

29 February 2012

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

**PCAOB Rulemaking Docket Matter No. 30
Proposed Auditing Standard related to Communications with Audit Committees; Related
Amendments to PCAOB Standards; and Transitional Amendments to AU Section 380**

Dear Mr. Seymour:

Ernst & Young LLP is pleased to submit comments on the Public Company Accounting Oversight Board's (PCAOB or Board) above referenced proposal (the Proposed Standard) related to communications with audit committees.

We recently submitted comments on another PCAOB rule proposal, PCAOB Rulemaking Docket Matter No. 37, Concept Release on Auditor Independence and Audit Firm Rotation. There, we noted, "In recent years, we have seen significant changes in audit committee engagement and performance and the rigor with which the audit process and auditor relationship is overseen and evaluated. Audit committees are asking the auditor probing questions, meeting with the audit firm's subject-matter experts and senior leadership, and challenging management on the appropriateness of its accounting and disclosure, all of which positively affect the tone and results of the audit." We are committed to robust and regular communication with audit committees or those charged with governance and in helping these bodies execute their important responsibilities. We believe the Proposed Standard will improve our practices in this area and help enhance audit quality and transparency.

We also appreciate the Board's responsiveness to comments submitted by EY and other parties in relation to the Board's initial proposal. The current proposal contains a number of significant improvements over the initial draft. For example, we support the Board's decision to remove the requirement that the auditor evaluate the effectiveness of the two-way communication between the auditor and the audit committee. Likewise, we believe the standard was improved by allowing the auditor to consider the communications made by management when determining the extent of the auditor's own communications with the audit committee. We also agree with the Board's decision to allow communications to be either written or oral. We believe this will allow auditors to communicate matters to audit committees in the way that they believe is most effective and adapt those communications based on the specific circumstances of the entity, the matters to be discussed and the

interests of the audit committee. On the whole, we believe the Proposed Standard would enhance the auditor's existing focus on providing timely, meaningful information to audit committees.

We do, however, have a handful of suggestions we think will further improve the final standard, which we discuss below.

Definition of certain terms and use of judgment in general

Several terms used in the Proposed Standard require the application of considerable judgment by the auditor. Two are particularly subjective in nature. First, the Proposed Standard requires communications to audit committees on "matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process." Second, the Proposed Standard requires the auditor to communicate to the audit committee "significant transactions, of which the auditor is aware, that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature."

As for the "difficult or contentious" phrase, Appendix 4 to the release accompanying the Proposed Standard provides a helpful discussion of the phrase's meaning (App. 4, at A4-28). For example, the Appendix states that a "contentious issue might be a matter that not only requires significant consultation but also leads to significant points of disagreement, debate, or deliberation between the auditor and management." We suggest this additional discussion of the meaning of this phrase be placed within the Proposed Standard itself.

As for the requirement regarding "significant transactions" that are "unusual" in nature, this communication would require the use of considerable judgment; what might appear "unusual" in hindsight to a non-auditor might not have been considered "unusual" to the auditor at the time he or she is completing the audit engagement. We think it would be helpful if the final standard made clear that (1) certain of the terms used in the standard, in particular the word "unusual," are not terms found generally or defined in the accounting literature and, accordingly, the auditor should use his or her best judgment in applying these terms to the relevant facts and in determining what communication may be required and (2) in this regard, the auditor's judgment should be controlling. Additionally, we assume that the Board will consider their proposed amendments regarding significant, unusual transactions prior to finalizing any communication requirements related to these types of transactions in order to fully align the communications and performance requirements.

Applicability to brokers and dealers

The release accompanying the Proposed Standard notes that these required communications would become applicable to the audits of brokers and dealers after the Securities and Exchange Commission (SEC) adopts rules requiring the use of PCAOB standards for such audits and the rules become effective. Because some broker and dealers do not have boards of directors or audit committees, the Board has modified the definition of “audit committee” to add “for the audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to a company, those persons designated to oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.”

Under this standard, some communications would become circular – that is, they would be made to the same individuals who provided the original information to the auditors. In many instances, the person designated to “oversee the accounting and financial reporting processes” of a non-issuer broker or dealer, and the audits of the financial statements of such an entity, would be the chief financial officer (CFO). Providing a copy of the letter of representations or communicating management’s selection of significant accounting policies to the CFO who signed that letter and approves such policies – along with other similar activities – would be a compliance exercise that would add no value to the audit process. Accordingly, we suggest the final standard be aligned with the definition of an audit committee in ISA 260 and AICPA AU Section 260. That definition refers to “the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.” Under that definition, the communication would likely be made to the Chief Executive Officer or another officer of the broker or dealer.

