



March 2, 2010

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Request for Public Comment: *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards, PCAOB Rulemaking Docket Matter No. 026*

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ appreciates the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB or the Board) *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards* (the reproposal or repropose standards). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

Identifying, assessing and responding to risks are integral to the audit process and fundamental to the conduct of high quality audits. We concur with the Board that risk assessment should underlie the entire audit process and result in appropriate audit procedures that are tailored to a company's facts and circumstances, including its size and complexity. As set out in our previous comment letter, we are supportive of efforts to improve auditors' assessment of and response to risks. We have organized our overall observations and comments based on the following:

- Improvements to transparency of the standards-setting process
- Convergence of auditing standards
- Organization and consistency of the PCAOB's standards

- Other comments on the standards-setting process

In addition, we have comments that are specific to each of the seven repropoed standards and the related amendments, which we have included as an Attachment to this letter.

Improvements to Transparency of the Standards-Setting Process

We recognize and appreciate the PCAOB's efforts to increase the transparency of its standards-setting process, including exposing a revised proposal for public comment. In addition, we appreciate the Board's consideration of the feedback from stakeholders on its original proposal and believe that the repropoed standards are significantly improved in a number of areas. For example, we believe the repropoed better integrates and aligns with the principles from PCAOB's Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements* (AS No. 5). In addition, we believe the repropoed standards have been significantly improved not only with respect to their organization but also in the clarity of the underlying requirements.

Further, we recognize and appreciate the Board's efforts to provide its perspectives on the differences between its proposed standards and those of the International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board (ASB). Comparisons with these standards, combined with the Board's rationale for any differences, provides registered firms and other interested parties with useful insights into the Board's thought process and some insight into its expectations for changes to audit practice. This perspective enhances the ability for commenters to provide thoughtful feedback in response to the Board's proposals, which in turn should enhance the Board's perspective and assist in its efforts to improve audit quality.

While we commend the PCAOB for these measures, we request the Board consider further enhancements to its standards-setting process that would provide additional visibility to the Board's rationale and expectations for changes to practice. We believe these enhancements are consistent with Acting Chairman Daniel L. Goelzer's¹ comments at the December 17, 2009 open meeting whereby he urged "the Board to continue to explore ways of making its standard-setting – and the thinking that underlies its proposals – more open." Suggested enhancements could include the following:

Highlight Desired Changes to Practice

We note that Board member Charles D. Niemeier² suggested at the Board's December 17, 2009 open meeting that the PCAOB, as part of the release of a proposed or final standard or rule, should more clearly express what they expect to change as a result of such standard or rule. We agree and believe that providing specific descriptions of the Board's desired changes to current audit practice as a result of a proposal, final standard or rule would assist auditors and other interested parties in understanding the changes expected from the relevant proposals or standards. We note that the Board could

¹ See statement of Daniel L. Goelzer at the December 17, 2009 open Board meeting at www.pcaobus.org.

² See statement of Charles D. Niemeier at the December 17, 2009 open Board meeting at www.pcaobus.org.



consider the approach utilized by the Financial Accounting Standards Board to provide this information.

In addition, with regards to the comparisons of the PCAOB's proposed standards to those of other standard setters, we note that a large number of registered firms conduct audits in accordance with standards from the PCAOB, ASB and IAASB. As such, given that the PCAOB uses different drafting conventions and terminology than the ASB and IAASB, in situations where the underlying objectives and requirements are similar, firms may infer that the PCAOB does not intend there to be a different auditor action unless it is specifically highlighted by the PCAOB (or otherwise clearly apparent within the context of the standard). As such, we continue to encourage the PCAOB to be as comprehensive in their comparisons as possible to assist firms in recognizing and implementing any intended differences.

