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February 18, 2009

Public Company Accounting Oversight Board  
Office of the Secretary  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

***Re: Request for Public Comment on Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards (PCAOB Release No. 2008-006, October 21, 2008, Rulemaking Docket Matter No. 026)***

Deloitte & Touche LLP ("D&T") appreciates the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards* (PCAOB Release No. 2008-006, October 21, 2008, PCAOB Rulemaking Docket Matter No. 026) (the "Proposed Standards").

The issues presented herein are complex and will likely warrant further discussion to fully understand the implications of particular comments made by us and by other commenters. As such, we encourage the PCAOB to engage in active and transparent dialogue with commenters as the Proposed Standards are evaluated and changes are considered. Such a dialogue will facilitate a more complete understanding of the comments and the consideration of related implications, and, we believe, will ultimately improve the final standards and the auditor's ability to implement them effectively and efficiently. We would welcome such an opportunity to further discuss these matters with the Board and the staff. If you have any questions or would like to discuss these issues further, please do not hesitate to contact James Schnurr at (203) 761-3539 or John Fogarty at (203) 761-3227. We thank you for your consideration of these matters.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Mark W. Olson, PCAOB Chairman  
Daniel L. Goelzer, PCAOB Member  
Bill Gradison, PCAOB Member  
Steven B. Harris, PCAOB Member  
Charles D. Niemeier, PCAOB Member  
Thomas Ray, Chief Auditor and Director of Professional Standards

Mary L. Schapiro, SEC Chairman  
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## I. Introduction

The Proposed Standards will create the basis for the performance of public company audits in the U.S., and, as a result, this is an important undertaking on the part of the PCAOB. Overall, we support the fundamental concept of a risk-based audit approach, and we support the PCAOB's efforts to improve auditing standards related to the auditor's identification of and responses to risk in the conduct of an audit. While we are supportive of this standard-setting initiative, we believe certain improvements should be made to the Proposed Standards, as described herein.

In the Release to the Proposed Standards, the Board requested comments on a series of matters including (1) whether the Proposed Standards appropriately consider the provisions of the International Standards on Auditing (ISAs) and whether they reflect necessary differences from risk assessment standards applicable outside the U.S.; and (2) whether the principles of the risk assessment process are articulated appropriately in the Proposed Standards and whether the direction provided in the Proposed Standards is clear and sufficient.<sup>1</sup> In addition, during the open meeting to approve the Proposed Standards for public comment, Board Member Goelzer indicated the Board may consider additional steps to promote transparency in the standard-setting process depending on the comments received.<sup>2</sup> Our overall comments below focus on these matters and present our most significant concerns about the Proposed Standards that we believe the Board should address.

First, we believe the PCAOB should further enhance its consideration of the ISAs in its standard-setting process, both specifically as it pertains to the Proposed Standards and on a going-forward basis. We recognize the efforts of the Board and its staff to reach a "degree of commonality" with the ISAs in the development of the Proposed Standards.<sup>3</sup> We strongly support the Board's expressed intention to "eliminate unnecessary differences between the Board's risk assessment standards and other risk assessment standards."<sup>4</sup> However, we do not believe that the Proposed Standards achieve this goal, as many unnecessary differences exist between the Proposed Standards and the ISAs. The benefits of converging audit standards are well recognized and supported by many, including certain members of the PCAOB,<sup>5</sup> the U.S. Government Accountability Office (GAO),<sup>6</sup> the CFA Institute,<sup>7</sup> as well as leaders in the financial community

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<sup>1</sup> PCAOB Release to the Proposed Standards (the "Release"), pp. 7 and 9. See also Appendix 9 of the Release, *Additional Discussion of Proposed Auditing Standards and Conforming Amendments*.

<sup>2</sup> Statement of Board Member Daniel L. Goelzer on the Proposed Standards, October 21, 2008.

<sup>3</sup> See Release, page 8.

<sup>4</sup> Ibid.

<sup>5</sup> See, for example, Chairman Mark Olson's Remarks at FEE Conference on Audit Regulation Brussels (November 27, 2007) stating, "It makes sense to not only avoid creating unnecessary differences in auditing standards applicable to listed companies, but to work to bring them closer together." Also, PCAOB Board Member Bill Gradison's Remarks at Conference of the American Accounting Association Public Interest Section and the Academy of Accounting Historians (April 11, 2008), suggesting "that we move towards 'convergence' (or, if you prefer, 'harmonization') with International Standards of Auditing."

<sup>6</sup> See for example, GAO letter to the PCAOB on May 12, 2008 in response to the PCAOB's proposed Engagement Quality Review Standard and remarks of Jeffrey C. Steinhoff, Managing Director, Financial Management and Assurance, GAO, at the April 4, 2007 SEC Open Meeting, including his statement that, "[e]veryone will be best served by having standard setters develop consistent core auditing standards and, where there are any differences, to articulate why there is a difference or a need in the particular environment we're in. Inconsistencies in such core standards can increase audit costs and lead to potential confusion among management, users, and auditors."

<sup>7</sup> See the CFA Institute's official position, [i]t is in the best interests of investors and for global financial markets generally for the differing standards to be harmonized and complete convergence to be achieved at the earliest possible time. [http://www.cfainstitute.org/centre/topics/reporting/official/harmonization\\_convergence.html](http://www.cfainstitute.org/centre/topics/reporting/official/harmonization_convergence.html)

who helped develop the recommendations regarding *Sustaining New York's and the US' Global Financial Services Leadership* (the "Bloomberg/Schumer Report").<sup>8</sup> In order to achieve these benefits and eliminate unnecessary differences with other risk assessment standards, we recommend the Board establish a standard-setting process whereby it uses the language in the ISAs (which are developed with PCAOB input) as the starting point (i.e., the "base"), and then adds to or modifies it as the Board determines necessary for audits of U.S. public companies.

Second, we believe the PCAOB should make additional improvements to the structure, composition, and drafting of its standards in order to more clearly communicate its expectations of auditors, enhance the usability of the standards, and improve their application. It is imperative for auditors to have a clear understanding of the standards in order to be able to apply them. We believe the PCAOB could significantly improve the understanding and application of its standards by clearly communicating the objectives of an audit through the adoption of an overall audit objectives standard and by developing and using consistent drafting guidelines for its auditing standards.

Third, we believe it is critical for the PCAOB to improve the transparency of its standard-setting process. Transparency could be increased, for instance, by having more public dialogue and debate about draft standards, sharing draft standards with advisory task forces and/or the public prior to their issuance, and having a second exposure draft of proposed standards if significant comments are received. Greater transparency would provide greater opportunity for gaining valuable insights, promote the development of quality standards, and lead to a better understanding and application of the final standards.

These Overall Comments are discussed further below, along with illustrative examples to explain our concerns. Our Overall Comments were developed not only based on the request for comments as highlighted above, but also based on the general themes emanating from our detailed comments on the Proposed Standards, which are explained in the Exhibits as follows:

- Exhibit 1 to this letter contains detailed comments on each of the Proposed Standards and the Conforming Amendments. These comments are reflective of the impact of the process and approach in developing the Proposed Standards. In order to illustrate the relation between the detailed comments in Exhibit 1 to our Overall Comments, the detailed comments are provided in columnar format with a reference, where applicable, to the related Overall Comment(s).
- Exhibit 2 provides our answers to the questions posed by the PCAOB in Appendix 9 of the Release. To answer several of the questions we refer to comments provided in Exhibit 1.
- Exhibit 3 provides our editorial comments, which are not significant but should be considered and addressed.

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<sup>8</sup> See [Recommendation 5](#), which, in part, states, "...the PCAOB should work with other national and international bodies towards a single set of global audit standards."  
[http://schumer.senate.gov/SchumerWebsite/pressroom/special\\_reports/2007/NY\\_REPORT%20FINAL.pdf](http://schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20FINAL.pdf)

## II. Overall Comments

Like the Board, we believe these Proposed Standards have the potential to set the "foundation for future standard-setting."<sup>9</sup> As Board Member Goelzer described, "[a] sound and sophisticated understanding of the risks of material misstatement, and planning and executing an audit in a way that responds to those risks, are essential to affording investors reasonable assurance that financial statements are free of material error."<sup>10</sup> With the foundational importance of these Proposed Standards in mind, as well as the Board's request for comments on whether the Proposed Standards reflect "necessary differences from risk assessment standards applicable outside the United States," we provide the following comments.<sup>11</sup>

### *A. Convergence of Standards*

#### ***1. The Board's consideration of the work by other standard setters is critically important in enhancing the effectiveness and efficiency with which standards are widely understood, implemented, and applied.***

We strongly believe that the PCAOB should further enhance the convergence of its standard-setting activities with those of the International Audit and Assurance Standards Board (the "IAASB"), both in relation to the Proposed Standards and on a going-forward basis. The PCAOB's Strategic Plan outlines its intention to benefit from the work of other standard setters and professional bodies and to leverage best practices and other auditing enhancements made by the IAASB and the Auditing Standards Board (the "ASB"). We believe significant opportunities exist to more fully leverage standard-setting work that has been completed and is currently taking place. For example, the PCAOB currently attends and participates in IAASB meetings, thereby providing input to the IAASB standard-setting process. As such, we believe it would be appropriate and logical for the PCAOB, in developing its own standards, to use the ISAs as the starting point. For those specific areas where the Board believes different requirements are needed for purposes of conducting an audit of a U.S. public company, the Board should diverge from the ISAs and add to or modify the ISA language as appropriate. Such an approach is consistent with the PCAOB's Strategic Plan as discussed above. Furthermore, following the above standard-setting approach would create several benefits.

First, converging auditing standards may significantly improve the performance of audits around the world. A general understanding exists of the creation process for the ISAs and the rationale behind the adoption of certain provisions, primarily due to the transparency of the IAASB's process and its broad-based membership. Moreover, many firms develop their global audit methodologies based on the ISAs. Adding PCAOB requirements and guidance to an ISA base will improve the overall understanding by all parties around the world of what is expected by the PCAOB for audits performed for U.S. public companies. Additionally, such an approach may result in other countries (and the IAASB) adopting requirements similar to those added by the PCAOB, much like the replication by other countries to create auditor oversight bodies similar to the PCAOB. Creating audit standards in such a way that any "plus PCAOB" requirements are

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<sup>9</sup> See Release, page 6.

<sup>10</sup> Statement of Board Member Daniel L Goelzer on the Proposed Standards, October 21, 2008.

<sup>11</sup> See Release, page 9.

obvious will make it easier for other countries (and the IAASB) to consider adding the same requirements.

Second, using the ISAs as a base would reduce confusion and misapplication of the standards in the U.S. It is much easier for auditors to understand, follow, implement, and apply one set of base standards (with specific additions for public company audits). The current process followed by the PCAOB to use different wording to explain the requirements and guidance for an audit is confusing. In many cases, the Proposed Standards are unclear as to whether the PCAOB is creating a different requirement or intends the same meaning, particularly when the Board seems to be referring to or explaining the same process or concept, but uses different words to do so.<sup>12</sup> Using different language significantly adds to the complexity of the standards, challenging auditors to interpret what exactly is required, which serves to adversely affect audit quality and efficiency (i.e., auditors will each independently and needlessly spend significant time attempting to interpret the standards' requirements, or may misinterpret the standards, and, as a result, may perform insufficient or inappropriate procedures). This confusion and complexity could grow exponentially as the PCAOB continues to issue new audit standards and revises its interim audit standards using the same approach as used in the Proposed Standards. Using the ISAs as a base will help avoid unintentional changes in practice, make the intentional changes obvious to all interested parties, and make comparability between the standards more apparent – all of which will help auditors apply the standards in practice.<sup>13</sup>

Third, having multiple sets of standards in the U.S. that use significantly different language, where the reasons for the differences are not clearly explained (and may be unintended), increases costs associated with educating, training, testing, and supervising auditors, and developing tools and methodologies, as well as standard-setting. In general, we believe standards should support the performance of both effective and cost-efficient audits. In this time of increased focus on costs, it is even more important to avoid duplication of efforts among standard-setters and to avoid creating obstacles to audit effectiveness and efficiency.

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<sup>12</sup> For example, Appendix 1, paragraph 3 states the following: "To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud." This guidance is in contrast to an equivalent paragraph in ISA 200, paragraph 17, which states the following: "To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion." It appears the PCAOB guidance is communicating the same information but using different language. It is not clear why the PCAOB Proposed Standard incorporates the "to form an appropriate basis" language and whether this language may in fact be intended to mean something other than obtaining reasonable assurance. If the PCAOB were using the ISAs as a base, paragraph 3 of Appendix 1 could state the following: "To obtain reasonable assurance, the auditor *must* obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion" (emphasis added to show changed words). Since it appears the PCAOB is communicating the same concept as that conveyed in ISA 200, paragraph 17, it appears appropriate in this instance to change only the "shall" to "must" to be consistent with PCAOB Rule 3101. By using this approach, it becomes clear that the PCAOB is conveying the same concept as what is in the ISA, and it is understandable to the reader why certain words need to be changed.

<sup>13</sup> We believe there could be many instances in the Proposed Standards where differences may have been unintentionally created. For instance, Appendix 4, Paragraph 4c states that, "[a]s part of the auditor's response to the risks of material misstatement due to fraud ("fraud risks"), the auditor should incorporate an element of unpredictability in the selection of auditing procedures..." In this paragraph, it appears the PCAOB is limiting the incorporation of elements of unpredictability to those areas identified as fraud risks. We do not believe this is the intention of the Board. We note that the language in this paragraph that refers to fraud is different than the language in the ISAs. (See ISA 330, paragraph A1).

For all of these reasons, we believe the Board should use the ISAs as the base for (1) the Proposed Standards, (2) updating its interim standards, and (3) developing new standards. We understand and accept that differences between PCAOB standards and the ISAs may be appropriate and needed; however, we also believe such differences should be clearly identified and understood by all parties. To facilitate this process, the PCAOB should continue to provide input as the ISAs are developed. When later developing its own versions of such standards, we recommend that the PCAOB commit to making changes only as needed to address issues particular to the audits of public companies in the U.S. In those instances where the Board decides to diverge from the ISAs, the Board should provide a clear and full explanation of the difference, the reason for the difference, and the intended outcome. Providing such information would improve the auditor's understanding of the Board's standards, the auditor's ability to apply the standards, and the transparency of the Board's standard-setting process.

