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Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 030 – Proposed Auditing Standard Related to Communications with Audit Committees

To the Board:

The Accounting Principles and Auditing Standards Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") is pleased to provide our comments to the PCAOB on PCAOB Rulemaking Docket Matter No. 030 – Proposed Auditing Standard Related to Communications with Audit Committees (the "Proposed Standard").

The Committee is the senior technical committee of CalCPA. CalCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

A. Objectives of the Auditor

Question 1: Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objective?

Response: The objectives established in the proposal are appropriate. However, the objectives should be met without communicating audit strategies, unless such communication is at a very high level. The admonition in paragraph 9 to avoid specific details, which admonition is focused on auditing procedures, is not adequate. Audit strategies can be communicated at a very high level without compromising the independence or integrity of the audit; for example, identified risk areas, sites to be visited, expected coverage of various financial statement categories, etc. Strategies on non-risk areas, strategy on rotation of audit procedures and specific strategies on auditing computer based systems should not be communicated. Illustrative examples of matters considered either appropriate or inappropriate to communicate would be helpful.

Paragraphs 1 and 3.d. of the proposed standard requires the auditor to evaluate the adequacy of two-way communication with the audit committee, and paragraphs 26 through 28 states what the auditor is to do if they are not adequate. This places the auditor in the impossible position of deciding whether the audit committee, which may not have been fully informed by management, has made adequate communication with the auditor, and then reporting to the board of directors, which includes the audit committee members, that something may be amiss. This puts the auditor in the position of making a serious accusation without the ability to get all the facts, and placing blame where it might not belong. This whole notion of evaluation of communications is far too complex to be relegated to four unclear paragraphs, and should be deleted.

Other matters need not be included in the objectives of the proposed standard.

Question 2: Are the objectives adequately articulated? Should the articulation of the objectives focus on the outcome that should be achieved by performing the required procedures?

Response: The objectives are adequately articulated. However, the outcome that the PCAOB appears to be trying to achieve is NOT directly related to the basic purpose of the audit, which is to determine whether the financial statements are fairly stated. If the PCAOB's desired outcome is something other than this, they should not articulate it, but restate what the focus of the audit is. The auditor is not the "keeper" of the audit committee, and any implication of that responsibility is wrong. The nature and extent of the auditor's evaluation of the audit committee's effectiveness in discharging its responsibilities related to overseeing the financial reporting process should be limited to identifying entity level control weaknesses in the context of the integrated audit, and nothing further.

B. Establish a Mutual Understanding of the Terms of the Audit

Question 3: Is it appropriate for the proposed standard to require that an engagement letter be prepared annually? If not, why?

Response: Yes, obtaining a written engagement letter prior to the commencement of interim review procedures for the 1st quarter of the audit period is an appropriate requirement.

Question 4: Are there other matters that would enhance investor protection that should be added to the engagement letter? If so, what other matters should be included in the engagement letter?

Response: No, there are not.

C. Obtaining Information Related to the Audit

Question 5: Is the proposed requirement to inquire of the audit committee appropriate? What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

Response: Yes, making inquiries of the audit committee is an appropriate means of obtaining information used in planning and executing the audit. We do not believe the proposed standard needs to be expanded in this area, as the auditor's application of professional judgment should be sufficient to expand the inquiries directed to the audit committee.

D. Overview of the Audit Strategy and Timing of the Audit

Question 6: Are the requirements to provide information on the auditor's strategy and timing of the audit appropriate? Does the auditor need more guidance related to the requirement to provide information on the auditor's audit strategy? If so, what type of guidance would be useful?

Response: Refer to our response to question 1 above concerning the need for caution in communicating certain aspects of the audit strategy. In light of the direction the proposed standard is aiming for, additional guidance will be needed, which will need to take the form of the PCAOB clarifying what is the real objective of the required communication, so the auditor has a better appreciation of what to communicate. Additional examples of how the audit committee communication process meets these objectives ought to be presented for clarity.