Comparison to Original Standards

We note that Board member Charles D. Niemeier³ also suggested at the Board's December 17, 2009 open meeting that a comparison of proposed standards to existing standards may be more useful than comparisons to standards developed by others. We agree that a comparison to the Board's existing standards conducted, for example, in a paragraph-by-paragraph fashion (where practical), would be very helpful (along with the Board's comparison of its proposed standards to those of the IAASB and ASB). Similarly, in situations where there are significant conforming amendments to existing PCAOB standards (such as, for example, the proposed conforming amendments to AU 316, *Consideration of Fraud in the Financial Statement Audit*) it would be helpful to auditors if the PCAOB provided a copy of the affected standard marked for the proposed amendments. Such comparisons, which are also likely to assist in the development and analysis of proposed standards by PCAOB staff, could be provided as supplemental information accompanying the proposals. These suggested practices would significantly assist commenters' ability to evaluate the effect of the proposal and therefore, improve the quality of their feedback.⁴

We believe that practices such as these would provide additional, helpful transparency to the Board's standards-setting process, facilitate a better understanding of the Board's expected changes to practice, enhance the feedback received by the Board, and encourage more consistent implementation through enhanced clarity – all of which we believe would contribute to advancing the Board's mission to improve audit quality.

Convergence of Auditing Standards

As we have stated in previous comment letters, we fully support the Board's consideration of the work of other standard setters, such as the IAASB and ASB. We recognize that the Board may decide that different procedures are appropriate in the U.S. public company audit environment. However, we encourage the Board

³ Ibid

⁴ We note that such comparisons are published by other audit standard setters for that very reason, and we would encourage the PCAOB to consider such efforts in the future.

to continue to minimize the differences in its standards to only those matters that are unique to audits of issuers in the U.S., as well as encourage the Board to continue highlighting the different procedures required for U.S. public company audits.

As we have previously indicated, we recognize the Board's efforts to provide increased information regarding the Board's rationale for the differences that remain through the Board's responses to the comments received. We also recognize the improvements made to reduce differences between the PCAOB's standards and the International Standards on Auditing (ISAs). For example, we noted a number of areas in which the requirements in the repropose standards were more closely aligned with the ISAs, including greater consistency with the terminology used by the IAASB. Additionally, we noted that in areas where differences in terminology remained, the Board provided rationale for maintaining the differences. We believe that minimizing differences in language, clearly articulating the rationale for any differences and explaining the expected auditor actions as a result of the differences can serve to enhance auditors' and other interested parties' understanding of the differences between standards issued by each standard setter. Such enhanced understanding will facilitate more consistent application of auditing standards, improve the effectiveness and efficiency of implementing new standards, and improve audit quality. Minimizing differences allows firms, for example, to cultivate synergies related to training, implementation, and the development and maintenance of quality control systems that accommodate the standards of the various standards-setting bodies - all factors that we believe contribute to enhanced audit quality.

However, we believe that the PCAOB should continue to work to further minimize differences between its standards and those of other audit standard setters. We acknowledge the PCAOB's efforts to participate in the work of other standard setters by attending IAASB meetings, inviting the IAASB and ASB Chairs to join the PCAOB Standing Advisory Group (SAG) meetings (as observers with speaking rights), and participating in joint meetings of standards setters. We encourage the PCAOB to continue these efforts, including working collaboratively with the IAASB in the development of standards. We believe that such participation would complement the role of the SAG and the other forums that currently inform the Board's agenda and standards-setting activities. In addition, the other standard setters would benefit from the PCAOB's perspective on current audit issues. Other advantages of participating in such activities include the opportunity for the Board to:

- Hear and participate in discussions among various constituents about potential ways to address issues while preserving the ability and flexibility to obtain perspectives and input through existing practices;
- Minimize and avoid unnecessary differences between the Board's standards and global and U.S. non-public company auditing standards; and
- Provide interested parties with an enhanced understanding of the rationale for differences that remain between the standards.

We believe that such collaboration and dialogue between the PCAOB could have positive effects on the standards-setting process and audit quality.