We further encourage the PCAOB to consider how it may best leverage work that is currently being performed through the ASB standard-setting process, particularly as the PCAOB commences its process to review and update its interim standards. The ASB is in its first year of a three-year project to improve the clarity of its standards and converge them with recently approved clarified ISAs.<sup>14</sup> Through this process, all current ASB standards (Statements on Auditing Standards or SAs) will be updated using an ISA base, with modifications only (1) as needed to better serve the needs of U.S. users of audited financial statements for nonissuers or (2) as appropriate for U.S. legal and regulatory reasons. The PCAOB may find it very helpful to observe and participate in this clarity project. We are not suggesting the PCAOB's standard-setting mission and review of its interim standards be narrowed or limited, but rather that the PCAOB may effectively and more efficiently accomplish its mission by leveraging its efforts through collaboration with the ASB. For instance, PCAOB staff could attend ASB meetings, participate in the discussions as the ASB is continuing its clarity project, comment on draft ASB standards, and use those meetings to gain additional insights as to how best to update the PCAOB interim standards. The ASB, we believe, would be very open to hearing the views of the PCAOB, such input would add value to the ASB's deliberations, and would provide the opportunity for the PCAOB to influence the ASB standard-setting process (which may ultimately lead to fewer differences between PCAOB and ASB standards). Similarly, staff from the U.S. General Accounting Office attend and participate in ASB meetings, observe and participate in ASB task forces, and comment on ASB draft standards, thereby providing input throughout the ASB standard-setting process.

We would also support the idea of the PCAOB, IAASB, and ASB working together to "develop a road map for a systematic, joint, comprehensive standard-by-standard review, identifying and merging the highest quality aspects of each standard," as suggested by Board Member Gradison.<sup>15</sup>

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<sup>14</sup> See the *Auditing Standards Board International Convergence Plan* at the following link: [http://www.aicpa.org/download/auditstd/ASB\\_Convergence\\_Plan.pdf](http://www.aicpa.org/download/auditstd/ASB_Convergence_Plan.pdf) and the ASB's Discussion Paper, *Improving the Clarity of ASB Standards*.

<sup>15</sup> See Board Member Gradison's Remarks to the Colorado Society of CPAs, December 19, 2008.



**2. The Board should carefully consider the need for each requirement and balance such need with the ability to exercise auditor judgment based on principles and objectives.**

In its Release, the Board specifically seeks comment on how the Proposed Standards would change current practice and whether the Proposed Standards allow sufficient flexibility in the audit process.<sup>16</sup> We are concerned with how the Proposed Standards are drafted in light of PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* ("Rule 3101") and the impact of such drafting on auditor performance. We believe the manner in which the Proposed Standards are constructed result in additional required audit procedures, less emphasis on auditor judgment in performing such procedures, and less flexibility in the standards for the auditor to tailor procedures based on risk, size, and complexity of the company being audited, and additional audit documentation requirements. Irrespective of whether the PCAOB decides to use the ISAs as a base in developing its audit standards, we believe the Board should evaluate its application of Rule 3101 in the Proposed Standards.

Under the Board's Rule 3101, the auditor is required to fulfill specific responsibilities within an audit standard based on use of the words "must" or "should" (i.e., an "unconditional" or a "presumptively mandatory" responsibility, respectively).<sup>17</sup> In order for the auditor to demonstrate that he or she has fulfilled these responsibilities, and to comply with Auditing Standard No. 3, *Audit Documentation* (AS No. 3), he or she must have appropriate documentation within the working papers demonstrating what procedures were performed relative to each instance of a "must" or a "should." We noted that there are 218 instances within the Proposed Standards where either an unconditional or presumptively mandatory responsibility exists. We note that in many instances the PCAOB has elevated guidance and application material in the ISAs to presumptively mandatory requirements in the Proposed Standards. For example:

- Appendix 2, paragraph 17 states, "[t]he auditor should determine whether it is necessary to expand the planning activities to establish an appropriate audit strategy and audit plan, e.g., to determine the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the opening balances," whereas this is application guidance in the ISAs (see paragraph A21 in ISA 300, *Planning an Audit of Financial Statements*).<sup>18</sup>
- Appendix 5, paragraph 11 includes a presumptively mandatory responsibility for the auditor to evaluate whether management's responses to unusual trends have been "vague." In contrast, Appendix 3 of ISA 240, *The Auditor's Responsibility to Consider*

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<sup>16</sup> See Release, page 6.

<sup>17</sup> PCAOB Rule 3101, sets forth three degrees of auditor responsibility based on the word usage in PCAOB audit standards as follows:

- *Unconditional Responsibility:* The words "must," "shall," and "is required" indicate unconditional responsibilities. The auditor must fulfill responsibilities of this type in all cases in which the circumstances exist to which the requirement applies.
- *Presumptively Mandatory Responsibility:* The word "should" indicates responsibilities that are presumptively mandatory. The auditor must comply with requirements of this type specified in the Board's standards unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard.
- *Responsibility to Consider:* The words "may," "might," "could," and other terms and phrases describe actions and procedures that auditors have a responsibility to consider.

<sup>18</sup> All references to ISAs herein refer to the ISAs as redrafted through the IAASB's clarity project. Information about the IAASB's clarity project can be found at the following link: <http://www.ifac.org/MediaCenter/?q=node/view/608>.

*Fraud in an Audit of Financial Statements*, provides this as an example of applying the guidance.

Also, in many instances, the Proposed Standards introduce a presumptively mandatory responsibility followed by lists of procedures the auditor "should" perform. As a result, the amount of auditor effort necessary to address and document compliance with the presumptively mandatory responsibility vastly increases when we believe the overarching requirement could be addressed through a subset of the procedures in the list. In several cases, the long lists are elevated from application material in the ISAs, where they are presented as guidance on how the auditor may address the overarching requirement. For example:

- Appendix 3, paragraph 52 contains a significant number of detailed inquiries the auditor "should include" related to fraud risk, including creating a presumptively mandatory responsibility for the auditor to inquire of accounting and financial reporting personnel. (See further discussion of this paragraph in Exhibit 1.)

We are concerned that writing standards to create multiple presumptively mandatory responsibilities will significantly impact audit quality and how audit work is assessed by the PCAOB (through its inspection process) and others (e.g., in the litigation context). This approach to drafting standards will likely encourage a check-the box approach to auditing and place an undue focus on performing and documenting work to demonstrate compliance, rather than a thoughtful process whereby auditors design and apply audit procedures based on the assessed risks and the auditor's judgment in responding to those risks. We believe audit standards should allow for the application of judgment so that (1) the audit can be designed based on the facts and circumstances present; and (2) the auditor is not inhibited or discouraged from looking beyond prescribed lists of procedures to consider other procedures that may be necessary and appropriate. Such a principles-based approach to setting standards results in the performance of quality audits.

Further, we believe the PCAOB inspection process must be capable of operating under principles-based standards and of accepting auditors exercising professional judgment consistent with such principles-based standards. Otherwise, auditors will become reluctant to engage in the exercise of judgment that is so critical to the performance of an effective audit. Auditors make significant judgments about which areas of a company and its financial reporting pose the greatest risk, where audit resources should be allocated, and what procedures should be performed to address the identified risks. Seasoned judgment allows for audits to be conducted in an effective and efficient manner by focusing effort on the most significant areas, and where the greatest risk of misstatement lies. Unless the inspection process respects auditor judgment, auditors will become incentivized to follow the check-the-box approach described above. This clearly is contrary to the purpose of a risk-based audit approach, and the conduct of quality audits.

Based on the above, we recommend the Board consider whether, in each instance, it is necessary and appropriate to elevate guidance in the ISAs to a presumptively mandatory responsibility in the Proposed Standards, particularly in light of the reduced auditor flexibility and increased documentation requirements that result. In this same regard, we also recommend that the Board limit the use of "must" and "should" within the Proposed Standards to only the primary objectives, or the broad principles applicable to the risk assessment process, and that these primary principles be followed with example procedures for the auditor to consider. This will allow the auditor to plan and perform a more effective and efficient audit, without having to focus on performing a prescribed list of procedures and preparing documentation to demonstrate compliance

with the repeated uses ( 218 occurrences) of these words, while at the same time providing sufficient and helpful guidance for the auditor to follow.

**3. *The Board should use definitions and phrases in a manner consistent with other standard setters.***

Regardless of whether the PCAOB decides to use the ISAs as a starting point in developing its standards, the Board should use definitions and phrases consistent with the ISAs, unless the Board is intending a difference in the conduct of the audit. In the Proposed Standards certain definitions and phrases are different than those used in the ISAs, and it is not clear what result the different language is intended to achieve. For example:

- Appendix 1 includes a definition of risk of material misstatement that is different than the ISAs. (Please see further discussion regarding paragraph 5 of Appendix 1 in Exhibit 1.)
- In several instances, the word "determine" is used in the Proposed Standards whereas "establish" or "evaluate" is used in the corresponding ISA.
  - For example, Appendix 2, paragraph 6b states the auditor should "determine" compliance rather than "evaluate" compliance as is stated in ISA 300, paragraph 5b.
- The Proposed Standards use the phrase "significant account and disclosure" rather than "material class of transactions, account balance, and disclosure." (See, for example, Appendix 4, paragraph 40 in contrast to ISA 330, paragraph 20.)
- The Proposed Standards use the phrase "plan and perform the audit" rather than "design and perform audit procedures," which is used in the ISAs. (See for instance, Appendix 7, paragraph 4 in contrast to ISA 500, paragraph 6.)

We recommend, to avoid confusion among all parties and to avoid unnecessary implementation issues and costs, that the PCAOB use the same definitions and phrases as those used in the IAASB and ASB standards, unless the PCAOB is intending a change in auditor procedures. We also recommend, as discussed above, that when the Board determines a difference is appropriate, that it clarify the purpose of the difference, what the difference means, and what resultant change in auditor conduct is expected. Or, alternatively, if the Board intends the same meaning, but believes it is inappropriate to conform, it should be explained that certain definitions and phrases used by the PCAOB are intended to convey the same concept as those in the IAASB and ASB standards.

***B. Drafting Conventions for Audit Standards (Including Content and Structure)***

We believe it is very important for the Board to explain the fundamental concepts related to the performance of audits and to create guiding principles related to the development of PCAOB standards. Doing so will help clearly communicate the principles of the audit and expectations for auditors. To achieve this, we recommend the following.

## ***1. Propose and adopt an overall audit objectives standard***

In its Release, the Board sought comment on whether the fundamental principles of the audit process are appropriately articulated in the Proposed Standards.<sup>19</sup> While we agree that some of these fundamental principles are articulated, they are intermingled throughout the various standards, and some are missing, such as a discussion about reasonable assurance and limitations of an audit. We believe, in order to clearly articulate the fundamental principles of the audit, the PCAOB should propose and adopt a standard that explains the overall objectives of an audit.

Such a standard would:

- Establish the auditor's overall responsibility when conducting an audit;
- Set out the overall objectives of the auditor;
- Explain the nature and scope of the audit and the inherent limitations of an audit;
- Explain the scope, authority, and structure of the PCAOB standards, including language that denotes requirements;
- Include a discussion of the use of professional judgment;
- Explain how the objectives of each standard relate to the overall framework of PCAOB standards.

The lack of such a PCAOB standard makes it difficult to understand the basic principles critical to understanding the objective of the audit, the level of assurance an audit provides, and the responsibilities of an auditor under the PCAOB standards. For example, the Proposed Standards do not provide a definition of "sufficient appropriate audit evidence;" therefore, when this term is used, the full context of its meaning is not clear.<sup>20</sup> In contrast, the ISAs the concept of sufficient appropriate audit evidence is explained in ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*. To avoid any misunderstandings about the principle concepts related to an audit, we recommend that the PCAOB use the material in Appendix 1 of the Proposed Standards and ISA 200 to propose and adopt an overall audit objectives standard, in lieu of adopting Appendix 1 as proposed. We believe such an overall audit objectives standard is important to fully understand the Proposed Standards, and, as such, we recommend that such a standard be part of the consideration of these Proposed Standards.

## ***2. Include clear objectives in all PCAOB standards***

We support the inclusion of objectives in the Proposed Standards. Each objective should contain a statement of purpose of the standard. However, they should not contain "must" or "should" statements requiring auditor performance. The "must" and "should" statements should be reserved for the requirements within the standard that support the objective and lead to meeting the objective.

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<sup>19</sup> See Release, page 7.

<sup>20</sup> "Sufficient appropriate audit evidence" can be explained in its fullest context as follows: The auditor gathers sufficient appropriate audit evidence in order to reduce audit risk to an acceptably low level and thereby enables the auditor to draw reasonable conclusions on which to base the auditor's opinion and provide reasonable assurance.

We note that the previous six standards approved by the Board do not include objectives. Currently, it is not clear what the Board intends in terms of re-drafting prior standards to include objectives. We recommend the Board revisit these prior standards to include objectives. Additionally, we recommend the Board follow the practice of setting objectives in its consideration of future standards and in its review of the interim standards.

### ***3. Enhance the integration of the audit by avoiding redundancy in the Proposed Standards***

In its Release, the Board sought comment on enhancing the integration of the audit and the issue of whether incorporating aspects of AS No. 5 will help to improve the effectiveness and efficiency of the audit.<sup>21</sup> We believe the current partial integration and repetition of AS No. 5 and AU 316 in the Proposed Standards is confusing and will detract from the effectiveness and efficiency of the audit. With partial integration, the auditor may think he or she is looking at the entirety of the guidance, when in fact additional guidance resides in AS No. 5 and AU 316. This may result in the auditor not being aware that additional guidance is available and not reading or following that additional guidance. Also, repeated guidance may result in the auditor, upon seeing similar guidance, consulting other related standards to verify if the guidance is identical. Such needless exercise results in inefficiencies, and can be avoided simply by not repeating guidance.

Additionally, language throughout the Proposed Standards creates the impression that the auditor performs two separate risk assessments (when performing an integrated audit) and that the audit of internal control over financial reporting (ICFR) is separate from the audit of the financial statements. For instance, paragraph 1 of Appendix 1 refers to one risk assessment process for the financial statement audit and then states that AS No. 5 establishes requirements and provides direction regarding the auditor's consideration of risk in an audit of ICFR.