Question 7: Is it sufficiently clear which types of arrangements should be communicated to the audit committee related to the roles, responsibilities, and locations of firms participating in the audit?

Response: Yes, this portion of the proposed standard is sufficiently clear.

E. Accounting Policies, Practices, and Estimates

Question 8: Are the proposed requirements regarding the auditor's communication responsibilities with respect to accounting policies and practices sufficiently clear in the proposed standard (e.g., is the difference between a critical accounting policy and a significant accounting policy or practice adequately described)?

Response: The primary responsibility for the communications in paragraphs 12 and 13 of the proposed standard is management's not the auditor's. The Note in paragraph 12 acknowledges this, but there is no similar acknowledgment in paragraph 13.

If the communication by management has not occurred, the auditor's first step would be to inquire of management about why it has not happened. The auditor should urge management to make the communication, and may consider informing the audit committee that a required communication has not happened. Only then should the auditor consider whether to make the required communication itself. The proposed standard should be amended to clarify the communications responsibilities.

The difference between a "critical" and a "significant" estimate is not clearly drawn. "Critical" is defined in Appendix A, but there is no definition of "significant." However, context demands that "significant" means something with a potentially material effect on the financial statements. Then, what is the difference between "material" and "critical"?

The definition of a critical accounting estimate focuses on materiality due to subjectivity and judgment, and materiality to the financial statements. There are many estimates made in preparing financial statements that have significant elements of subjectivity and judgment, but they do not have a material effect on the financial statements; so, the distinguishing feature in making the estimate "critical" is the materiality to the financial statements.

Thus, there does not seem to be any difference between "critical" and "material." We suggest that the word "critical" not be used, and that expressions of importance, or "significance" be in the context of what is "material" to the financial statements.

The definition of a "critical accounting policy and practice" in Appendix A is even more problematic; it focuses on "most important," "required judgments" and "inherent uncertainty." Where does "most important" fit in the regime of "critical," "material," and "significant"? Further, application of many of a company's accounting policies and practices involve judgments and uncertainty. We suggest that a critical accounting policy and practice be defined in terms solely with relation to its materiality to the financial statements.

Question 9: Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

Response: Yes, placing all applicable standards in one place will be helpful.

Question 10: Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

Response: Refer to our response to Question 8 above concerning use of the word "critical". The proposed standard's definition is not clear or useful. Substitute the word "material".

Question 11: Are the communication requirements regarding critical accounting estimates appropriate? If not, how should the proposed standard be modified to provide appropriate information to the audit committee?

Response: As stated above, we do not agree with the use of the word "critical." The communication requirements should be described in terms of what is "material".

Paragraph 12.b.iv. would require communication of how various selections in a range of possible outcomes would affect the company's financial statements. This may not be realistic. Calculations are often complex and time consuming, and possible ways to make the estimate are rejected because they are too difficult to implement, involve an excessive level of uncertainty or are at the outer edges of what might be considered acceptable. The communication requirement, as stated, should be modified to state that the communication does not require quantification of the various outcomes that were not selected.

Paragraph 13.a.i. would require a discussion of the quality, clarity and completeness of the company's financial statements. It should be clarified that this should be done in the context of existing generally accepted accounting principles. Those principles themselves can lack quality, clarity and completeness, but that does not need to be communicated.

Paragraph 13.b.i. is something the audit committee can do on its own. Paragraph 13.b.ii. has the auditor second guessing management, and paragraph 13.b.iii. requires a crystal ball to look into the future.

Paragraph 13.f should not require communications with those outside the engagement team. Accounting and auditing have gotten so complex that few practitioners can pretend to have all the answers, and registered auditing firms have responded to this by, among other things, encouraging or mandating communication with firm experts in other offices or in national or regional offices. To now have to track and report those communications could stifle the communication process, and the purpose and benefit of such communication is unclear.

F. Management Consultations with Other Accountants

Question 12: Should this requirement be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms?