Organization and Consistency of the PCAOB's Standards

As we noted in our previous comment letter, adoption of these repropoed standards continues the development of a third "style" of PCAOB standards that is inconsistent with the Board's other standards (i.e., interim standards, AS No. 6 and earlier standards) and there is not a clearly stated plan for updating existing standards in the future. Given the PCAOB's recent commitment to an extensive standards-setting agenda, we are concerned that new standards may become increasingly cumbersome to navigate and apply with the remaining interim standards without an overarching framework to guide the development of such standards, as well as a plan for updating existing standards. Therefore, we recommend that the PCAOB consider undertaking a project, similar to that undertaken by the ASB and IAASB, to redraft all of its auditing standards in a consistent manner (e.g., consistent use of objectives), with the intent of encouraging greater understanding and more consistent application. While we recognize that the PCAOB's resources are limited, we believe such a project, and the potential benefits to auditor understanding and performance, merits priority on the Board's agenda.

In the interim, we have noted a number of drafting conventions that we believe may make it more cumbersome to understand and use these repropoed standards. Details of these conventions are included below, including our recommendations to address them:

Use of Notes

The existence of requirements within notes may make them appear less prominent than if they were placed in the paragraphs of the standards. As a result, we recommend that in situations where the Board is establishing a requirement, that the PCAOB consider placing them in paragraphs, as opposed to notes.

Use of Appendices

Although we understand that appendices carry the same level of authority as the paragraphs within the standard, the inclusion of requirements within appendices to standards may increase the likelihood that auditors could overlook those particular requirements. Similar to the Board's rationale for incorporating the guidance from the Board's interim standards related to fraud into the respective auditing standards to encourage integration of fraud procedures within the various stages of the audit, we recommend the Board consider incorporating requirements currently located in appendices into the body of the applicable standards.

Other Comments on the Standards-Setting Process

Release Text

As we have previously indicated, we are supportive of the Board's efforts to increase the transparency of the standards-setting process, including efforts to provide its perspective on the differences between its proposed standards and those of the IAASB and ASB, as well as its consideration of comments received. However, we are concerned that in some situations, it appears that in addition to providing insight into the Board's decision-making process, the Board is also attempting to interpret aspects of the standard in the release (e.g., see comment 2c included in the Attachment to this letter). Interpreting standards through release text can result in potential confusion over the requirements within the related standard and result in inconsistent



application by auditors. In addition, given that the release is not ultimately part of the final standard, any interpretive guidance contained within it may not be given the same consideration by auditors and other interested parties. Also, to the extent such interpretive guidance is included in the release to a final standard, such guidance could affect commenters' previous understanding of the Board's intent from previous proposals, which not only causes confusion but also may have affected the quality of comments provided to the Board during the public comment process. As a result, we encourage the Board to consider providing such interpretive guidance within proposed standards as opposed to an accompanying release.

Public Involvement in the Standards-Setting Process

In addition to our comments supporting the PCAOB's efforts to increase transparency in its standards-setting process above, we encourage the Board to seek ways to increase the depth and accelerate the timing of public involvement, including the auditing profession, in its standards-setting process. We acknowledge and appreciate the recent efforts the Board has taken to more proactively engage the SAG in standards-setting matters. In addition, consistent with Acting Chairman Daniel L. Goelzer's⁵ remarks at the PCAOB's October 21, 2008 open meeting (at which the original proposed standards were approved for exposure) we recommend that the Board consider additional public forums or Board meetings to discuss comments received on a proposal before final adoption of a standard.

We believe the Board could enhance its standards-setting process by establishing external task forces that consist of members with significant expertise (including members of the auditing profession) to participate in developing and updating its auditing standards. We note that the PCAOB utilized a similar model in the development of the PCAOB's *Staff Views of An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies*, which included the input of a working group composed of auditors who had experience with audits of internal control over financial reporting in smaller, less complex companies. In developing this guidance, the PCAOB also consulted with financial executives from smaller public companies.

Establishing external task forces consisting of members with relevant expertise would provide the Board with an opportunity to: 1) obtain public input from interested persons or organizations during the development stage of its standards-setting process; and 2) identify any significant implementation issues prior to the formal publication of a proposed standard for public comment. We also encourage the PCAOB to consider whether field-testing certain proposed standards as part of the Board's overall standards-setting process would provide it with an opportunity to gain insights as to whether the proposed standards result in the Board's intended changes to auditor performance. We believe that such additions to the process would enhance the efficiency and effectiveness of the standards-setting process.