Based on the above, it is difficult to understand how these Proposed Standards will be integrated with the Board's other interim standards and with PCAOB Auditing Standards Nos. 1-6. Because of the repetition, it is not clear how the Proposed Standards will be codified in combination with existing standards. Without codification, the Board's standards will be difficult to follow.

Instead of repeating certain paragraphs in the Proposed Standards, we recommend that if guidance from AS No. 5 is equally relevant to an audit of the financial statements, it should be incorporated into the Proposed Standards and removed from AS No. 5 through a conforming amendment. In contrast, if there is guidance incorporated from AS No. 5 into the Proposed Standards that has no relevance unless the auditor is performing an integrated audit, we believe the guidance should remain in AS No. 5. For Example, Appendix 4, paragraphs 10, 14-17, 31-32, and 36 need not be repeated in the Proposed Standards; these paragraphs relate only to an audit of ICFR and would remain in AS No. 5. Additionally, to further enhance the integration of the audit, we recommend that AU 316 be fully incorporated into the Proposed Standards. Further, it should be made clear throughout the standards that when performing an integrated audit, the auditor performs one risk assessment process.

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<sup>21</sup> See Release, page 7.

#### **4. Consistently apply or revise PCAOB Rule 3101, Certain Terms Used in Auditing and Related Professional Practice Standards**

The application of Rule 3101 in the Proposed Standards is not consistent with the language in Rule 3101. For instance, the Proposed Standards include the following phrases:

- The auditor "should take into account."
- For example, Appendix 4, paragraph 48 requires that "the auditor should take into account" certain matters in determining whether it is appropriate to perform substantive procedures at interim.
- The auditor "should not assume." (See comments on Appendix 3, paragraph 60 in Exhibit 1)

Since these phrases are not included or explained in Rule 3101, it is not clear how and whether the auditor would be expected to document or demonstrate compliance in these situations.

Additionally, in some cases, the present tense or the phrase "needs to be" is used in the Proposed Standards. Using the present tense and the phrase "needs to be" creates ambiguity and confusion as to what is required, as it is not clear how such phraseology fits into the Rule 3101 framework, and these statements are provided without explaining how the auditor's procedures should be performed. For example:

- Appendix 3, paragraph 11 states "Industry, regulatory, and other external factors that are relevant to the auditor's understanding..."
- Appendix 3, paragraph 12 states "Obtaining an understanding of the nature of the company includes obtaining an understanding of the following..."
- Appendix 4, paragraph 39 states that "the degree of reliance on controls needs to be reassessed..."
- Appendix 6, paragraph 5 states that "the materiality level for the financial statements as a whole needs to be expressed as a specified amount."

Moreover, a consistent rationale or a meaningful set of criteria is not apparent for making certain procedures requirements. For example, in Appendix 3, paragraphs 8-19 are written using various Rule 3101 word constructions; however, all of these paragraphs relate to how an auditor "should obtain an understanding of the company and its environment," which is the overarching presumptively mandatory responsibility in paragraph 8. For example, paragraph 13 states "the auditor *should consider* performing the following procedures...", paragraph 15 states "the following *are examples* of business risks that *might be relevant*," and paragraph 17 states "the following *examples...might affect*." As the overarching presumptively mandatory responsibility exists in paragraph 8, one would expect consistent direction in achieving paragraph 8 in the paragraphs that follow; however, this is not the case. See further discussion of this comment in Exhibit 1.

Based on the foregoing, we recommend that the PCAOB reconsider Rule 3101, as it appears the application of Rule 3101 has become cumbersome and unwieldy in writing standards. Further, auditors may be applying the Rule 3101 levels of responsibility differently than intended by the Board. For example, perhaps it is not the intention of the Board to require the auditor to document

the procedures performed and related results of all "should" statements. This is something the Board should consider in revisiting Rule 3101.

We also recommend the PCAOB consider using "shall" as it is defined and used in the ISAs for those matters that are to be requirements, instead of the must/should construction under Rule 3101. The *Preface to the International Standards on Quality Control, Auditing Review, Other Assurance and Related Services* explains that the word "shall" is used to express requirements and, further, that:

The auditor complies with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective. A requirement is not relevant only in the cases where: the ISA is not relevant; or the circumstances envisioned do not apply because the requirement is conditional and the condition does not exist. The auditor is not required to comply with a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.<sup>22</sup>

As a result, the word "shall" in the ISAs is a stricter construction than use of the word "should" under Rule 3101; it is also different than the use of "must/shall" under Rule 3101. Adopting the use of "shall" as defined above would simplify PCAOBs standards, and would be consistent with the ISAs.

Additionally, we recommend the PCAOB develop a set of guidelines for using certain terms (such as "assess," "determine," "establish," "evaluate," etc.) and for using the present tense (for instance when providing a statement of fact), so that auditor performance requirements and expectations are clear. In applying such guidelines in the standard-setting process, the Board should consider the implications of the language chosen, including the resulting audit performance and documentation requirements, and consider whether the result will be an improvement in audit quality. Both the IAASB and ASB have put forth such drafting guidelines, which we believe would be helpful in this regard.

##### ***5. Follow a set order for all standards***

We recommend that, in drafting standards, all requirements be explained first in the standard, followed by application guidance. Currently, requirements are spread throughout the Proposed Standards in paragraphs, notes, and appendices. As a result, it is more difficult for the auditor to find all of the required procedures and it is more difficult to assess whether all requirements are met. Placing the requirements first followed by additional guidance is the structure used by both the IAASB and the ASB in developing their clarified standards. Further, in adopting this structure the ASB has received very favorable comments from auditors, many of whom are small practitioners, to the effect that standards organized in this manner are much easier to understand, read, and apply.

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<sup>22</sup> See *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, paragraphs 17-18. December 2006.

## **6. *Modify the use of Notes and Appendices within the standards***

The practice of using Notes in the Proposed Standards is confusing. The authority of Notes is not clear, and they are used for different purposes. In many cases, Notes contain presumptively mandatory responsibilities, and it is not clear whether this guidance is intended to be a part of the standard. For example, paragraph 21 of Appendix 3 contains a Note that states the auditor "should obtain an understanding of controls over the completeness and accuracy of that information..." Also, in some instances Notes contain references to other standards, but in other cases, similar references to other standards reside in the footnotes. For example, paragraph 42 of Appendix 4 contains a Note that refers to the Proposed Standard *Audit Evidence*. In contrast, paragraph 41 of Appendix 4 contains a Note with a footnote referring to AU sec. 350 *Audit Sampling*.

The practice of including certain guidance, including presumptively mandatory responsibilities, in Appendices is also confusing. For example, Appendix 3 of the Proposed Standards contains its own Appendix, and this Appendix includes presumptively mandatory requirements such as, "the auditor should obtain an understanding of how a company uses IT..." (see paragraph A1 of the Appendix to Appendix 3). Practitioners may not know how to apply this presumptively mandatory responsibility, as it is not clear what level of authority Appendices maintain within the PCAOB standards. Current PCAOB interim standards explain the following regarding Appendices:

Interpretive publications consist of auditing Interpretations of the SASs, *appendices to the SASs*, auditing guidance included in AICPA Audit and Accounting Guides, and AICPA auditing Statements of Position. Interpretive publications are not auditing standards. Interpretive publications are recommendations on the application of the SASs in specific circumstances, including engagements for entities in specialized industries....The auditor should be aware of and consider interpretive publications applicable to his or her audit. If the auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance.<sup>23</sup> (Emphasis added.)

So, while "should" statements are within Appendices to the Proposed Standards, some may view these matters as "interpretive publications" to be aware of rather than presumptively mandatory responsibilities.

Based on the above, we believe auditor responsibilities (as defined in Rule 3101) should not be presented in Notes, Appendices, or footnotes. We recommend that the PCAOB end the practice of using Notes, avoid using Appendices, and that all auditor requirements, presumptively mandatory requirements, and considerations be presented in numbered paragraphs within a standard.

## **7. *Provide a glossary of terms***

We recommend the Board follow a consistent approach with respect to defining terms. Some of the Proposed Standards (e.g., Appendix 3) define terms in a Definitions section. Other Proposed Standards define terms within the text of the standard (e.g., the definition of fraud risk in paragraph 4c of Appendix 4.) When the PCAOB adopted AS No. 5, however, a glossary of terms

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<sup>23</sup> See PCAOB Interim Standards, AU 150.05 and 150.06.



was included in an Appendix. We recommend the PCAOB consistently define terms in a Definitions section of each standard, as appropriate, and create a Glossary with all defined terms.

#### ***8. Seek public comment on a reasonable effective date for the of Proposed Standards***

We note that the Proposed Standards do not contain a proposed effective date. Prior to adopting an effective date, the Board should seek public comment on what would be a manageable implementation timetable. The amount of lead-time needed to implement a new audit standard depends upon the extent of changes in practice the standard will necessitate. However, it is most helpful (in terms of providing an adequate time frame to properly train our professionals and to modify methodologies and tools) if new standards become effective for audits of fiscal years beginning twelve months after the date the SEC approves the final standard.

#### ***C. Transparency and Public Involvement in the Standard-Setting Process***

##### ***1. The PCAOB should improve the transparency of its standard-setting process to provide greater opportunity for gaining valuable insights, promote the development of quality standards, and lead to a better understanding and application of final standards.***

The Board should increase the transparency of its standard-setting process, and develop practices to receive additional public input as standards are developed. This can be achieved, for example, by:

- Improving the visibility of Proposed Standards as they are being developed;
- Holding additional roundtables, providing detailed direct comparisons of proposed standards and new standards to current standards and to the ISAs;
- Re-exposing a revised standard after considering public comments prior to Board adoption;
- Using the SAG meetings as a vehicle to discuss comment letters and responses to the comments; and
- Having the Board more publicly debate the various issues when considering standards.

Further, the PCAOB could improve its transparency by establishing task forces of members with significant auditing expertise to deliberate standards at a level of detail that is not currently discussed at SAG meetings. Such detailed discussions would provide the Board with needed input and reactions from practitioners as to the implications, usability, and application of the standards, prior to their proposal.<sup>24</sup> Additionally, more visible and active participation by the PCAOB in the IAASB and ASB standard-setting process, including submitting comment letters, is yet another way for the PCAOB to be more transparent about its views and considerations, as the IAASB and ASB meetings are open to the public.

The Sarbanes-Oxley Act of 2002 (the "Act") and the Board's rules provide significant flexibility to the Board in determining the best way to establish professional standards and in using various means to accomplish its standard-setting objectives. Section 103 of the Act states:

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<sup>24</sup> If the PCAOB adopts the ISA base approach to its standard-setting process, these discussions could be focused on the areas where the PCAOB is considering diverging from the ISAs.

...the Board shall, by rule, establish, including to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4)...

Paragraph 4 of Section 103 of the Act states the following:

The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

Additionally, PCAOB Rule 3700 regarding Advisory Groups allows the Board to convene one or more advisory groups, in accordance with Section 103(a)(4) of the Act, to assist it in carrying out its responsibility to establish auditing and related professional practice standards. As a result, the Board may establish, at its discretion, ad hoc task forces to assist in the establishment of professional standards.

The Board should use the flexibility it has to enhance the input and feedback received throughout the standard-setting process. Neither the Act nor the Board's rules limit the means by which the PCAOB can make the standard-setting process transparent. The result will be improved quality, enhanced understanding, and improved application of the PCAOB standards.

### **III. Significant Detailed Comments**

As discussed in the Introduction, our detailed comments on the Proposed Standards are described in Exhibit 1. Of the many detailed comments we have, the matters discussed below are of greatest concern. These matters are presented here in order to highlight those issues which, depending on how they are resolved, may have the most significant impact on the performance of an audit. The comments explained below are not repeated in Exhibit 1.

#### Appendix 3

- *Definition of significant risk.* The PCAOB's definition of significant risk in Appendix 3 is different than that of the ISAs. The proposed definition does not refer to "identified and assessed" risks, but rather only refers to "risks." The resulting implications are unclear. We believe the definition of significant risk should use the phrase "identified and assessed" risk. The concept of the auditor's risk assessment process is that the auditor identifies and then assesses significant risk, and then plans the audit procedures according to the "identified and assessed" risks. To remove these descriptors from the definition results in the auditor's risk assessment process becoming disconnected from the planned audit procedures and is contrary to the fundamental premise of the auditor's risk assessment forming the basis for the auditor's procedures.
- *Effect of fraud risk factors on the understanding of controls.* Appendix 3 provides guidance for the evaluation of controls over financial reporting, including topics that are highly dependent on the attitudes and actions of management, such as management's philosophy, style, integrity and risk assessment process (see paragraph 26). However, the Proposed Standards do not mention or require any consideration of the potential

- management bias that may exist due to the existence of significant incentives/pressures, opportunities, or attitudes/rationalizations. These "fraud risk factors" are addressed elsewhere in the standard (see paragraph 58), but there is no guidance to consider how the presence of those factors could undermine the effectiveness of otherwise well-designed controls.
- Management override. The guidance provided in the Proposed Standards regarding the risk of management override is minimal. Appendix 3 makes passing references to management override (paragraphs 52, 62, 65); and Appendix 4 provides some guidance (see paragraphs 9-13). As a result, the Proposed Standards do not recognize the pervasive effect of this risk. We note that AU 316 contains guidance with respect to how to respond, but does not discuss how to assess the risk of management override.
  - Risk factors vs. fraud risk factors. The promulgation of these standards creates an opportunity to develop an integrated list of risk factors. Appendix 3 refers to the existing list of fraud risk factors in AU 316. A review of that list reveals that many of the items are also indicators of potential errors. An integrated list could be set up in table form with columns for fraud and error, with checkmarks to indicate whether the factors could contribute to fraud, error, or both. A third type of risk could also be added — going concern risk — as many of the factors would contribute to that assessment as well. Such an integrated list would likely become a key part of an auditor's toolkit, as it would provide an integrated and efficient way of identifying potential risks.
  - Based on the comments above regarding fraud risk factors and management override and those previously discussed in this letter, we recommend that AU 316 be incorporated in full with the Proposed Standards.

