paragraphs 52(a), (b), and (c) of management, the audit committee, and internal audit personnel, respectively, are appropriate, and that the auditor should make inquiries of others as he or she considers necessary in the circumstances. However, the proposed requirement to inquire of the personnel described in paragraph 52(d) could involve an impractical number of individuals, without corresponding benefit to the audit process.

In combination, the lack of clear overarching audit objectives in each standard (or for some proposed standards, no stated objective) and the inclusion of very detailed presumptively mandatory requirements contradict the PCAOB's stated recognition of the importance to the audit process of sound professional judgment. We believe the proposed standards should promote the use of auditor judgment to tailor the audit based on facts and circumstances of an individual audit to achieve stated audit objectives.

Finally, there is lack of consistency in how definitions and application guidance are presented in the proposed standards. Definitions are included in varying ways throughout each proposed standard, including within the text of the proposed standard, as an appended glossary, or in a separate section of the proposed standard. Similarly, application guidance appears in varying forms—within the text of the proposed standards, as an appendix, or as "Notes" to paragraphs of the proposed standards. The lack of consistency among the proposed standards makes it more difficult for the auditor to know what level of audit requirement is being put forth.

We recommend the Board consider imposing a consistent structure to its proposed standards that include a principles-based objective, specific requirements to achieve the objectives, and additional guidance that assists the auditor in fulfilling the objective, but does not create additional presumptively mandatory requirements.

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Codification of PCAOB Standards

The Board's standards are becoming increasingly challenging and inefficient for practitioners to use. PCAOB Release No. 2008-006 states that the proposed standards will supersede five interim auditing standards (AU 311, AU 312, AU 313, AU 319, and AU 326). This will result in three separate types of PCAOB standards – the interim standards, Auditing Standards No. 1 through 6, and the new AU sections. As noted above, there is variety in the styles and structure among the seven proposed standards. There is even more variety when additional forms of existing PCAOB standards are considered.

We suggest a codification be provided so that practitioners are able to more readily navigate and apply the standards in a consistent manner. The codification should provide consistent identification of an objective, the stated requirements, and relevant application guidance. We believe this will improve the quality of audits. As the Board acknowledges, the principles set forth in the proposed standards are fundamental to the performance of a public company audit. As such, it is critical that the proposed standards be used as a foundation for the consistent integration of existing and future standards.

We also believe a codification would promote the integration of the audits of financial statements and internal control over financial reporting. Codification of PCAOB standards is likely to increase efficiencies when conducting an integrated audit (in part because it would mitigate the effect of the matters we note in the section titled "Integration with AS 5"), and allow for more consistent interpretation and application by practitioners.

PCAOB's Standards-Setting Process

We believe the PCAOB could improve its standards setting process by involving individuals with significant standards-setting experience and users of the PCAOB's standards earlier in the process. The input of these groups would result in a more effective and efficient process, and ensure that the majority of conflicts and implementation difficulties have been addressed and resolved in advance of exposure for public comment.

As noted above, we also believe the Board's process could benefit from leveraging more from the work already performed by the IAASB and use the ISAs as a common base for current and future standards-setting, modify as it sees fits for a public company audit. As noted in some of our comments above, it is unclear to us why the Board diverged from

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the ISAs with many of its requirements in the proposed standards. As noted above, we believe a more common base would allow for easier identification of differences, and fewer challenges to the auditor in applying the Board's standards to public company audits, resulting in higher quality audits.

Effective Date of the Proposed Standards

The PCAOB did not propose an effective date. In determining an appropriate effective date for the proposed standards, we encourage the Board to consider the need to provide sufficient time for firms to incorporate the standards into their audit methodology, develop or revise tools and documentation methods, and deliver training programs prior to implementation. The more divergent the final standards are from the standards of the IAASB and ASB, the longer the time should be to allow practitioners and firms to prepare. We believe at least 18 months is necessary between the adoption date and the effective date. In addition, due to the fundamental structural revisions we believe are necessary, we strongly urge the PCAOB to re-expose revised proposed standards, including a proposed implementation date, for public comment prior to adoption of the standards.

In summary, we appreciate the effort and time the Board and its staff have devoted to this proposal. While we believe the proposed standards are a step in the right direction of establishing risk-based audit standards for audits of public companies, we believe they require more consideration with respect to the areas outlined above. Above all, we believe audit standards that are of high quality and are as consistent as possible with those of other standards setters provide a common foundation for all audits and will result in better trained auditors applying auditing standards consistently, resulting in improved audit quality.

Thank you for the opportunity to comment on the proposed standards. 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,

Moss Adams LLP
Moss Adams LLP