Effective Date

We commend the PCAOB for responding to comments received from the original proposal and including a discussion of the expected effective date in the release to the repropoed standards. With respect to the PCAOB's expectation that the standards would be effective for audits of fiscal years beginning on or after December 15, 2010, we note that such an expectation may be aggressive given the time required to consider public comments received and obtain Board and SEC approval. As we have stated previously, we believe

⁵ See statement of Daniel L. Goelzer at the October 21, 2008 open Board meeting at www.pcaobus.org.



that given the foundational nature of the proposed standards, the effective date chosen should provide time required for firms to incorporate the standards into their audit methodologies and training programs prior to implementation, as well as be effective as of the beginning of the audit planning process.

Enclosed with this letter is an Attachment that provides more detailed comments specific to each of the proposed standards and conforming amendments. As mentioned previously, we appreciate the Board's careful consideration of our comments, its efforts with regards to the repropoed standards, as well as the overall improvements to its standards-setting process. We appreciate the opportunity to comment on the proposed standards and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,



Cindy Fornelli
Executive Director
Center for Audit Quality

Enclosure

cc: PCAOB

Daniel L. Goelzer, Acting Chairman
Willis D. Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin Baumann, Chief Auditor and Director of Professional Standards

SEC

Chairman Mary Schapiro
Commissioner Luis Aguilar
Commissioner Kathleen L. Casey
Commissioner Troy Paredes
Commissioner Elisse B. Walter
James L. Kroeker, Chief Accountant

Attachment

CAQ Comment #	Appendix 1 – Audit Risk
1a	Paragraphs 9-10 – We note that the repropoed standard could be improved by including certain language currently included in the PCAOB’s interim standards related to the concept of detection risk (i.e. paragraph 81 of the PCAOB interim standard AU 319, <i>Consideration of Internal Control in a Financial Statement Audit</i> , which states “The auditor uses the assessed level of control risk (together with the assessed level of inherent risk) to determine the acceptable level of detection risk for financial statement assertions.”) We believe this language could serve to enhance the understanding of the audit risk model and would recommend that the PCAOB consider including it.

CAQ Comment #	Appendix 2 – Audit Planning and Supervision
2a	Paragraph 7 – This paragraph states that the auditor should evaluate whether certain listed matters are important to the company’s financial statements and internal control over financial reporting (ICFR) and if so, how they should impact the audit strategy and audit plan. The ninth bullet in the list requires the auditor to consider “preliminary judgments about the effectiveness of internal control over financial reporting.” However, unlike the fifth bullet point related to the auditor’s preliminary judgments of materiality, this bullet is not clear that it refers to the auditor’s judgments. We recommend that the PCAOB modify the ninth bullet point to clarify that it pertains to the <u>auditor’s</u> preliminary judgments or consider clarifying the intent behind the omission.
2b	Paragraph 7 – As noted above, this paragraph states that the auditor should evaluate whether certain matters listed are important to a company’s financial statements and ICFR and, if so, how they will affect the auditor’s procedures. We are not clear how the auditor’s actions to “evaluate whether” such matters, as currently drafted, would differ from the requirement in the Board’s extant auditing standard (paragraph 3 of AU 311, <i>Planning and Supervision</i>) that the auditor “should consider” such matters. Therefore, we recommend the PCAOB consider modifying the language in paragraph 7 to replace “should evaluate” with “should consider” or alternatively, describe any intended difference in auditor performance and documentation requirements.
2c	Paragraphs 11-14 – These paragraphs outline the auditor’s responsibilities with respect to multi-location engagements. However, the Board states in Appendix 10 that these provisions “are applicable to all multi-location audits, not just group audits.” The Board’s existing interim standard (AU 543, <i>Part of the Audit Performed by Other Independent Auditors</i>), is the PCAOB’s prevailing guidance with respect to referring to the work of another auditor. The multi-location requirements in paragraphs 11-14, as well as in other repropoed standards, are not clear as to how they are to be applied when another auditor audits the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements – specifically in situations where an auditor refers to the work of another auditor. In addition we note that the Board’s standards do not currently contain a definition of a “group audit,” nor do the

	standards or the Board’s release to the repropoed standards contain any discussion of what the similarities and/or differences between multi-location audits and group audits might be. Therefore, we request the Board to clarify its intent with respect to the application of these paragraphs. (see further discussion in “Release Text” section on page 5 of this letter)
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2d	<p>Paragraph 14 – This paragraph appears to create a narrower or more prescriptive requirement than the requirement set forth in paragraph 5c of the repropoed standard, <i>Auditor’s Responses to the Risks of Material Misstatement</i>, relating to introducing an element of unpredictability in the auditing procedures auditors perform at locations or business units from year to year. Paragraph 14 appears to require auditors to change the nature, timing and extent of audit procedures performed at various locations each year, whereas paragraph 5 requires that auditors incorporate unpredictability and provides varying the locations where procedures are performed as an example of how that might be achieved.</p> <p>We agree with the requirement for auditors to introduce an element of unpredictability in the audit plan. However, we do not believe it is necessary to dictate the specific manner in which the element of unpredictability is to be introduced. Given that the requirement in paragraph 5 is intended to impact the auditor’s overall response to the assessed risks of misstatement, including the risk of fraud, we recommend deleting paragraph 14 from this standard or including this paragraph as an example to paragraph 5 of the repropoed standard <i>Auditor’s Responses to the Risks of Material Misstatement</i>.</p>
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CAQ Comment #	Appendix 3 – Consideration of Materiality in Planning and Performing an Audit
3a	As in the original proposal, the repropoed standard uses the term “tolerable misstatement” (e.g., paragraphs 8 and 9), which is different from the term “performance materiality” used in ISA 320 (Revised and Redrafted), <i>Materiality in Planning and Performing an Audit</i> for essentially the same concept. As described by the Board in Appendix 9 of the repropoed standards, we recognize that the term is well understood by auditors and that the Board is not seeking to change the concept as described in existing PCAOB standards. However we note that currently, the term is defined and largely understood by auditors in the context of audit sampling (as defined in AU 350, <i>Audit Sampling</i> , in the PCAOB’s interim standards). Using the same term in two separate fashions – to both assist auditors in assessing risks of material misstatement for the purpose of determining an appropriate audit response and to plan a sample – could result in confusion for auditors and result in misapplication of the concepts, which in turn, could have adverse impacts on audit quality. Therefore, to avoid potential confusion, we recommend that the PCAOB replace the term “tolerable misstatement” in the repropoed standard with “performance materiality,” which is the equivalent term used in the ISAs and in the ASB’s analogous redrafted proposed standard.

CAQ Comment #	Appendix 4 – Identifying and Assessing Risks of Material Misstatement
4a	<p>Paragraph 3 – This standard contains requirements and guidance related to the procedures auditors should perform to identify and assess the risks of material misstatement. Additionally, a significant portion of this standard relates to risk assessment procedures auditors should perform to obtain an understanding of the entity and its environment in order for the auditor to provide himself/herself with a reasonable basis to assess those risks. However, we note that the objective excludes the concept that the identification and assessment of risks are obtained through the auditor’s understanding of the company and its environment. As such, we recommend the objective be modified to recognize that the auditor’s identification and assessment of risks is “through understanding of the entity and its environment.” The addition of this language to the objective will help emphasize how the requirements articulated in the standard are intended to provide the auditor with the requisite understanding of the entity and its environment. Such a clarification would appear to be consistent with the PCAOB’s repropose standard and would also be consistent with the objective of ISA 315, <i>Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement</i>.</p>
4b	<p>Paragraph 11 – This paragraph contains procedures an auditor should consider performing as part of obtaining an understanding of the company. We agree that information from such procedures, in many instances, would provide the auditor with meaningful insights into the company and therefore, enhance the assessment of risks. However, we note that the broad nature of the procedures, combined with the presumptively mandatory requirement to consider performing the procedures, may result in auditors expending significant efforts to identify such information and/or documenting the considerations regarding the importance of such information to the auditor’s understanding of the company (e.g. observing or reading transcripts of ... other meetings with investors...). Such excess efforts may not result in a commensurate increase in audit quality. As such, we recommend the PCAOB consider amending the requirement to indicate that the auditor “might consider” the procedures outlined within the paragraph.</p>
4c	<p>Paragraphs 13 and 68 – Paragraph 13 requires the auditor to identify the “necessary disclosures for the company’s financial statements” in identifying and assessing the risks of material misstatement related to omitted or incomplete disclosures. Paragraph 68 states that the “auditor’s evaluation of fraud risks...should include evaluation of how fraud could be perpetrated or concealed through omitting or presenting incomplete disclosures.” However, the repropose standards contain no guidance related to the context in which this assessment should be conducted. Therefore, we recommend that the PCAOB clarify that, while the responsibility for identifying “necessary” disclosures resides primarily with management, the auditor’s identification, assessment and evaluation of omitted or incomplete disclosures should be conducted in the context of the company’s financial reporting framework and the auditor’s overall assessment of the risk of material misstatement of the financial statements.</p>
4d	<p>Appendix A5 - The definition of significant risk should make clear that it is the <i>auditor</i> who makes a determination of the areas that are deemed significant risk and thus require special audit consideration based on the auditor’s assessment of the entity’s risks. This concept is excluded from the definition as set forth in Appendix A. We believe the</p>