#### Appendix 4

- The auditor's response to the risks of material misstatement. The proposed objective of the Proposed Standards states, "the auditor is to address the risks of material misstatement through appropriate overall audit responses." This objective is disconnected with Appendix 3, which requires the auditor to identify and assess risks and then respond to those assessed risks. As a result, the Proposed Standard ignores the risk assessment process. The implication is that there is no purpose for performing the procedures required in Appendix 3. The PCAOB should make it clear in Appendix 4 that the objective of the auditor is to address the identified risks of material misstatement through appropriate overall audit responses and audit procedures.
- Performing tests of details. Paragraph 11 of Appendix 4 states that "the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the fraud risks." It appears that this language is creating a presumptively mandatory responsibility that tests of details should always be performed in response to identified fraud risks. We are not sure that this is the intent of the PCAOB, particularly as it is neither a requirement in the PCAOB's interim standards, nor in the ISAs to always respond to fraud risks in this manner. This paragraph, therefore, should be clarified and an illustration should be provided in order for auditors to understand what the PCAOB's intentions are and what change in audit practice (if any) is expected. As it is written now, this language may produce no change or many unintended changes. We believe the auditor, based on judgment, the risks identified, and the facts and

circumstances of the situation, should be able to decide whether to perform substantive analytical procedures or test of details in response to any identified risk and should not be limited to the types of procedures to perform.

- *Substantive procedures and sufficient appropriate audit evidence.* Paragraph 19 indicates that in certain situations substantive procedures alone cannot provide sufficient appropriate audit evidence, without explaining further when this might be the case. This is an important, but complex concept, and we therefore believe it should be more fully explained in the Proposed Standards. This can be accomplished by including the following guidance, excerpted from ISA 315, paragraph 29:
  - In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them.

**Exhibit 1: Specific Comments on Proposed Standards, by Paragraph**<sup>25</sup>

<b>A. PCAOB Appendix 1 – Audit Risk in an Audit of Financial Statements</b>	
<p>Paragraph 2 – The following observations support our recommendation, as discussed in our Overall Comments, that the PCAOB should propose and adopt an overall audit objectives standard, rather than adopting this standard as proposed.</p> <p>In describing the objective of the auditor, paragraph 2 of Appendix 1 states, "The objective of the auditor is to conduct the audit of the financial statements in a manner that reduces audit risk to an appropriately low level." However, this objective relates to the overall objective of the auditor when performing an audit, and does not specifically relate to the title of this standard, <i>Audit Risk in an Audit of Financial Statements</i>. Further, the title of this Proposed Standard leads one to believe that audit risk, risk of material misstatement, and detection risk only relate to the audit of the financial statements, and not to an audit of ICFR, which is misleading. Additionally, we also note that while the topics included in this Proposed Standard relate to the overall audit, important concepts, guidance, and principles related to an audit on an overall basis are not included. For instance, a description of reasonable assurance and the inherent limitations of an audit are not included in this standard.</p> <p>For the reasons above and those articulated in our Overall Comments, we recommend the PCAOB use the material in Appendix 1 and ISA 200 to propose and adopt an overall audit objectives standard, in lieu of adopting Appendix 1 as proposed. We believe such an overall audit objectives standard is important to fully understand the Proposed Standards, and as such, we recommend that such a standard be part of the consideration of these Proposed Standards.</p> <p>In developing the overall audit objectives standard, we believe the objective ("reducing audit risk to an 'appropriately low level' ") and the description of reasonable assurance should align with ISA 200 and the exposure draft of the proposed SAS, <i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>. Currently, the objective in this Proposed Standard is different than the ISAs and the exposure drafts of the proposed SASs, which describe the objective of the auditor as reducing audit risk to an "<u>acceptably</u> low level" (emphasis added). Based on the information in the Proposed Standards and Release, it is not clear whether this is an intentional departure from ISA 200 and the exposure drafts of the proposed SAS, why such a departure is necessary, or whether the PCAOB, despite using different words, intends the objective of the auditor to be the same as for an audit conducted in accordance with the ISAs. According to Webster's Dictionary, the definition of acceptable is "satisfactory," whereas the definition of appropriate is</p>	<p><b>Drafting Conventions &amp; Convergence</b></p>

<sup>25</sup> As described previously, to illustrate the relation between the detailed comments in Exhibit 1 to our Overall Comments, the detailed comments are provided in columnar format with a reference, where applicable, to the related Overall Comment(s).

<b>A. PCAOB Appendix 1 – Audit Risk in an Audit of Financial Statements</b>	
<p>"suitable for a particular person, place, etc.; proper or fitting." In the context of reducing risk in an audit, the concept of "acceptable" seems more suitable than "appropriate," which would appear to be more subjective and open to interpretation. We recommend that the PCAOB use the same words as the ISA to describe the objective of the auditor and the concept of reasonable assurance, unless the PCAOB intends the audits for U.S. public companies to have a different objective. If it is the case that the PCAOB is creating an intentional difference, this difference should be fully explained by describing (1) the reason therefor, (2) how the auditor's performance would be different, and (3) the intended outcome.</p>	
<p>Paragraph 5 – The Proposed Standard defines the risk of material misstatement as referring to "the risk that the financial statements are materially misstated due to error or fraud." This definition is in contrast to ISA 200 paragraph 13 and the exposure draft of the proposed SAS (<i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>, paragraph 13), which describe the risk of material misstatement as "the risk that the financial statements are materially misstated <u>prior to the audit</u>" (emphasis added). Including the words "prior to the audit" makes it clear that the risk of material misstatement is the entity's risk, and not a function of the auditor's risk (which is affected by the auditor's actions or lack thereof). We recommend adding the words "prior to the audit" to the definition of risk of material misstatement.</p>	<b>Convergence</b>
<p>Paragraph 6 – The Proposed Standard does not sufficiently describe the types of risks of material misstatement at the financial statement level, how to identify such risks, and how to respond to such risks. In order to provide sufficient guidance to auditors regarding the risk assessment process (that is focused on identifying and responding to identified risks), we believe this Proposed Standard should include additional guidance similar to that included in ISA 315 paragraphs A98-A101 related to assessment of risks of material misstatement at the financial statement level.</p>	<b>Drafting Conventions &amp; Convergence</b>
<p>Paragraphs 9 and 10 are inconsistent with each other and with paragraph 13 of Appendix 7. The first sentence in paragraph 10 implies that the auditor's ability to reduce detection risk is limited to the performance of substantive procedures alone, rather than all audit procedures. Paragraph 9 when describing detection risk refers to "procedures performed by the auditor" and to "audit procedures;" paragraph 13 of Appendix 7 states that audit procedures can be classified as falling into three categories: risk assessment procedures, tests of controls, and substantive procedures. As a result, the first sentence in paragraph 10, by only referring to substantive procedures, is confusing. We believe the concept of how to reduce</p>	<b>Drafting Conventions</b>

<b>A. PCAOB Appendix 1 – Audit Risk in an Audit of Financial Statements</b>	
detection risk is sufficiently explained in paragraph 9. As such, the first sentence in paragraph 10 should be deleted.	

<b>B. PCAOB Appendix 2 – Audit Planning and Supervision</b>	
Paragraph 3 relates to the objective of the standard; however, we note this paragraph includes a "must" statement. We do not believe objectives should include "must" statements, as they should not establish requirements. See related recommendations in our Overall Comments. As such, we recommend deleting paragraph 3, as paragraph 2 sufficiently describes the objective of the auditor.	<b>Drafting Conventions</b>
Paragraph 6b states that the auditor should "determine compliance with independence and ethics requirements..." We recommend adding a footnote to this statement to clarify that determining compliance with independence rules can be achieved through a centralized process (i.e., that the auditor can rely on processes conducted by his or her firm in satisfying this requirement).	<b>Other</b>
Paragraph 7 repeats consideration points from AS No. 5, paragraph 9 (without referencing AS No. 5 and with a few wording differences), which we believe implies that these steps are performed separately for the financial statement audit and for the audit of ICFR. The consideration of the matters in paragraph 7 should be performed to provide the basis for planning both the audit of the financial statements and, if applicable, the audit of ICFR. Consequently, consistent with our recommendation in our Overall Comments, we think this guidance should be in the Proposed Standards and the duplicate paragraph removed from AS No. 5 through a conforming amendment.  Additionally, the reference to "public information relevant to the evaluation of the likelihood of material financial statement misstatements..." is open-ended and could encompass wide-ranging information. We believe the auditor's consideration of public information should be limited to the information that comes to the auditor's attention.	<b>Drafting Conventions</b>
Paragraph 9b states that the auditor "should determine the significant factors that affect the direction of the engagement team." It is not clear what is meant by "affect direction" of the engagement team and how this differs or relates to item 9d, which refers to the "nature, timing, and extent of resources." The PCAOB should clarify what is meant. For instance, if the PCAOB is referring to directing the engagement team's efforts (as is described in similar guidance in ISA 300,	<b>Convergence &amp; Drafting Conventions</b>

<b>B. PCAOB Appendix 2 – Audit Planning and Supervision</b>	
paragraph 7), we recommend this language be revised to be consistent with the ISA and state: "consider the factors that are significant in directing the engagement team's efforts."	
Paragraph 10b – Proposed Auditing Standard <i>The Auditor's Responses to the Risks of Material Misstatement</i> and Auditing Standard No. 5 include requirements to consider an assertion-level audit response. However, paragraph 10b does not specify the audit plan should include planned tests at the assertion level. We recommend paragraph 10b be revised to state "the planned nature, timing and extent of tests of controls and substantive procedures at the assertion level." This would be consistent with AS No. 5 and paragraph 8 of ISA 300.	<b>Convergence</b>
<p>Paragraph 11 of the Appendix contains a requirement to determine the extent to which audit procedures are to be performed at selected locations in a multi-location entity. It is not clear how these multi-location considerations are different from (or the same as) those multi-location considerations related to the audit of ICFR (in Appendix B of AS No. 5). When performing an integrated audit, we believe the auditor should consider multi-location matters for purposes of a financial statement audit and an ICFR at the same time. The consideration of the matters in paragraph 11 should be performed to provide the basis for planning both the audit of the financial statements and, if applicable, the audit of ICFR. Consequently, consistent with our recommendation in our Overall Comments, we think this guidance should be in the Proposed Standards and the duplicate guidance removed from AS No. 5 through a conforming amendment.</p> <p>Additionally, a number of issues exist related to planning and performing multi-location audits. We believe these issues should be addressed in greater detail by the PCAOB, including consideration of ISA 600, <i>Special Considerations — Audit of Group Financial Statements (Including the Work of Component Auditors)</i>; however, we believe the other projects on the PCAOB's standard-setting agenda should have higher priority.</p>	<b>Drafting Conventions &amp; Convergence</b>
Paragraph 17 states that for an initial audit, the auditor should determine whether it is necessary to expand the planning activities; this is application material in the ISA. We question whether this needs to be elevated to a "should" presumptively mandatory responsibility, as we believe this is guidance with respect to achieving the requirements in paragraph 9. Moreover, this type of guidance (i.e., for initial audits) could be provided with respect to every aspect of the Proposed Standards, but we do not believe it is necessary. As such, we recommend revising this paragraph such that the auditor may consider whether it is necessary to expand the planning activities.	<b>Convergence</b>



## **B. PCAOB Appendix 2 – Audit Planning and Supervision**

<p>Paragraphs 19-20 provide an example of using multiple "should" statements when it is not necessary, resulting in lack of flexibility and the creation of unnecessary documentation requirements. We believe paragraphs 19 and 20 are guidance to the requirements in paragraph 18, which states, "the engagement partner should supervise other engagement team members..." Paragraph 19 then states "Supervision should include the following" and then provides a list. Paragraph 20 continues and states that the level of supervision "should be appropriate for the circumstances..." Creating multiple "should" statements and imposing multiple requirements is not necessary. We believe the initial "should" statement in paragraph 18 is appropriate and sufficient. Therefore, we recommend that paragraphs 19 and 20 be revised to provide guidance on how to implement paragraph 18. For instance, paragraph 19 should be revised to begin with "Elements of supervision may include..." Paragraph 20 should be revised to state "the level of supervision of other engagement team members depends on many factors, including..."</p> <p>If the "shoulds" are not removed from paragraphs 19 and 20, the language should be changed to more clearly indicate what action the auditor is expected to perform that can then be documented. For instance, paragraph 20 as drafted states the level of supervision "should be appropriate...", which is not a direct action the auditor can undertake.</p> <p>The structure of paragraphs 18-20 can be contrasted with paragraph 14, which we believe provides a good example of how to structure guidance and direct the action expected of the auditor. The first sentence of paragraph 14 contains the "should" statement that is actionable. This is then followed by factors "that may be relevant to the auditor's determination."</p>	<b>Drafting Conventions</b>
<p>Paragraph 21 states that the partner and team members "should make themselves aware" of certain procedures to be followed when there are differences of opinion amongst the team. This phrase does not clearly set forth what the auditor is expected to do to satisfy this requirement, yet it is a presumptively mandatory responsibility that would also require documentation of how it has been achieved.</p>	<b>Drafting Conventions</b>

**C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement**

<p>A significant portion of this Proposed Standard relates to obtaining an understanding of the entity and its environment. We note that the equivalent ISA standard (ISA 315) and the proposed equivalent SAS standard (AU 314) include this language in the title of the standard. We recommend the title of this Proposed Standard include a reference to obtaining an understanding of the entity and its environment. Because PCAOB interim standard AU 319, <i>Consideration of Internal Control in a Financial Statement Audit</i>, will be superseded, including such a reference in the title of the standard may help practitioners find the guidance related to gaining an understanding of the entity and its environment (including internal control).</p>	<p><b>Drafting Conventions &amp; Convergence</b></p>
<p>Paragraph 3 – The objective for this standard states that "the auditor is to identify and appropriately assess the risks of material misstatement." This objective is different than ISA 315, which states "The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement." The intention behind this difference is not explained in Appendix 10. As a result, it is not clear if the Board has different expectations of the auditor in the context of this Proposed Standard. We think that the additional clarification in ISA 315 is helpful and provides direction as to the premise for and purpose of the auditor's risk assessment. Further, it is not clear what the PCAOB considers to be "appropriately" assessing the risks of material misstatement. We recommend using the objective in ISA 315, paragraph 3.</p>	<p><b>Convergence</b></p>
<p>Paragraph 5 states that "the auditor should perform risk assessment procedures to obtain sufficient appropriate audit evidence to identify and appropriately assess the risks of material misstatement due to error or fraud." However, the purpose of performing risk assessment procedures is <i>to identify and appropriately assess the risks</i> of material misstatement due to error or fraud, not "to obtain sufficient appropriate audit evidence." To obtain sufficient appropriate audit evidence requires the auditor to perform risk assessment procedures and other procedures that address the identified risks (including tests of controls and substantive tests). Footnote 2 explains this by stating, "risk assessment procedures by themselves do not provide sufficient appropriate audit evidence." The language in paragraph 5 contradicts footnote 2. We suggest the phrase "sufficient appropriate audit evidence" be deleted from paragraph 5.</p>	<p><b>Drafting Conventions</b></p>

### C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement

Paragraphs 8-19 are written very differently, but all address how the auditor obtains an understanding of the company and its environment. Paragraph 8 sets up the presumptively mandatory requirement that "the auditor should obtain an understanding of the company and its environment..." However, this is then followed by inconsistent instructions to the auditor. For instance:

- Paragraph 11 states certain factors "are relevant" (which is an example of using present tense, resulting in the question of whether or not this is imposing a requirement on the auditor).
- Paragraph 12 states obtaining understanding "includes" certain matters.
- Paragraph 13 states the "auditor should consider." (See further comments on this paragraph below.)
- Paragraph 15 states certain examples "may be relevant."
- Paragraph 17 states certain examples "might affect the risks of material misstatement."
- Paragraph 19 states "the auditor should obtain an understanding."