In addition, in some cases non-issuer brokers and dealers may be subsidiaries of issuers. There may be instances where providing communications regarding the audit of a subsidiary non-issuer broker or dealer to the parent’s audit committee may not be that important. However, we also recognize there may be other cases where reporting such matters to the parent’s audit committee may be a relevant and valuable communication. Given the potential for there to be more than one corporate governance body for entities that encompass broker or dealer subsidiaries, we recommend revisiting the Proposed Standard to allow the auditor to determine the most appropriate body to which the required communications should be directed.

Finally, the Board requested comment on whether there are additional matters related to the audits of brokers and dealers that should be considered for specific audit committee communications. We believe that the Board should consider adding in the final standard communication requirements relating to the additional attestation reporting required for brokers and dealers as outlined in SEC Rule 17a-5. For example, there are provisions in SEC Rule 17a-5 that require filing certain supplementary information with the financial statements

on which the independent auditor is required to opine. Additionally, the independent auditor is required to issue a report on internal control. When the SEC's proposal to update the existing requirements of SEC Rule 17a-5 is finalized, auditors will be required to either (1) issue an examination report regarding the entity's assertions of compliance with specified rules and related internal controls, or (2) issue a review report that addresses the assertion that the broker or dealer is exempt from Rule 15c3-3. We encourage the PCAOB to consider whether these additional reporting requirements warrant specific audit committee communications given their importance to the audits of brokers and dealers.

Going concern

We understand the PCAOB's interest in improving communications relating to the auditor's assessment of an issuer's ability to continue as a going concern, and we have supported suggestions that the PCAOB reconsider its standards in this area. Our comment here is to urge that communication in this area be consistent with the auditor's current responsibilities.

Specifically, the Proposed Standard includes a requirement for the auditor to make certain communications regarding his or her evaluation of the company's ability to continue as a going concern. This includes communicating the conditions or events identified by the auditor that indicate there "could be" substantial doubt about the entity's ability to continue as a going concern and, if the auditor's doubt is mitigated, the information that mitigated such doubt. Under AU 341, however, the auditor first considers whether, as a result of audit procedures performed related to various audit objectives (that is, the auditor is not required to design procedures solely to identify such events and conditions), the auditor believes there "could be" doubt regarding the entity's ability to continue as a going concern. The auditor is not required to obtain information regarding management's plans and conclude upon the likelihood that those plans can be implemented unless he or she believes "there is" substantial doubt regarding the entity's ability to continue as a going concern. This is further clarified in AU 341.7, which states that the auditor is required to consider management's plans only upon believing "there is" substantial doubt (a step beyond "could be"). Additionally, AU 341.17 establishes the following documentation requirements:

"As stated in paragraph .03 of this section, the auditor considers whether the results of the auditing procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he or she follows the guidance in paragraphs .07 through .16. In connection with that guidance, the auditor should document all of the following..."

Thus, documentation is required only after the auditor has concluded that he or she believes “there is” a substantial doubt about the entity’s ability to continue as a going concern and not when he or she has considered there “could be” substantial doubt. We do not believe the communication requirements should exceed the AU 341 performance and documentation standards. We suggest the auditor be required to communicate to the audit committee circumstances where (1) the auditor believes “there is” substantial doubt regarding an entity’s ability to continue as a going concern, as described in AU 341.7, and (2) if that substantial doubt is somehow mitigated by management’s plans, to communicate the information that mitigated such substantial doubt.

In this regard, AU 341.6 provides examples of items an auditor considers in assessing whether there could be doubt about an entity’s ability to continue as a going concern, which include recurring operating losses, negative cash flows from operating activities, default on loan agreements, negative legal proceedings, labor issues, etc. We believe these are items that the audit committee would be familiar with (as a result of its financial reporting oversight role, the financial information provided to the audit committee, and through its discussions with management). As a result, we have doubts that the proposal for a separate communication on such matters from the auditors will be particularly helpful or would accomplish the goal of providing the audit committee with an “early warning.”

If the Board decides not to take our suggestion on modifying the going concern communications trigger from “could be” to “there is,” we suggest the Board nonetheless provide some guidance on how the “could be” communications requirement might be applied. As noted, AU 341.06 gives examples of conditions and events that the auditor might consider, and it includes a wide range of possible events, including “labor difficulties,” or “uneconomic long-term commitments,” or “uninsured or underinsured catastrophe such as a drought, earthquake, or flood.” As discussed above, auditors might consider all of these “could be” events but are not required to document such considerations (or communicate their considerations) under current performance standards. It would be unfortunate if, under the Board’s final standard, auditors felt compelled to communicate to the audit committee their consideration of *any* “could be” event under the broad baskets of conditions outlined in AU341.06. We assume this is not the Board’s intention and that by imposing a “could be” reporting requirement, the Board would expect an auditor to exercise his or her judgment as to what events might reasonably apply to the audit client’s particular risks and operations. However this intention is not clear and we believe it would be helpful if the final standard were to state this.