	<p>definition of significant risk would be enhanced by including the following language:</p> <p><i>Significant risk</i> – A risk of material misstatement that <i>the auditor determines</i> requires special audit consideration.</p>
4e	<p>Paragraph 20 – With respect to control design effectiveness, the first Note to paragraph 20 states that “Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.” However, the second Note to this paragraph, which discusses evaluating whether a control has been implemented as designed, does not make the same statement as it relates to evaluating whether a control has been implemented through the performance of a walkthrough. Paragraphs 64-65 (as well as paragraphs 34 and 37 of AS No. 5) appear to indicate that walkthroughs <i>would</i> be sufficient for the purpose of evaluating whether a control has been implemented as designed. We agree and, accordingly, we recommend the Board clarify within the second Note to paragraph 20 that a walkthrough would “ordinarily” be sufficient for this purpose.</p>
4f	<p>Paragraph 42 – This paragraph states that “If the auditor has obtained other information relevant to identifying risks of material misstatement through other engagements performed for the company, the auditor should take that into account in identifying risks of material misstatement.” In the release to the repropoed standard, it appears that the Board’s intent was for the auditor to consider and document the effect of <i>all</i> engagements performed by the firm when assessing risks. We are concerned that this is a requirement that extends beyond the existing guidance in AU 9311, <i>Planning and Supervision: Auditing Interpretations of Section 311</i> and may result in significant effort without a corresponding benefit to audit quality.</p> <p>Therefore, we recommend that the Board reconsider this requirement. We believe the language included in the PCAOB’s interim standard, AU Section: 9311 provides the appropriate responsibility for considering other engagements performed by the firm; it states the following: “The auditor should consider the nature of non-audit services that have been performed. He should assess whether the services involve matters that might be expected to affect the entity’s financial statements or the performance of the audit...” We recommend similar language be included in the repropoed standard.</p>
4g	<p>Paragraph 54 –This paragraph requires auditors to identify other individuals within the company to whom inquiries about their views regarding fraud risks should be directed. We recommend that certain deleted words from paragraph 24 of the PCAOB’s extant AU 316, the source for paragraph 54, be reinstated. Specifically, we recommend making the following changes to the second sentence, “The auditor should identify other individuals within the company to whom inquiries should be directed <u>and determine the extent of such inquiries</u> by considering whether others in the company might have additional knowledge <u>that will be helpful to the auditor in identifying risks of material misstatement due to about</u> fraud, alleged or suspected fraud ...” Retaining the extant language will make clear that the auditor is to make a determination about the extent of such inquiries and explicitly relates the need for these inquiries to the risks of material misstatement.</p>
4h	<p>Paragraph 56 – This paragraph sets forth a process for identifying and assessing the risks of material misstatement using the information obtained from the risk assessment</p>