Because the presumptively mandatory responsibility is created in paragraph 8, each of the paragraphs that follow should provide additional guidance, not additional requirements. Such lists, as discussed in our Overall Comments, potentially result in audit inefficiency as a result of documenting how all of the matters have been addressed. As such, paragraphs 11-19 should provide elements or factors for the auditor to consider, rather than additional presumptively mandatory responsibilities. This would be consistent with ISA 315.

We are also concerned with respect to the open-ended nature of the guidance in paragraph 13. It is not clear how an auditor can fulfill the responsibility of reading "public information;" this should be limited to information that comes to the auditor's attention. We also do not believe it is the responsibility of the auditor to observe or listen to live earnings calls; it is not the auditor's responsibility, nor should it be the auditor's responsibility to monitor or correct statements made during such calls. If the auditor is observing or listening this may likely create an inappropriate expectation of the auditor. We recommend this bullet be limited to reading transcripts. Further, it is not clear what would be sufficient in terms of the auditor "obtaining information about significant unusual developments regarding trading activity." For instance, is it expected that the auditor would obtain information about daily trade volumes and volatility or intra-day activity? We recommend the PCAOB be specific with respect to its expectations regarding the auditor's consideration of trading activity.

Additionally, we note that paragraph 19 states "the auditor should obtain an understanding of the degree of transparency of the application of significant

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<b>C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement</b>	
accounting principles and related financial reporting processes." This is not an actionable item for the auditor to achieve, as it is not clear what "degree of transparency" means as it pertains to application of accounting principles and financial reporting processes. We recommend deleting this bullet.	
Paragraphs 26 and 32 repeat information from AS No. 5. Additionally, paragraphs 20-33 are categorized as part of "Obtaining an Understanding of ICFR;" however, much of this is achieved through guidance in AS No. 5 related to "identifying entity-level controls" (see paragraphs 22-27 of AS No. 5). It is confusing to repeat information from AS No. 5 and to include procedures that are similar in both the Proposed Standards and in AS No. 5. It should be clear that when performing an integrated audit, the auditor obtains an understanding of internal control through a single process. Consequently, consistent with the recommendation in our Overall Comments, we think this guidance should be in the Proposed Standards and the duplicate paragraphs removed from AS No. 5 through a conforming amendment.	<b>Drafting Conventions</b>
Paragraph 34 – The Note to paragraph 34 is confusing because it implies that the auditor's identification of significant accounts and disclosures would be different in an audit of the financial statements, than for an audit of ICFR. This is not consistent with the concept of an integrated audit and with paragraph 7 of this Proposed Standard. The auditor's understanding of control activities should consider those control activities that are determined to be relevant in the context of the single set of accounts and disclosures that have been identified as significant to the integrated audit. The auditor's understanding of control activities, therefore, does not "encompass a broader range" of accounts and disclosures for purposes of the audit of ICFR as described in the Note to paragraph 34. We suggest that the PCAOB delete this Note.	<b>Drafting Conventions</b>
Paragraph 35 – Appendix 3 does not refer to the consideration of the internal audit function when obtaining an understanding of internal control. We believe it would be helpful to add a footnote to paragraph 35 that states the following (similar to ISA 315, paragraph A95): <ul style="list-style-type: none"> <li>○ In many entities, internal auditors or personnel performing similar functions contribute to the monitoring of an entity's activities. AU 322, <i>The Auditor's Consideration of the Internal Audit Function</i>, establishes requirements and provides guidance on the auditor's consideration of the work of internal auditing. Management's monitoring activities may also include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.</li> </ul>	<b>Convergence</b>

**C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement**

<p>Paragraph 38 states that "the auditor should <i>incorporate</i> knowledge obtained during past audits into the auditor's process for identifying risks of material misstatement" (emphasis added). This is not an actionable instruction that the auditor can carry out, as it is not clear what "incorporate" means or how the auditor would demonstrate compliance with this requirement. Moreover, we disagree with making this a "should" statement; rather, we believe this is something the auditor may consider doing. It is not clear what the desired outcome is of making this a presumptively mandatory requirement.</p>	<p><b>Drafting Conventions</b></p>
<p>Paragraph 41 – This paragraph states that the auditor should assess information obtained in "other engagements." The Note to this paragraph refers to "certain components audited by affiliated firms." As a result, the meaning of paragraph 41 is different from the ISAs. When referring to "other engagements" in ISA 315, paragraph 8, the intention of the IAASB was to refer to non-audit engagements, not procedures performed by affiliated firms for purposes of the audit. Other areas of the PCAOB standards, namely AS No. 3, address the information to be obtained in connection with audit procedures performed by affiliated firms. As such, we recommend deleting this Note.</p> <p>Also, the guidance in paragraph 41 should be limited to other engagements performed by the auditor for the entity. As the language is currently worded, it could be misunderstood to mean engagements for other clients. We do not believe this is the intention of the Board. As such, we recommend revising paragraph 41 to state the following: Where the auditor has performed other non-audit engagements for the entity, the auditor should consider whether information obtained in performing those other engagements is relevant to identifying risks of material misstatement.</p>	<p><b>Convergence</b></p>
<p>Paragraphs 42 and 44 – The language in paragraphs 42 and 44 seems to be describing substantive analytical procedures as opposed to preliminary analytical procedures, particularly in paragraph 44, which discusses developing expectations and comparing those expectations with recorded amounts. Without additional context, auditors may believe preliminary analytical procedures need the same degree of rigor as substantive analytical procedures, particularly since the existing guidance in PCAOB interim standards (in AU 329) regarding analytical procedures in planning the audit will be removed through the proposed Conforming Amendments. We do not believe it is the intent of the Board to require the same degree of rigor in analytical procedures for planning purposes as that required for substantive analytical procedures. This issue can be addressed by deleting the second sentence in paragraph 44 and adding the guidance included in paragraphs A7-A9 of ISA 315, which states the following:</p>	<p><b>Convergence &amp; Other</b></p>

**C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement**

<p>Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.</p> <p>Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.</p> <p>However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.</p>	
<p>Paragraph 49 states certain "matters should be emphasized." Additionally, the second bullet states all engagement team members "need to be alert." It is not clear how the auditor is expected to perform these procedures. Additionally, it is not clear how an auditor documents "placing emphasis" or being "alert."</p>	<p><b>Drafting Conventions</b></p>
<p>Paragraph 52 – Item d(1)-(4) creates a presumptively mandatory responsibility for the auditor to make inquiries of all accounting and financial reporting personnel regarding:</p> <ul style="list-style-type: none"> <li>○ Views as to whether accounting policies were appropriately or aggressively applied;</li> <li>○ Views as to the risks of fraud;</li> <li>○ Knowledge of fraud, alleged fraud, or suspected fraud affecting the company;</li> <li>○ Awareness of instances of management override of controls and the nature and circumstances of such overrides.</li> </ul> <p>Requiring inquiries of all personnel is onerous and does not allow for the application of professional judgment in carrying out these procedures. We note</p>	<p><b>Convergence &amp; Drafting Conventions</b></p>

**C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement**

<p>that paragraph 54 states "the auditor should assess who might reasonably be expected to have information..." It is confusing to create a presumptive mandatory responsibility in paragraph 52d and then seemingly modify this responsibility in paragraph 54.</p> <p>Because paragraph 50 provides the overarching requirement (that "the auditor should make inquiries of the audit committee, management, the internal audit function, and others within the company who might be expected to have information that is important to the identification and assessment of risks of material misstatement"), we recommend paragraph 52 be revised to include those matters the auditor may consider in conducting such inquiries. Such a construction would allow for greater use of auditor judgment, would be more consistent with principles-based standard setting, and would be consistent with ISA 240 and ISA 315.</p>	
<p>Paragraph 55 – This paragraph states that "the auditor should take into account that management is often in the best position to commit fraud..." This is not an actionable item for the auditor as it is not clear what "take into account" means.</p> <p>Paragraph 55 also states, "the auditor should obtain evidence to address inconsistencies in response to the inquiries." However, it is possible for management to provide incorrect information for which evidence cannot be obtained. As a result, the auditor may not be able to fulfill this presumptively mandatory responsibility, as the auditor may not be able to "obtain evidence to address the inconsistencies."</p> <p>Based on the above and in order to clearly communicate the expected auditor action, we recommend replacing paragraph 55 with the following guidance from paragraph A17 of ISA 240: "Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information. "</p>	<p><b>Drafting Conventions &amp; Convergence</b></p>
<p>Paragraph 56c states that the auditor should "evaluate the types of potential misstatements..." We recommend that the PCAOB use the phrase "what could go wrong" rather than "the types of potential misstatements." Such language is consistent with paragraph 30 of AS No. 5 and paragraph 25c of ISA 315 and was also used by the Panel on Audit Effectiveness.<sup>26</sup></p>	<p><b>Convergence</b></p>

<sup>26</sup> *The Panel on Audit Effectiveness Report and Recommendations*, August 31, 2000, Recommendation 2.48 that the ASB "Require the auditor to make inherent risk assessments for significant account balances and classes of transactions by considering what could go wrong at the individual assertion level."

<b>C. PCAOB Appendix 3 – Identifying and Assessing Risks of Material Misstatement</b>	
<p>Paragraph 60 states that "the auditor should not assume that all of the conditions discussed in the preceding paragraph must be observed or evident to conclude that a fraud risk exists." This is not an actionable procedure that the auditor can perform and document as it is not clear how an auditor "not assumes" and then documents that negative assumption.</p>	<b>Drafting Conventions</b>
<p>Paragraph 61 states that "the auditor should presume that there is a fraud risk involving improper revenue recognition and evaluate the types of revenue or revenue transactions to which the risk relates." We agree with this statement. However, to appropriately respond to fraud risks and alter the nature, timing, and extent of procedures accordingly, we also believe that the auditor should evaluate which types of assertions give rise to such risks. Otherwise, the auditor may perform generic audit procedures across all types of revenue, rather than tailoring the procedures to the type of revenue and assertions involved. As described in the PCAOB's 4010 Report, <i>Observations on Auditors' Implementation of PCAOB Standards Relating to Auditor's Responsibilities With Respect to Fraud</i>, "The auditor should evaluate whether the fraud risk assessment can be linked to individual accounts or classes of transactions and related assertions. Linking in this manner assists the auditor in designing the appropriate audit procedures."</p> <p>As such, we recommend that the PCAOB add language similar to that in paragraph 26 of ISA 240, such that paragraph 61 states the following: The auditor should presume that there is a fraud risk involving improper revenue recognition and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks.</p>	<b>Convergence</b>
<p>Paragraphs 64 and 65 – It is confusing to see a repetition of guidance regarding the evaluation of controls, which is already discussed in paragraphs 20-36 of this standard. The PCAOB should make it clear why this guidance appears in these paragraphs, for instance by adding to the beginning of these paragraphs: "When the auditor has determined that a significant risk, including a fraud risk exists..."</p>	<b>Drafting Conventions</b>
<p>Appendix A – It is not clear why this guidance appears in an Appendix rather than the standard itself. Both paragraphs A1 and A4 contain presumptively mandatory responsibilities for the auditor. If the Appendix is intended to hold the same authority as the standard, it should be incorporated into the standard, particularly those paragraphs that contain "should" statements.</p>	<b>Drafting Conventions</b>



**D. PCAOB Appendix 4 – The Auditor's Response to the Risks of Material Misstatement**

Paragraph 4 states that "The auditor should design and implement overall responses to address the risks of material misstatement as follows" and then includes a list of those overall responses the auditor "should design and implement." One of these responses is "making general changes to the nature, timing, or extent of audit procedures." (See item e of paragraph 4.) It is then noted "the auditor should evaluate whether it is necessary to make general changes..." While we recognize the guidance in paragraph 4 is similar to that in ISA 330 paragraphs 5 and A1, it is important to point out that ISA paragraph 5 contains the requirement (i.e., "the auditor should design and implement overall responses to address the risks of material misstatement") and this is followed by guidance in paragraph A1, which states what the overall responses "may include" making "general changes." In contrast, paragraph 4 of Appendix 4 creates a presumptively mandatory responsibility of "making general changes," and this is followed by an explanation in item e that the auditor "should evaluate" whether changes are necessary. This construction, with multiple varying "should" statements, is confusing. Moreover, it is not clear how "making general changes" can be a presumptively mandatory responsibility. We recommend paragraph 4 be revised to state, "the auditor should design and implement overall responses to address the risks of misstatements," and be followed by overall responses that may be considered by the auditor (which would consist of items a through e in paragraph 4).

It is also not clear how "general changes" in nature, timing, and extent in paragraph 4e are different from the changes in nature, timing, and extent discussed in paragraphs 6-8. We believe paragraphs 6-8 refer to changes at the assertion level. If this is the case, we recommend that the header prior to paragraph 6 be changed to "Responses to Material Misstatements at the Assertion Level."

Further, in paragraph 4c it appears the PCAOB is limiting the incorporation of elements of unpredictability to those areas identified as fraud risks (as previously described in footnote 14 of our Overall Comments). We do not believe this is the intention of the Board. We note that the language in this paragraph that refers to fraud is different than the language in the ISAs. (See ISA 330, paragraph A1, which states, "Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.") We recommend deleting "due to fraud" from the second sentence in 4c.

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Paragraph 5 – We note that this paragraph specifically refers to the application of professional skepticism and provides a definition of professional skepticism. Auditors apply professional skepticism throughout the audit, and, as a result, direct reference here seems to be limiting the application of professional skepticism to risks and not to the entire audit. We do not believe this is the intention of the Board. We recommend deleting this paragraph and instead

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<b>D. PCAOB Appendix 4 – The Auditor's Response to the Risks of Material Misstatement</b>	
including a discussion of professional skepticism in an overall audit objectives standard similar to ISA 200, as discussed further in our Overall Comments.	
Paragraph 7b and 9 – Paragraph 7b states the auditor "should take into account the types of potential misstatements..." The Note to paragraph 9 states, "the auditor should take into account those deficiencies when developing his or her response to fraud risks." Both of these paragraphs are creating a presumptively mandatory responsibility to "take into account" yet it is not clear what "take into account" means. As a result, it is not clear how the auditor fulfills these presumptively mandatory responsibilities and documents the procedures. As such, we recommend replacing "the auditor should take into account" with "the auditor should consider."	<b>Drafting Conventions</b>
Paragraphs 14-39 – The inclusion of this guidance, which is partially directed towards a financial statement audit (paragraphs 17-20), partially directed towards an internal control audit (paragraphs 14-16), and paragraphs that seem to apply in both a financial statement audit only and an integrated audit (paragraphs 21-39), is very confusing and difficult to follow. It is particularly confusing, as much of this guidance is already included in AS No. 5. As discussed in our Overall Comments, if AS No. 5 guidance relates solely to an integrated audit, it should remain in AS 5. If AS No. 5 guidance relates to both an integrated audit and an audit of the financial statements, then we recommend incorporating it into the Proposed Standards and removing it, through conforming amendments, from AS No. 5.	<b>Drafting Conventions</b>
Paragraph 18 – This paragraph discusses obtaining evidence that controls are effective during the entire period of intended reliance. AS No. 5, paragraph B4 provides additional guidance regarding obtaining evidence that the controls operated effectively during the entire period. If the PCAOB agrees the guidance in AS No. 5, paragraph B4 relates to both an integrated audit and an audit of the financial statements, then we recommend incorporating it into the Proposed Standards and removing it, through conforming amendments, from AS No. 5.	<b>Drafting Conventions</b>

<b>D. PCAOB Appendix 4 – The Auditor's Response to the Risks of Material Misstatement</b>	
<p>Paragraph 19 – Assessing completeness and accuracy of financial information is limited in this paragraph to information used in performing substantive analytical procedures; however, the auditor may need to test completeness and accuracy of data when performing other types of procedures, including tests of details. As such, this paragraph should be revised accordingly or an additional paragraph could be created to address the concept of testing the completeness and accuracy of data (as this is a separate concept from that in the first part of the sentence related to areas where substantive testing alone cannot provide sufficient appropriate audit evidence).</p>	<b>Other</b>
<p>Paragraph 37 – The text of paragraph 37 appropriately states, "when controls have been tested in past audits, the auditor should take into account the following factors to determine the evidence needed in the current year audit to support the auditor's control risk assessment." However, the discussion in Appendix 10 states that "the proposed standard required auditors to obtain evidence about controls selected for testing each year" and contrasts this to ISA 330, which allows the auditor to use evidence from prior audits about operating effectiveness of controls without retesting, subject to certain conditions and limitations set forth in the audit. We believe that for financial statement audits it is appropriate for the auditor to, based on the facts and circumstances, evaluate the length of the time period that may elapse before retesting the operating effectiveness of a control and not test the operating effectiveness of every control each year, and we believe paragraph 37 as drafted permits this. If the PCAOB intends to require auditors to test the operating effectiveness of each relevant control every year when performing a financial statement audit, this will be a significant change in current practice, and one we do not believe to be necessary.</p>	<b>Convergence</b>
<p>Paragraph 38 – The Proposed Standard continues to use the term "control risk." Both the ISAs and the SASs are no longer using this term. We recommend that the PCAOB not use this term, as we believe it is not necessary and will cause confusion. Continuation of this term in the PCAOB standards could indicate a conceptual difference, when one is not intended. As such, we recommend that inherent risk and control risk not be referred to separately, but rather referred to as a combined assessment of the "risks material misstatement."</p>	<b>Convergence</b>
<p>Paragraph 41 – The last sentence of the Note to this paragraph states "Also, when performing a dual-purpose test, the auditor should evaluate the results of the test in forming conclusions about both the <i>assertion and the effectiveness of the control</i>" (emphasis added). However, when discussing dual-purpose tests, this Note should discuss forming a conclusion about the "<i>substantive test</i> and effectiveness of</p>	<b>Other</b>

<b>D. PCAOB Appendix 4 – The Auditor's Response to the Risks of Material Misstatement</b>	
<p>control" (not the "<u>assertion</u> and the effectiveness of the control") as this is the purpose of a dual-purpose test.</p> <p>Additionally, this note creates requirements for designing and evaluating dual-purpose tests. We do not believe these need to be presumptively mandatory responsibilities, but rather can be drafted as guidance.</p>	
<p>Paragraph 45 – See comments (in the Significant Detailed Comments on page 19) related to performing tests of details for significant risks as explained in relation to paragraph 11 of this Proposed Standard.</p>	<b>Other</b>
<p>Paragraph 48 states that "the auditor should take into account" certain matters when determining whether it is appropriate to perform substantive procedures at an interim date. This is not an actionable instruction that the auditor can perform and document, as it is not clear what "take into account" means.</p>	<b>Drafting Conventions</b>

<b>E. PCAOB Appendix 5 – Evaluating Audit Results</b>	
<p>Paragraph 3b proposes a definition of misstatement. However, the first sentence actually defines a material misstatement. While the first sentence is a factual and accurate statement, it does not belong in the definition of misstatement. We suggest deleting the first sentence of 3b.</p> <p>Additionally, in the second sentence of 3b, the PCAOB says a misstatement "may relate to" a difference. ISA 450 explains that a misstatement is a difference. It is not clear what the intention is of using "may relate to." We suggest replacing the words "may relate to" with "is."</p>	<b>Convergence</b>

<b>E. PCAOB Appendix 5 – Evaluating Audit Results</b>	
<p>Paragraph 8 – This paragraph states, "the nature, timing, and extent of the analytical procedures that should be performed during the overall review depend on the nature of the company and its industry." Analytical procedures performed in the final stages of the audit are similar to the analytical procedures performed during risk assessment. To make this point clear, ISA 520, paragraph A19 states that such analytical procedures "...may be similar to those that would be used as risk assessment procedures." We recommend the PCAOB add such clarification to paragraph 8. Without such clarification, the requirement in paragraph 8 may lead to inconsistency in practice; particularly, the performance of substantive analytical procedures that are not necessary to achieve the aim of the requirements in paragraphs 6 and 7.</p>	<p><b>Convergence</b></p>
<p>Paragraph 11 states that the auditor "<i>should evaluate</i>" inconsistent responses from management, whereas ISA 240, paragraph 14, and the exposure draft of the proposed AU 316, paragraph 14 states the auditor "<i>shall investigate</i>" such inconsistencies (we also note that the existing PCAOB interim standard uses the phrase "<i>should consider</i>"). "Should evaluate" could be interpreted as being a different requirement. Drafting guidelines for ASB standards provide that "investigate" is used only when follow-up procedures are required to more thoroughly look into a matter once suspicions have arisen, whereas "evaluate" directs the auditor to identify and analyze the relevant issues. The PCAOB should clarify the intent of using the words "should evaluate," and if a difference is not intended, use the same language as the ISA.</p> <p>Additionally, although we recognize AU 316.68 currently references "vague responses," we believe the meaning of "vague responses" is unclear. As currently used in the interim standards, "vague" it is in the context of "a condition that may be identified" rather than a presumptively mandatory responsibility. We recommend replacing "vague" with "imprecise or not at a sufficient level of detail to be useful," as we believe this is the intended meaning of "vague" in the current guidance.</p>	<p><b>Convergence &amp; Drafting Conventions</b></p>
<p>Paragraph 14 of the Appendix describes three categories of misstatements, but uses terms that are inconsistent with ISA 450, even though the descriptions of the terms seem to be the same. The Proposed Standard uses the terms "specifically identified misstatements, projected misstatements from substantive audit sampling, and misstatements related to accounting estimates that are outside of a reasonable range." Whereas the ISAs use the terms "factual misstatements, judgmental misstatements, and projected misstatements." We have several concerns with the terms in the Proposed Standard as follows:</p> <ul style="list-style-type: none"> <li>○ Using the term "specifically identified" is confusing, as one could argue</li> </ul>	<p><b>Convergence</b></p>

## E. PCAOB Appendix 5 – Evaluating Audit Results

<p>that all misstatements are "specifically identified." We suggest the PCAOB use the term "factual misstatement" rather than "specifically identified."</p> <ul style="list-style-type: none"> <li>○ The PCAOB's reference to "misstatements related to accounting estimates that are <i>outside of a reasonable range</i>" seems to equate to the ISA term "judgmental misstatements" (emphasis added). However, we believe the PCAOB's description is too narrow, as misstatements related to accounting estimates might not "be outside of a reasonable range," but rather may relate to a misstatement of a point estimate.</li> <li>○ Additionally, the terminology in the Proposed Standard does not seem to recognize judgmental misstatements related to "the selection or application of accounting policies that the auditor considers inappropriate." We suggest that the PCAOB, rather than using the term "misstatements related to accounting estimates that are outside of a reasonable range," use the term "judgmental misstatements" and describe these as differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.</li> </ul>	
<p>Paragraph 15 – The Note to this paragraph states that detection risk will "<i>likely be</i>" unacceptably high if misstatements approach materiality, whereas ISA 450, paragraph A5 says it "<i>may be</i>." "Likely be" could be interpreted as being stronger than "may be." It is not clear if the Board is intentionally diverging from the ISA and what the expected difference in auditor performance is.</p>	<p><b>Convergence</b></p>
<p>Paragraph 16 requires the auditor to communicate accumulated misstatements to management, but does not require the auditor to request management to correct the misstatements as in ISA 450, paragraph 8. The PCAOB standard should include this requirement and conform to the ISA.</p>	<p><b>Convergence</b></p>
<p>Paragraphs 18 and 19 – The PCAOB standard splits the requirements relating to the evaluation of uncorrected misstatements into two separate paragraphs, whereas these concepts are combined into one paragraph in ISA 450 (see paragraph 11). By splitting the requirement, the Proposed Standard has lost the connection between these two paragraphs and why the procedures in paragraph 19 are being performed. We suggest combining paragraphs 18 and 19.</p> <p>Also, paragraph 18 includes a Note that states, "If the financial statements contain material misstatements, the auditor <i>should</i> issue a qualified or an adverse opinion</p>	<p><b>Convergence &amp; Drafting Conventions</b></p>

<b>E. PCAOB Appendix 5 – Evaluating Audit Results</b>	
<p>on the financial statements" (emphasis added). While this is a factual statement, this concept is included in the reporting standards, and it is not necessary to repeat this guidance within this Proposed Standard.</p> <p>Additionally, within paragraph 19, the PCAOB uses the words "<i>detected</i>" in prior years instead of "<i>related</i>" to prior years as used in ISA 450, paragraph 11. This changes the meaning of the guidance since there may be misstatements detected in the current year and related to the prior year (which would be encompassed in the ISA language, but not the PCAOB language). We recommend "detected in" be changed to "related to."</p>	
<p>The second sentence of paragraph 20 requires the auditor to evaluate the effect of <i>all</i> accumulated misstatements on the assessed risk of material misstatement, whereas the ISA 330, paragraph A57 notes this evaluation should be done on <i>individual</i> misstatements, which we believe is appropriate. The Proposed Standards should conform to the ISA language and refer to the evaluation of individual misstatements.</p>	<b>Convergence</b>
<p>Paragraph 26 begins by referring to "examples" of forms of management bias, but then makes the auditor's evaluation of such examples a presumptively mandatory requirement. This paragraph should be revised to clearly state the actions expected of the auditor, perhaps by first articulating the responsibility, then providing examples.</p> <p>Additionally, a-c of paragraph 26 are meant to provide examples of "bias." However, examples b and c use the word "bias;" as a result, the example of "bias" is "bias." These examples should be amended to provide more descriptive examples of bias, without using the word "bias."</p>	<b>Drafting Conventions</b>
<p>Paragraph 28, which discusses what to do when there is a difference between management's estimate and the auditor's estimate, attempts to combine two separate concepts — the use of a point estimate and the use of a range in evaluating management's estimate. By doing so, it is not clear how the auditor determines the amount of the misstatement in these different circumstances. The guidance in paragraph 28 should mirror ISA 540, paragraph A116, which separately discusses point estimates and ranges in evaluating management's estimate. As such, paragraph 28 should be revised to include the following guidance:</p> <ul style="list-style-type: none"> <li>○ Where the audit evidence supports a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement.</li> </ul>	<b>Convergence</b>