Finally, we understand the 2012 standard setting agenda of the PCAOB’s Office of the Chief Auditor incorporates “evaluating potential revisions to the going concern auditing standard.” We suggest that any changes to the audit committee communication requirements in this area be deferred pending clarification of the Board’s broader standard setting efforts on going concern.

Procedures performed by other firms or persons

Paragraph 10(d) of the Proposed Standard requires that the auditor communicate the “names, locations, planned roles, and responsibilities” of other firms, including member firms in the network or persons that performed audit procedures for the current period. We support providing additional information to audit committees regarding other firms or persons involved in the audit process. However, the Proposed Standard, as written, would appear to require the auditor to communicate every instance where another firm, including member firms in a network, or person has performed work on behalf of the auditor, even if the involvement is quite limited (for example, where a member firm in the network participated in an inventory observation). We are concerned that providing this granular level of information for all participants may result in a lengthy list of other participating firms that would be of little, if any, value to the audit committee and may take focus away from more important matters, including the nature and extent of work performed by other auditors that have a significant role in the audit.

The extensive level of detail that could be required for audits of large, multinational issuers is not consistent with other required communications in this paragraph, which are more focused on areas that are critical or significant (for example, the communication of specialized skills or knowledge in procedures to be performed related to significant risks). We believe that establishing a threshold to communicate meaningful involvement of other firms or persons would more effectively achieve the Board’s intent of improving communication with audit committees so that the audit committee could focus on two-way communications regarding locations that are of significance to the audit and use that opportunity to ask questions of the auditor regarding the involvement of those other audit firms. As described in our comment letter to the PCAOB dated 9 January 2012 regarding Improving the Transparency of Audits, we believe an appropriate minimum threshold for disclosure within the audit report of other participants is 10% of total audit hours. We believe the threshold for communicating to the audit committee should be the same. Aligning the threshold with the transparency proposal also would provide consistency throughout the standards, if adopted, and would lead to more consistent application of the standard in practice.

Other matters

Engagement letter

The Proposed Standard requires providing the engagement letter to the audit committee on an annual basis and determining that the audit committee has “acknowledged and agreed to the terms of the engagement.” Appendix 4 states that the acknowledgement of such terms can be either written or oral (App. 4, at A4-6). We suggest that the final standard itself contain this statement.

New accounting pronouncements

The Proposed Standard requires auditors to communicate “situations in which, as a result of the auditor’s procedures, the auditor identified a concern regarding management’s anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.” The phrase “identified a concern” is undefined and is likely to be difficult to address in practice. We suggest that required communications in this area be tied to management’s disclosure of recently issued accounting pronouncements, as required by Staff Accounting Bulletin 74. That is, auditors should communicate their assessment of whether the disclosures are in conformity with the applicable financial reporting framework and the bases of amounts set forth (as described in paragraph 13(d) of the Proposed Standard). Thus, we believe the required communication related to new accounting pronouncements should be: “The results of the auditor’s evaluation of management’s disclosure of the impact that recently issued accounting standards will have on the financial position and results of operations of the entity when such standards are adopted in a future period.” Communicating the auditor’s assessment of management’s disclosures required under Staff Accounting Bulletin 74 would be helpful to audit committees and can be implemented in practice.

Use of “boilerplate”

The release accompanying the Proposed Standard states that communications should be “tailored to the circumstances” and that the auditor should avoid using “boilerplate” or “standardized” discussions. We agree that meaningless “boilerplate” communications are not helpful to an audit committee, but there are many types of communications that a firm can make in a consistent fashion and still be meaningful and directed to an entity’s specific circumstances. In other words, we do not think that a firm’s consistency of approach in communicating particular matters renders those communications mere “boilerplate,” and we think it would be helpful if the PCAOB were to make this point clear in the final standard.

Minor edit to paragraph on timing

Paragraph 25 of the Proposed Standard states that audit committee communications should be made in a timely manner, depending on such factors as the significance of the matters to be communicated, “unless other timing requirements are specified by PCAOB rules or standards or the rules or regulations of the Securities and Exchange Commission.” We suggest the standard include a reference to “the federal securities statutes” as well as to SEC rules and regulations; this is because Section 10A of the Securities Exchange, which imposes certain communications requirements on auditors, is a statute rather than an SEC rule or regulation.

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In conclusion, we support the Board's effort to improve communications to audit committees. We believe that our suggested modifications are consistent with the Board's objectives and will help to strengthen the final standard.

We would be pleased to discuss our comments with members of the Board or its Staff.

Sincerely,

Ernst + Young LLP