	<p>procedures and other relevant knowledge possessed by the auditor. Paragraph 56d requires auditors to consider the likelihood and magnitude of potential misstatements to assess the possibility that the risk could result in a material misstatement of the financial statements. However, we note that paragraph 56f, which requires auditors to determine whether any of the identified and assessed risks of material misstatement are significant risks, does not contain similar language related to an auditor’s consideration of likelihood and magnitude when evaluating whether an identified risk is a significant risk. While the Note to 56f correctly states that the determination of significant risk is based on inherent risk, without regard to the effect of controls, we believe an auditor’s evaluation of whether or not a risk is significant when evaluating inherent risk includes consideration of the likelihood and magnitude of the risk of misstatement. As such, we recommend the Board clarify the note to 56f that likelihood and magnitude are factors for consideration in significant risk determinations.</p>
4i	<p>Paragraph 62 – This paragraph contains requirements related to objectives for the auditor to achieve to understand the likely sources of misstatement, including a requirement to identify controls that a company has implemented to address potential misstatements. While these are largely consistent with AS No. 5, we note that in a financial statement audit an auditor ordinarily would only be required to obtain an understanding of controls sufficient to plan the audit. Therefore, we request the Board to consider whether such a requirement significantly enhances the auditor’s ability to plan and perform the audit given the potential increase in costs this identification may require, particularly in financial statement audits where auditors may elect not to rely on a company’s controls.</p>

CAQ Comment #	Appendix 5 – The Auditor’s Responses to the Risks of Material Misstatement
5a	<p>Paragraph 2 – The objective as defined appears to be inconsistent with the discussion in paragraph 3. Paragraph 3 clarifies that to meet the objective of the standard, the auditor must address the risks that are identified and <i>assessed</i> in accordance with the repropoed standard, <i>Identifying and Assessing Risks of Material Misstatement</i>. The objective does not include the notion of addressing the risks “assessed” by the auditor. We recommend that the Board add the word “assessed” to the objective to clarify the auditor’s responsibilities. While we support the Board’s changes to include the concept of “assessed risk” to create a better linkage to audit responses, we believe that the objective of the standard should include “assessed risk” to make this same linkage.</p>
5b	<p>Paragraph 5 – This paragraph requires the auditor to design and implement overall responses to address the assessed risks of material misstatements. More specifically, item 5c of this requirement entitled “<i>Incorporating elements of unpredictability in the selection of audit procedures to be performed</i>” indicates that the auditor should incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year as part of the auditor’s response to the assessed risks of material misstatement due to error and fraud. While we believe that the focus of incorporating an element of unpredictability into the auditor’s procedures should be based on the auditor’s response to the assessed risks of material misstatement due to fraud, we recommend that the PCAOB consider providing additional clarity regarding its application in response to risks other than fraud risks.</p>

5c	<p>Paragraph 6 – This paragraph requires the auditor to “... evaluate whether it is necessary to make <u>pervasive</u> changes to the nature, timing, or extent of audit procedures to adequately address the assessed risks of material misstatement. Examples of such <u>pervasive</u> changes include performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.”</p> <p>Given the overall requirements of the repropoed standard is to address the risks of misstatement by obtaining sufficient appropriate evidence, we do not believe the term “pervasive” is needed and could result in confusion related to the underlying requirement.</p>
5d	<p>Paragraph 31 – This paragraph provides guidance to assist auditors in determining to what extent evidence obtained in past audits related to the design and operating effectiveness of controls can impact the evidence needed to support the auditor’s control risk assessments during the current year audit. While we recognize that this paragraph is largely consistent with the requirements of AS No. 5, we believe it could be interpreted as requiring auditors to evaluate and document their considerations of <i>all</i> controls tested in connection with the prior year audit and consequently could result in a significant increase in effort without providing a commensurate benefit to audit quality. We note that the requirement in AS No. 5 is intended to allow the auditor’s experience in prior years to inform its assessment of risk, which in turn impacts the nature, timing and extent of testing necessary. As such, we recommend the PCAOB modify paragraph 31 to be consistent with paragraphs 47, 57 and 58 of AS No. 5 to better articulate the requirement.</p>

CAQ Comment #	Appendix 6 – Evaluating Audit Results
6a	<p>Paragraph A2 of Appendix A in the repropoed standard defines the word “misstatement;” however due to the sequencing of the sentences, the definition could instead be interpreted as defining “material misstatement.” As a result, we recommend that the PCAOB move the second sentence, which deals simply with “misstatement,” to the first sentence of the paragraph.</p>
6b	<p>Paragraph 15 – This paragraph includes guidance for the auditor to communicate accumulated misstatements to management on a timely basis to provide them with an opportunity to correct them. Both the IAASB and ASB standards include a requirement that the auditor request management to correct those misstatements and to understand management’s reasons, if any, for not making the corrections. We believe that understanding management’s rationale for not correcting misstatements could provide the auditor with perspective that could enhance the risk assessment, including the fraud risk assessment. In addition, requiring the auditor to make such a direct and specific request of management may improve the likelihood that such corrections will be made in the current period. As such, we believe this requirement should also exist in the PCAOB standards.</p>
6c	<p>Paragraphs 28 and C1 – Paragraph 28 provides that when evaluating the results of the audit, the auditor should evaluate whether the accumulated results of audit procedures and other observations affect the assessment of fraud risks made throughout the audit and whether audit procedures need to be modified to respond to those risks. This paragraph</p>

	also references Appendix C, which is titled “matters that might affect the assessment of fraud risks.” However, paragraph C1 lists matters, if identified during the audit, that “...the auditor should determine whether the assessment of fraud risks remain appropriate or needs to be revised. “ This seems to indicate that the auditor is required to determine if each item identified during the audit individually affects the assessment of fraud risks, which appears inconsistent with paragraph 28. We recommend the following sentence replace the first sentence of paragraph C1 in order to be consistent with paragraph 28 and the title of Appendix C – “The following matters might affect the auditor’s assessment of fraud risks, including whether that assessment remains appropriate or needs to be revised.”
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CAQ Comment #	Appendix 7 – Audit Evidence
7a	Paragraph 18 – The original proposed standard included a description that “[w]ritten confirmations might be received in paper form, or by electronic or other medium.” We note that this description is excluded from the reposed standard. While we understand the PCAOB is in the process of considering amendments to its interim standard, AU 330, <i>The Confirmation Process</i> , we are concerned that the removal of the expectation that confirmations be “written,” could have an effect on the auditor’s evaluation of information provided from third parties as part of the audit. As such, we recommend that the Board consider re-inserting the word “written” in the first sentence so it refers to a “direct written response.” We believe such language would better maintain the existing guidance until the completion of the Board’s current project on confirmations.
7b	We note that a number of terms are used in this standard to describe the nature of audit evidence obtained through the audit. For example, the words, “sufficiency”, and “appropriateness” are used throughout to describe the characteristics of evidence that auditors are required to evaluate in order to conclude the evidence they have obtained is both sufficient and appropriate to support the related assertion. These terms, however, are not formally defined. We recommend that the Board consider providing formal definitions for these terms, using the guidance in paragraphs 5 and 6 of the reposed standards, which would allow them to be easily located within the standards as well as promote consistency in performance of audits.

CAQ Comment #	Appendix 8 – Proposed Amendments to PCAOB Standards
8a	Proposed amendments to AU 350 – In our comment letter on the original proposed standards, we expressed concern that the suggested amendments to paragraph 23A and 38 of AU 350, <i>Audit Sampling</i> , would require auditors who use non-statistical sampling methods to calculate sample sizes using both statistical and non-statistical approaches in all circumstances in order to be in a position to be able to compare the sample sizes and demonstrate that the sample size under the non-statistical method equaled or exceeded sample size under a statistical method. In Appendix 9 of the reproposal, the Board appears to have clarified its view that this was not its intent by stating “[t]he proposed amendments are not intended to require auditors

<p>to compute sample sizes using statistical methods in all instances to demonstrate compliance with the requirements.” Although we appreciate that the Board has attempted to address the concern, we recommend the Board include this guidance within the standard itself to avoid potential confusion or misinterpretation. The potential guidance could leverage the language used in the release or, alternatively, language similar to paragraph A11 of redrafted ISA 530 or footnote 5 from paragraph 23 of the ASB’s revised AU 350.</p>
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