<b>E. PCAOB Appendix 5 – Evaluating Audit Results</b>	
<p>○ Where the auditor has concluded that using the auditor's range provides sufficient appropriate audit evidence, a management point estimate that lies outside the auditor's range would not be supported by audit evidence. In such cases, the misstatement is no less than the difference between management's point estimate and the nearest point of the auditor's range.</p> <p>Further, paragraph 28 does not discuss "bias," which is indicated in the heading to this paragraph "Assessing Bias in Accounting Estimates." As such, perhaps this guidance should be located elsewhere in the Proposed Standard, for instance in the section "Accumulating and Evaluating Identified Misstatements." This guidance should apply regardless of whether bias exists.</p>	
<p>Appendix 5, Paragraph 32 – This paragraph seems to be inappropriately included in this Proposed Standard. Paragraph 30 of this Proposed Standard already addresses the requirement to evaluate whether the accumulated results of auditing procedures and other observations affect the assessment of fraud risks and the need to modify the audit procedures to respond to those risks. We recommend moving paragraph 32 to Appendix 3, <i>Identifying and Assessing Risks of Material Misstatement</i>, and that a footnote reference to Appendix 3 be added to paragraph 30 of Appendix 5. We also suggest replacing the phrase "earlier in the audit" in paragraph 30 with the phrase "throughout the audit," as fraud risks are considered throughout the audit.</p>	<p><b>Drafting Conventions</b></p>
<p>Paragraph 35 provides the requirement for the auditor to conclude whether sufficient appropriate audit evidence has been obtained to support the opinion. Paragraph 36 then lists factors relevant to this conclusion, but does so by using the present tense in stating "Factors that are relevant to the conclusion...include the following..." As currently drafted, paragraph 36 is creating an implied requirement to consider the factors. We recommend revising paragraph 36 to state, "When concluding on whether sufficient appropriate audit evidence has been obtained, the auditor may consider the following factors..."</p>	<p><b>Drafting Conventions</b></p>
<p>Paragraphs 39 and 40 limit the implications of deficiencies on the risk assessments and overall evaluation of the financial statements to integrated audits. However, these procedures would pertain to a financial statement audit, not just an integrated audit. Additionally, these paragraphs are taken directly from AS No. 5 (see paragraphs B5 and B6). As discussed previously, we do not believe guidance should be repeated. Since this guidance equally relates to an integrated audit and an audit of the financial statements only, we recommend this guidance remain in the Proposed Standard, and be removed from AS No. 5 through a conforming amendment.</p>	<p><b>Drafting Conventions</b></p>



<b>E. PCAOB Appendix 5 – Evaluating Audit Results</b>	
<p>Paragraphs 41-44 are also taken directly from AS No. 5. As discussed previously, we do not believe guidance should be repeated. Consistent with our Overall Comments, because this guidance relates solely to an integrated audit, we recommend this guidance remain solely in AS No. 5.</p>	<b>Drafting Conventions</b>
<p>Paragraph A1 of Appendix A includes a requirement for the auditor to determine whether the assessment of fraud risks needs to be reassessed. This requirement should not be included in the Appendix, as it is already addressed in paragraph 32. Additionally, as discussed in our Overall Comments, it is not clear why certain guidance exists in an Appendix or what level of authority the Appendix holds. If the Appendix is intended to hold the same authority as the Proposed Standard, it should be incorporated into the standard.</p>	<b>Drafting Conventions</b>

<b>F. PCAOB Appendix 6 – Consideration of Materiality in Planning and Performing an Audit</b>	
<p>Paragraph 3 – In the Note to this paragraph, the PCAOB states "it <i>ordinarily</i> is not practical to design audit procedures to detect misstatements that are material based solely on qualitative factors." This implies that there are instances when it would be practical to design such audit procedures. We disagree with this notion.</p> <p>Additionally, the first sentence of the Note states the auditor should be "alert" for misstatements; this is not actionable by the auditor. It is not clear how an auditor can perform or document being "alert."</p> <p>Based on the above, we suggest this Note be deleted.</p>	<b>Other &amp; Drafting Conventions</b>
<p>Paragraphs 8 and 9 use the term "tolerable misstatement" to explain what we believe is the concept of "performance materiality" as used in the related ISA (see ISA 320, paragraph 11) and exposure draft of the related proposed SAS (See proposed AU 312, paragraph 11). Using the words "tolerable misstatement" to describe what is defined as "performance materiality" in the ISAs will cause confusion.</p> <p>The term "tolerable misstatement" in the ISAs is the <i>application</i> of performance materiality to a particular sampling procedure, and may be the same amount or an amount lower than performance materiality. "Performance materiality," however, is 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</p>	<b>Convergence</b>

<b>F. PCAOB Appendix 6 – Consideration of Materiality in Planning and Performing an Audit</b>	
<p>the financial statements as a whole.</p> <p>To avoid confusion, we suggest the PCAOB use the term "performance materiality" in paragraphs 8 and 9. Additionally, the PCAOB should maintain the use of the term "tolerable misstatement" in AU 350, as this term specifically relates to sampling. Incorporating both the concepts of performance materiality and tolerable misstatement (as used in the ISAs) in the PCAOB standards will be helpful to auditors.</p>	
<p>Paragraph 9 uses the phrase "the auditor <i>should take into account</i>." It is not clear what this means. For instance, it is not clear if this is the same as "the auditor should consider" or if the PCAOB intended a different auditor action. We recommend changing "should take into account" to "should consider."</p>	<b>Drafting Conventions</b>
<p>Paragraph 10 states that the auditor should "<i>reassess</i>" the established materiality, whereas ISA 320, paragraph 12 says the auditor shall "<i>revise</i>" materiality. To "reassess" may be interpreted as being a weaker audit procedure because it might not drive the auditor to make changes; as opposed to "revise" which implies that a change is required (which would be appropriate in situations 1 and 2 included in this paragraph.) Therefore, we recommend the PCAOB use the word "revise" instead of "reassess."</p>	<b>Convergence</b>
<p>Paragraph 11 includes a Note that the reassessment of materiality and tolerable misstatement "<i>is also relevant</i>" to the evaluation of identified misstatements. Paragraph 10 of ISA 450 states this as an auditor requirement, that the auditor "shall reassess" materiality prior to the evaluation of misstatements. We recommend making this a "should" statement and including it before paragraph 18 of Appendix 5 (which relates to the evaluation of uncorrected misstatements).</p>	<b>Convergence</b>

<b>G. PCAOB Appendix 7 – Audit Evidence</b>	
<p>Paragraph 2 – This paragraph describes audit evidence and seems to be describing the same concept as that conveyed in the ISAs; however, this paragraph contains different language than what is included in ISA 500, paragraph 5c.</p> <p>Paragraph 2 defines audit evidence as "all the information, whether obtained from audit procedures or other sources, that is used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence consists of both</p>	<b>Convergence</b>

<b>G. PCAOB Appendix 7 – Audit Evidence</b>	
<p>information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and any information that contradicts such assertions."</p> <p>ISA 500, paragraph 5c defines audit evidence as "Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information."</p> <p>To avoid confusion and unnecessary differences in terminology, we recommend that the PCAOB use the ISA language to describe audit evidence. If the PCAOB intends to create a different definition of audit evidence, this difference should be clearly described and explained.</p>	
<p>Paragraph 3 – The proposed objective of this Proposed Standard is overly broad as it relates to the entire audit. The focus of this Proposed Standard, however, is how to design and perform audit procedures to obtain sufficient appropriate audit evidence, and this should be the focus of the objective of the standard. As such, we recommend that paragraph 3 be replaced with language in paragraph 4 of ISA 500, which describes the auditor's objective as the following: "the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion." We believe it is unnecessary to diverge from the ISA on the objective of audit evidence, as this should be a universal concept.</p>	<b>Convergence</b>
<p>Paragraph 6 states that audit evidence <i>must</i> be relevant and reliable. This sentence is creating an unconditional responsibility under PCAOB Rule 3101; however, this is not an action-oriented statement that can be implemented by the auditor. Additionally, this paragraph (and those that define relevance and reliability) does not seem to acknowledge that there are degrees of relevance and reliability, which is recognized in paragraph 5 of the Proposed Standard. As such, we recommend that the word "must" be removed from paragraph 6 and that it be revised as the follows: Appropriateness is the measure of the quality of audit evidence (i.e., its relevance and reliability). When designing and performing audit procedures, the auditor should consider the relevance and reliability of the information to be used. This would be consistent with ISA 500, paragraphs 5 and 7.</p>	<b>Convergence &amp; Drafting Conventions</b>
<p>Paragraph 12 – The structure of paragraph 12 implies that different assertions exist for a financial statement audit and an integrated audit, as it seems to imply that different assertions may exist if you did (b) as opposed to (a). This is confusing. We believe that the reason for the auditor to base his or her work on different</p>	<b>Drafting Conventions</b>

<b>G. PCAOB Appendix 7 – Audit Evidence</b>	
assertions would be the same under either a financial statement audit only or an integrated audit. This paragraph should be revised to make this clear.	
This Proposed Standard is silent on use of evidence from previous audits and the auditor's cumulative knowledge for purposes of supporting the auditor's risk assessment. ISA 500 application material acknowledges that information from previous audits and the auditor's cumulative knowledge may be used and included as audit evidence, provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit. See paragraphs A1, A11, and A26 of ISA 500. The PCAOB should acknowledge that information from previous audits may be used as possible audit evidence.	<b>Convergence</b>
Paragraph 27 – The Proposed Standard does not acknowledge that "selective examination of specific items, particularly if those items are selected based on the auditor's belief that they are more likely to contain a misstatement, may provide the auditor with some audit evidence concerning the remainder of the population" as is described in the exposure draft of proposed AU 318, paragraph A26. As a result, it is not clear that if the items tested are wrong, there may be implications on the rest of the items. We recommend this language be added to the Proposed Standard.	<b>Convergence</b>
<b>H. PCAOB Appendix 8 – Conforming Amendments</b>	
As we have previously recommended, when proposing and making Conforming Amendments to the interim standards, the PCAOB should provide a full mark-up of the proposed changes to the interim standards. <sup>27</sup> We understand that perhaps the PCAOB does not wish to add to the length of its proposals; however, if this is a concern, the PCAOB could post such mark-ups to its Web site, so that they are available for all interested parties. Such mark-ups of the interim standards should show both deleted and new text and should be provided at the time of the exposure draft, at the time the standard is approved by the Board, and at the time the standard is approved by the SEC (if further changes are made). Providing such mark-ups enhances the auditor's understanding of the proposed and final changes being made and the related effects. Such information also facilitates efficient and effective implementation of a new standard because the auditor, by reading a	<b>Drafting Conventions</b>

<sup>27</sup> See D&T comment letter to the PCAOB on its Proposed Auditing Standard – *Evaluating Consistency of Financial Statements and Proposed Amendments to Interim Auditing Standards* [PCAOB Release No. 2007-003; PCAOB Rulemaking Docket Matter No. 23], May 18, 2007.

<b>H. PCAOB Appendix 8 – Conforming Amendments</b>	
<p>mark-up, can more easily identify and understand the changes being made to current standards and practice. Additionally, providing such information at the time a standard is proposed will facilitate a more effective comment process as potential practice issues might be more readily identified and, therefore, raised through the comment process. As such, the Board and its staff would have an opportunity to address such issues at the front-end of the standard setting process rather than on the back-end by, for example, having to issue staff questions and answers to resolve implementation issues.</p>	
<p>AU 316.30 of the PCAOB interim standards, which discusses analytical procedures performed for planning purposes generally using data at a high level, would be deleted through the proposed Conforming Amendments. This guidance is not included in the Proposed Standard, <i>Identifying and Assessing Risks of Material Misstatement</i>. We recommend this paragraph be added to this Proposed Standard (in the section that discusses performing analytical procedures, Appendix 3, paragraphs 42-44) to remove any indication that the analytical procedures described in this Proposed Standard are substantive analytical procedures. See additional comments regarding paragraphs 42-44 of Appendix 3.</p>	<b>Other</b>
<p>AU 316.49 – The Conforming Amendments propose to remove the guidance regarding withdrawing from an engagement if it is not practicable to design procedures that sufficiently address the risks of material misstatement due to fraud. We recommend that this paragraph (AU 316.49) be retained either in AU 316 (or in the Proposed Standards if AU 316 is incorporated in full into the Proposed Standards).</p>	<b>Other</b>
<p>AU 316.77 – The proposed Conforming Amendments would delete items c and d in paragraph 77; however, this guidance is not included in the Proposed Standards. These items include guidance regarding situations when the auditor believes a misstatement is a result of fraud and directs the auditor to (1) discuss the matter and the approach for further investigation with an appropriate level of management that is at least one level above those involved, and with senior management and the audit committee and (2) if appropriate, suggest that the client consult with legal counsel. We believe this guidance is very important and recommend keeping this guidance either in AU 316 or in the Proposed Standards.</p>	<b>Other</b>

<b>H. PCAOB Appendix 8 – Conforming Amendments</b>	
AU 316.78 – The proposed Conforming Amendments would delete the guidance in AU 316.78 (which relates to withdrawing from an engagement when significant risks of fraud exist), but no equivalent guidance appears to be in the Proposed Standards. This is important guidance. We recommend retaining the paragraph in AU 316 or in the Proposed Standards.	<b>Other</b>
AU 350.48 – We recommend adding back the last sentence of item 2 of paragraph .48, which states "However, the second standard of field work contemplates that ordinarily the assessed level of control risk cannot be sufficiently low to eliminate the need to perform any substantive tests to restrict detection risk for all of the assertions relevant to significant account balances or transactions classes." We believe this is helpful guidance.	<b>Other</b>
AU 9350 – The proposed Conforming Amendments would delete the guidance in AU 9350. As the concepts included in AU 9350 are not included in the Proposed Standards, we recommend adding the interpretation back to the section.	<b>Other</b>

<b>I. PCAOB Appendix 10 – Comparison of Requirements to the Standards of the IAASB</b>	
<p>While we appreciate and commend the Board for providing a high-level comparison between these Proposed Standards and the comparable ISAs in Appendix 10, this comparison is not sufficient. Many of the firms' methodologies are based on the ISAs or on GAAS. As such, in order to effectively and efficiently understand and implement the Board's standards and intended changes in practice, auditors need full, detailed word-by-word comparisons of Proposed Standards and final standards to the current PCAOB standards and to the ISAs. For this particular set of Proposed Standards, due to the number of interim standards being superseded and replaced, it would also be helpful for the PCAOB to provide a high-level matrix indicating which Proposed Standards are replacing which interim standard(s). Additionally, we encourage the Board to clearly articulate in its Release to the final standards the expected changes in practice (going forward we recommend that such articulation be included in both proposed standards and in final standards). Similar to the method the Financial Accounting Standards Board (FASB) has used, this could be accomplished by including a section titled "Differences between this Statement and Current Practice." Providing this information will help auditors (1) obtain a better understanding of the impacts of the standards and (2) more efficiently and effectively implement new standards.</p>	<b>Drafting Conventions</b>

## **Exhibit 2: Answers to PCAOB Questions**

### **Audit Risk in an Audit of Financial Statements – Appendix 1**

- 1. Does the Proposed Standard appropriately describe audit risk and its component risks?*

No. Please refer to our Overall Comments regarding proposing and adopting an overall audit objectives standard, and our comments regarding paragraphs 2, 5, and 6 of Appendix 1 in Exhibit 1.

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

- 2. Is it reasonable and appropriate to extend the Auditing Standard No. 5 requirement regarding consideration of matters important to the audit of internal control over financial reporting to audits of financial statements?*

Please refer to our comments on paragraph 7 of Appendix 2 in Exhibit 1.

- 3. Is the direction regarding multi-location engagements reasonable and appropriate?*

Please refer to our comments regarding paragraph 11 of Appendix 2 in Exhibit 1.

- 4. Is more direction needed regarding multi-location engagements? If so, in what areas is additional direction needed?*

Please refer to our comments regarding paragraph 11 of Appendix 2 in Exhibit 1.

- 5. Are the responsibilities of the engagement partner for planning and supervision appropriate and reasonable, and is the proposed direction clear?*

Please refer to our comments regarding paragraphs 19-20 of Appendix 2 in Exhibit 1.

### **Identifying and Assessing Risks of Material Misstatement – Appendix 3**

- 6. Does the Proposed Standard clearly and adequately describe the auditor's responsibilities for performing risk assessment procedures?*

No. Please refer to our Overall Comments regarding drafting conventions and our detailed comments on Appendix 3 in Exhibit 1.

- 7. Are the additional procedures in paragraph 13 that the auditor should consider performing when obtaining an understanding of the company and its environment reasonable and appropriate for audits of issuers? Should these procedures be specifically required for all audits, or is the responsibility to consider performing the procedures sufficient?*

Please see comments on paragraphs 11-19 of Appendix 3 in Exhibit 1.

- 8. *Is the new requirement to assess certain matters related to the control environment component of internal control over financial reporting reasonable and appropriate? Is the difference between the required performance for an audit of internal control over financial reporting and an audit of financial statements only clear?***

As the matters outlined in paragraph 26 are consistent with AS No. 5, we believe they are appropriate; however, we do not believe this guidance should appear in two places. Please refer to our comments on paragraphs 26-32 of Appendix 3 in Exhibit 1.

- 9. *Is the additional direction regarding the period-end reporting process reasonable and appropriate for audits of financial statements only?***

As the direction regarding period-end financial reporting in the Proposed Standard is the same as paragraph 32 of AS No. 5, we believe it is appropriate. However, we do not believe such guidance should appear in two places. Please refer to our comments on paragraphs 26-32 of Appendix 3 in Exhibit 1.

- 10. *Are the requirements and direction regarding the auditor's responsibilities for evaluating design and implementation of controls as part of obtaining an understanding of internal control over financial reporting sufficient and clear? If not, what additional direction is needed?***

Please refer to our comments regarding paragraphs 20-36 of Appendix 3 in Exhibit 1.

- 11. *Does the additional description of the key engagement team members provide a better understanding of the expected participants in the discussion?***

Yes, the description of the key engagement team members is sufficient.

- 12. *Does the discussion of significant risks in this standard provide sufficient direction to enable auditors to identify significant risks?***

No. The discussion of significant risks in paragraph 63 would be enhanced by adding guidance similar to that in paragraphs A112-A114 of ISA 315, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*. Please refer to additional comments about this Proposed Standard in Exhibit 1.

- 13. *Should the Proposed Standards include specific requirements and direction regarding documentation, e.g., summaries of the identified and assessed risks and the linkage to the auditor's responses?***

No. As documentation requirements are contained in AS No. 3, we do not believe additional specific documentation requirements are needed in the Proposed Standards.



## **The Auditor's Response to the Risks of Material Misstatement – Appendix 4**

***14. Does the Proposed Standard clearly describe the auditor's responsibilities regarding tests of controls in integrated audits and in audits of financial statements only?***

No. Please refer to our comments regarding paragraphs 14-39 of Appendix 4 in Exhibit 1.

***15. Are the requirements and direction regarding tests of controls appropriately aligned with Auditing Standard No 5?***

Please refer to our comments regarding paragraphs 14-39 of Appendix 4 in Exhibit 1.

***16. Does the Proposed Standard clearly describe the auditor's responsibilities regarding substantive procedures?***

Please refer to our comments on paragraphs 11, 41, 45, and 48 of Appendix 4 in our Significant Detailed Comments and Exhibit 1.

## **Evaluating Audit Results – Appendix 5**

***17. Does the Proposed Standard clearly describe the auditor's responsibilities regarding the evaluation of audit results?***

No. Please refer to our comments on Appendix 5 in Exhibit 1.

***18. Are the requirements and direction regarding the accumulating identified misstatements and evaluating uncorrected misstatements appropriate and adequate?***

No. Please refer to our comments on paragraphs 14, 15, 16, 18, 19, and 20 of Appendix 5 in Exhibit 1.

***19. Are the requirements and direction regarding the evaluation of the results of the integrated audit appropriately aligned with Auditing Standard No. 5?***

The requirements regarding the evaluation of the results of the integrated audit are the same as those included in AS No. 5 and, as such, are appropriately aligned. However, we do not believe these requirements should be repeated. Please refer to our comments on paragraphs 41-44 of Appendix 5 in Exhibit 1.

## **Consideration of Materiality in Planning and Performing an Audit – Appendix 6**

***20. Are the requirements and direction in this standard appropriately aligned with the concept of materiality as described in the courts' interpretation of the federal securities laws?***

Please refer to our comments on paragraph 3 of Appendix 6 in Exhibit 1.

**21. Does the Proposed Standard sufficiently and clearly describe the auditor's responsibilities regarding (a) establishing an appropriate materiality level for the financial statements as a whole and (b) establishing a lower materiality level or levels for particular accounts or disclosures? If not, what additional direction is needed?**

No. We believe the Proposed Standard should provide more guidance on how to establish the materiality level for the financial statements as a whole as well as the lower level of materiality for particular accounts or disclosures. Paragraphs A3 through A5 of ISA 320, *Audit Materiality*, provide a list of factors that may affect the appropriate benchmark to use, examples of such benchmarks, and the relevant financial data to be used in relation to the chosen benchmark. Paragraph A10 of ISA 320 provides examples of factors that may indicate the need for lower materiality levels for particular accounts or disclosures. Similar guidance would be useful in assisting the auditor in applying the requirements in the PCAOB standard.

**22. Is the use of the term "tolerable misstatement" in the Proposed Standard appropriate and sufficiently clear?**

No. Please refer to our comments on paragraphs 8 and 9 of Appendix 6 in Exhibit 1.

### **Audit Evidence – Appendix 7**

**23. Does the Proposed Standard clearly describe the principles necessary for evaluating the sufficiency, relevance, and reliability of audit evidence?**

No. Please refer to our comments on Appendix 7 in Exhibit 1.

**24. Are the auditor's responsibilities regarding the authentication of documents reasonable and appropriate?**

Yes.

**25. Are the requirements and direction related to selecting items for testing appropriate and clear?**

Please refer to our comments regarding paragraph 27 of Appendix 7 in Exhibit 1.

**26. Are the five categories of assertions in this standard sufficient or should they be expanded? If so, how would such expansion affect auditor performance?**

The five categories of assertions are sufficient and consistent with other standards.

## **Exhibit 3: Editorial Comments**

### **Appendices 1-7**

Appendix 2, Paragraph 10 – The Proposed Standard indicates "the auditor should develop a written audit plan..." The term "written" can be misleading in the age of electronic workpaper documentation. In addition, this creates an unnecessary inconsistency with the ISAs (See ISA 300, paragraph 8) and the exposure draft of the related proposed SAS (AU 311, paragraph 8), neither of which include the word "written" in relation to the audit plan. We recommend the word "written" be deleted.

Appendix 3, Paragraph 21 – In the Note to this paragraph it is not clear why the second sentence is not part of ICFR. This Note states:

The auditor also might obtain an understanding of certain controls that are not part of internal control over financial reporting. For example, if the auditor plans to use information produced by the company, he or she should obtain an understanding of controls over the completeness and accuracy of that information if necessary to evaluate the sufficiency and appropriateness of the information.

However, controls over completeness and accuracy of information are part of ICFR. Perhaps the PCAOB is intending to refer to situations in which the auditor plans to use operational information produced by the company; if so, this paragraph should be changed accordingly.

Appendix 3, Paragraph 32 – The Note to this paragraph refers to "monitoring activities." This appears to be a typographical error, as we believe this should refer to obtaining an understanding of "the period-end financial reporting process."

Appendix 3, Paragraph 46 – We suggest deleting the Note to paragraph 36. Similar guidance related to a one-person engagement could apply to many other paragraphs within the Proposed Standards; however, such guidance is not provided. We also believe that the guidance provided is self-evident and, therefore, not particularly helpful. As such, we suggest deleting it here.

Appendix 3, Paragraph 56 – The Note to 56c seems to relate more to item b, but seems to repeat what item b is stating. We suggest deleting the Note after item c.

Appendix 4, Paragraph 38 – This paragraph implies that the financial statement audit is separate from the audit of ICFR. Rather than referring to an integrated audit, it refers to the audits separately. We suggest deleting the words "for the audit of internal control and the audit of the financial statements" as well as the words "during the financial statement audit."

Appendix 4, Paragraph 43 is redundant of paragraph 7b. We recommend paragraph 43 be deleted.

Appendix 4, Paragraph 50 – The first sentence of this paragraph does not make sense. Either a word is missing, or perhaps the word "detects" should be moved from after "risks of material misstatement" to after "if the auditor."

Appendix 5, Paragraph 27 – Initially this paragraph refers to "potential bias" but then this changes to "bias" in the last part of the sentence. This paragraph should refer to "potential bias" in both cases.

Appendix 7, Paragraph 13 – The first sentence is redundant of paragraph 4. The first sentence of paragraph 13 should be deleted.

### **Appendix 8 Conforming Amendments**

General Comment – While we agree with replacing "competent" with "appropriate" throughout the standards, this change results in the phrase "sufficient appropriate evidential matter." The entire phrase should be replaced with "sufficient appropriate audit evidence" to be consistent with the title of Appendix 7 and language used in the Proposed Standards.

AU 150 – Footnote 2 to paragraph .04 was deleted. Rather than deleting this footnote reference ("See section 312, *Audit Risk and Materiality in Conducting an Audit.*"), a new reference to the appropriate risk assessment standard should be added.

AU 230 – Within footnote 3 to paragraph .06, the reference to AU 311 was deleted. Rather than delete this reference, a reference to the Proposed Standard, *Audit Planning and Supervision*, should be added. Also, a reference to paragraph .08 of the Proposed Standard, *Audit Evidence*, is included in paragraph .12 after the sentence discussing documentation authentication. We believe this reference should be to paragraph .09 of Proposed Standard, *Audit Evidence*, which discusses the auditor's responsibilities related to documentation authentication.

AU 316 – The following paragraph is deleted from Footnote 2 of paragraph .01:

Auditors are sometimes requested to perform other services related to fraud detection and prevention, for example, special investigations to determine the extent of a suspected or detected fraud. These other services usually include procedures that extend beyond or are different from the procedures ordinarily performed in an audit of financial statements

We recommend such paragraph be retained in the standard.

A reference to paragraph .53 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, was added to the fifth bullet of paragraph .53. We recommend paragraph .54 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, be added as a reference in addition to paragraph .53, as both paragraphs discuss inquiring of others regarding fraud.

Through the Conforming Amendments the phrase "in accordance with GAAS" in Footnote 21 and 22 would be changed to "an audit of financial statements." We recommend using the phrase "in accordance with PCAOB audit standards."

AU 317 – The last sentence of paragraph .13, which has been revised, should include the phrase "For example" at the beginning of this sentence. The revised paragraph would appear as follows:

In evaluating the materiality of an illegal act that comes to his attention, the auditor should consider both the quantitative and qualitative materiality of the act. For example, an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility that it could lead to a material contingent liability or a material loss of revenue.

AU 322 – Based on the proposed Conforming Amendments, footnote 3 to paragraph 4 contains a reference to Proposed Standard, *Identifying and Assessing Risks of Material Misstatement*; however, there is no discussion of internal audit as being part of the entity's control environment in Appendix 3. We suggest either such a discussion be added, or this footnote be deleted.

Additionally, we recommend changing the reference to paragraph .44 of Proposed Standard, *The Auditor's Responses to the Risks of Material Misstatements*, in Footnote 5 to paragraph 18 to Proposed Standard, *Audit Evidence*.

AU 9326 – We recommend deleting the reference to section 313 in paragraph .04, as section 313 is superseded by the Proposed Standards.

AU 329 – While paragraph .03 was deleted (see text below), this paragraph still appears to be relevant to substantive analytical reviews; therefore, we recommend retaining this paragraph.

Understanding financial relationships is essential in planning and evaluating the results of analytical procedures, and generally requires knowledge of the client and the industry or industries in which the client operates. An understanding of the purposes of analytical procedures and the limitations of those procedures is also important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires judgment by the auditor.

Footnote 2 to paragraph .20 was deleted; however, we question the deletion of this footnote and recommend retaining it and providing an updated reference to the applicable Proposed Standard.

Footnote 3 to paragraph .21 was deleted. We recommend retaining this footnote and inserting a reference to the appropriate Proposed Standard.

AU 332 – We recommend editing the revision to paragraph .35 to state "provides direction" rather than "provide directions" as the subject of this sentence is the Proposed Auditing Standard, not the paragraph references.

AU 342 – We recommend editing the revision to paragraph .14 by changing "discuss" to "discusses" as the subject of this sentence is the Proposed Auditing Standard, not the paragraph references.

AU 350 – Paragraph .04 of Proposed Standard, *Audit Evidence*, which is referenced in Paragraph .07, does not describe the concept of "a reasonable basis for an opinion." We recommend referencing to AU 230.11.

In paragraph .09, we recommend the reference should be to paragraphs 3 through 10 of Proposed Standard, *Audit Risk in an Audit of Financial Statements*, as opposed to paragraphs 5 through 10.

We recommend removing the remaining references to section 313 that still exist throughout this section.

AU 9543 – Footnote 4 to paragraph .16, which included a reference to where the term "assistants" is defined, was deleted. Within paragraph .16, the term "assistants" is retained; however, the Proposed Standards use the phrase "engagement team members." We recommend replacing the term "assistants" with "engagement team members" throughout the standards.

AU 380 – We recommend changing the reference to section 316A in the last sentence of Footnote 5 to section 316.

ET 102 – The reference in footnote 1 to paragraph .05 has been revised to refer to the Proposed Standard, *Audit Planning and Supervision*. As with the original footnote reference, a specific paragraph reference to this standard should be included.