Response: The requirements for disclosure of management consultation with other accountants stemmed from a concern over "opinion shopping." We see no purpose in expanding beyond the current requirement. Frequently, management will consult with non-accountants on transactions that have accounting implications (e.g., compensation or business acquisitions) and discuss the accounting implications with the consultants as part of their due diligence; these will later be reviewed with the auditors, if relevant. We see no reason for these discussions with consultants to be reported to the audit committee.

In addition, any communication with law firms may be subject to privilege concerns that may preclude communication to the auditor and/or the audit committee.

G. Going Concern

Question 13: Is the communication requirement on going concern clear? If not, how could the requirement be clarified?

Response: We believe the communication requirement is clear.

H. Corrected and Uncorrected Misstatements

Question 14: Are the requirements appropriate regarding the communications for uncorrected misstatements?

Response: We agree with the communication on the uncorrected misstatements. However, we do not agree with the discussion of the basis for concluding the uncorrected misstatements were not material; that discussion gives the audit committee, which is the company, too much insight into the auditor's judgment process, and could compromise the auditor's independence.

Question 15: Should all corrected misstatements including those detected by management be communicated to the audit committee?

Response: Corrected misstatements detected by management should not be reported. The financial statements are not completed until they are issued. Management establishes Internal controls over their preparation that include preventive and detective controls that detect what the preventive controls fail to report. The fact that the detective controls worked properly does not need to be reported to the audit committee. Such communications are best left with the company's internal audit function.

Corrected misstatements detected by the auditor should be reported, because it is indicative of a failure of some aspect of the company's internal controls over financial reporting.

I. Other Matters – No Questions

J. Form and Content of Communications

Question 16: Like the existing standard, the proposed standard would allow the auditor to communicate many matters orally or in writing. Should the standard require that all or certain matters be communicated to the audit committee in writing? If only certain matters should be communicated to the audit committee in writing, what are those matters?

Response:

Written communications should not be required. The auditor has a record of the communication in its work papers if it is ever needed. Auditors and audit committees should have the flexibility to choose the form of communication that they are comfortable with.

K. Timing

Question 17: Are the requirements in the proposed standard on the timing of the auditor's communication appropriate? Should only certain matters be communicated annually? If so, which ones?

Response: Paragraph 24 of the proposed standard is adequate. Paragraph 25 should be deleted; it states that the communication can take place just prior to the issuance of the auditor's report, which may be too late to be considered timely.

L. Adequacy of the Two-way Communication Process

Question 18: Does the requirement to evaluate the adequacy of the communication process promote effective two-way communications? Is more information on this requirement needed?

Response: No, the proposed standard cannot insure that the communication process is effective. The auditor's requirement to communicate any number of matters required under the current standard or the proposed standard are only one way. In order to provide some clarification, we suggest replacing the word "determines" in paragraph 27 with "feels" or "concludes". The use of the word "determines" implies that there is a process by which the auditor can determine that there has been adequate two-way communication, and that can never be "determined", but the auditor can have a sense, or feelings about whether there has been adequate two-way communication.

M. Other Communication Requirements

Question 19: Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?

Response: The other communication requirements appear to be a continuation of existing requirements, and so no need to comment on them. We do not have any additional suggestions for matters requiring communication to the audit committee.

Question 20: Are the matters included as significant difficulties in paragraph 21 of the proposed standard appropriate? What other matters should be included as significant difficulties?

Response: Yes the matters suggested in the proposed standard are adequate and no additional matters are proposed.

Question 21: Are any of the requirements included in the proposed standard inappropriate for auditors to communicate to audit committees based on the size or industry of the company under audit?

Response:

No, we believe a consistent application of the proposed standard to entities of all sizes and industries will help to improve the communication process.

N. Appendices

Question 22: Is the information included in Appendix A-C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Response: Please refer to the previous discussion regarding use of the word "critical" under our responses to questions 8 and 10.

We thank you for the opportunity to comment on the Proposed Standard. We would be glad to discuss our opinions with you should you have further questions or require additional information.

Very truly yours,

Jo Ann Guattery, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants