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Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 026, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board or PCAOB) *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards*. We were pleased to see that the re-proposed standards more closely align with International Standards on Auditing (ISA) and Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements*.

As a member of the Center for Audit Quality (CAQ), we participated in the development of the CAQ's letter of comment in response to the re-proposed standards. Overall, we support the comments in the CAQ's letter, and therefore, we minimized repeating the same comments herein. We respectfully submit our comments and recommendations below.

Convergence

We continue to support the PCAOB's convergence with the ISAs. Yet, we observed differences in the language used to describe some requirements where we believe differences need not exist. When the requirements are the same, but the language differs, we are concerned that there will be unintended disparity in application. At a minimum, much needless effort will be expended by auditors in analyzing what the differences mean. Minimizing language differences will enhance audit quality by promoting consistency in application. In this regard, when additional requirements are needed for audits of issuers, we recommend including the incremental requirements, rather than modifying the language in the ISAs.

In addition, we appreciate the analysis of differences with the ISAs. We can only assume that if there are language differences, and the Board has not highlighted the requirement as a difference, then the expected performance must be the same. However, as detailed in our comments below, we identified certain inconsistencies in the requirements that are highlighted as differences. In these situations, if the language was more consistent and incremental

requirements were separately included, the analysis would contain true differences making it easier for the auditor to understand the Board's intent.

General Areas of Comment

Overall, we support the issuance of the proposed standards. In addition to the comments in the CAQ letter and our responses to the Board's request for specific comments below, we have the following observations:

- With respect to the definitions in the appendices to the proposed standards, we request the Board to reconsider the phrase "for purposes of this standard." Many of the defined terms pertain to other standards as well. A glossary of terms may be helpful.
- In future releases, we suggest that the Board:
 - Avoid labeling release text as an appendix. The PCAOB has previously stated that appendices to a standard "...are an integral part of the standard and carry the same authoritative weight as the body of the standard." By labeling the release text something different, this would eliminate the misperception that the release text is an appendix that is part of the standard.
 - Eliminate interpreting the requirements in release text. Although we find the Board's analysis of proposed standards and disposition of comments received helpful, information that is essential in applying the requirements, or requirements themselves, should be contained within auditing standards to mitigate differences in practice.
 - Consider the need to provide application guidance. In many cases, application guidance is essential to fully understand the requirements. With the elimination of application guidance and the various language differences, the Board complicates the process of understanding and applying PCAOB standards as intended.

The following includes our response to the Board's specific question.

1. Are the objectives in the new proposed standards useful in providing context for the requirements in the standards?

We support the objectives in the proposed standards and believe they are useful in providing context for the requirements. However, as the Board continues to revise its interim standards, we believe that the Board should eventually consider an "umbrella" standard that addresses the overall objectives of the auditor and the relationship of those objectives to the objectives in each of the Board's standards, similar to ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Appendix 1 - Audit Risk

The following includes our responses to the Board's specific questions.

2. Does the new proposed standard on audit risk describe clearly the concept of audit risk and its components?
The new proposed standard is clear regarding the concept of audit risk and its components, except for the last sentence in paragraph 3, which we believe is awkward and can be misconstrued. By itself, due professional care does not reduce audit risk to an appropriately low level. Due professional care is a responsibility exercised throughout the audit, similar to professional skepticism and judgment, and need not be repeated throughout the Board's standards. We recommend the sentence be rephrased to state that reasonable assurance is achieved by obtaining sufficient appropriate audit evidence.
3. Does the new proposed standard on audit risk describe clearly the relationship between detection risk and substantive procedures?
We agree that the acceptable level of detection risk bears an inverse relationship to the risk of material misstatement and, at the assertion level, detection risk is reduced by performing effective substantive procedures. However, because the risk of material misstatement also consists of inherent risk and control risk, we believe the proposed standard would be clearer if it acknowledged that the acceptable level of detection risk is determined based on the auditor's assessment of these risks.

Appendix 2 - Audit Planning and Supervision

The following includes our responses to the Board's specific questions.

4. Are the proposed requirements for multi-location engagements appropriately aligned with Auditing Standard No. 5?
We believe the proposed requirements for multi-location engagements are appropriately aligned with Auditing Standard No. 5.
5. Is it clear how the proposed requirements for multi-location engagements would be applied in audits of financial statements only?
We believe the proposed standard is clear with regard to how the requirements for multi-location engagements would be applied in a financial statement only audit.

Because Appendix 10 references ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, in explaining the differences with the ISAs, we suggest that the Board clearly state that the multi-location provisions do not apply to “locations” audited by another auditor. Otherwise, the new multi-location provisions, including those in the proposed standard *Consideration of Materiality in Planning and Performing an Audit*, may be confusing to some auditors, particularly those in foreign jurisdictions that apply the ISAs. Under the Board's standards, the auditor's use of the work of another auditor is addressed by AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, which differs from ISA 600.

6. Are the differences between the responsibilities for supervision of engagement team members and oversight of specialists in accordance with AU sec. 336 appropriate in light of the auditor's responsibilities to opine with reasonable assurance on whether the financial statements are fairly presented, in all material respects, in conformity with the applicable financial reporting framework?

We believe the differences between the responsibilities for supervision of engagement team members and oversight of specialists are appropriate. However, unless we misunderstand the Board's intent, the note in paragraph 16 does not seem necessary. This note essentially states that the term "specialized skill or knowledge" includes persons employed by the auditor, as well as those engaged by the auditor. Yet, we believe the other paragraphs in this section are clear as to their applicability to such persons, which makes the note redundant.

Appendix 3 - Consideration of Materiality in Planning and Performing an Audit

Paragraph 9 requires the auditor to "take into account" the nature, cause (if known), and "amount" of misstatements accumulated in prior audits in determining tolerable misstatement, and planning and performing audit procedures. We do not fully comprehend what the requirement means or how it is to be applied. Some firms, including ours, calculate tolerable misstatement, for the financial statements as a whole, as a percentage of materiality. Though, tolerable misstatement can be lowered for a particular account based on the characteristics of the account.

We believe the inclusion of this specific requirement, in conjunction with the lack of application guidance, will result in a high likelihood of misapplication. In our view, the requirement appears to dictate a particular methodology for calculating tolerable misstatement that considers the amount of expected errors. This may differ from other methodologies where inherent risk is deemed higher due to the amount of expected errors, thereby increasing audit effort without reducing tolerable misstatement.

If the Board intends to change practice with regard to the calculation of tolerable misstatement, such as the language seems to indicate, additional guidance is critical in understanding the requirement. However, we prefer that the Board continue to allow flexibility in how tolerable misstatement is determined, consistent with the ISA and the extant interim standard.

The following includes our responses to the Board's specific questions.

7. Are the provisions in the new proposed standard regarding consideration of materiality in multi-location engagements appropriate in light of the auditor's responsibility to plan and perform audit procedures to detect misstatements that, individually or in combination, would result in material misstatement of the financial statements?

We believe the provisions regarding the consideration of "materiality" in multi-location engagements are generally appropriate. However, the description of "materiality level" in paragraph 10 is appropriately equivalent to the description of "tolerable misstatement" in paragraph 8. Accordingly, it would seem more appropriate to use "tolerable misstatement," in paragraph 10 to describe the level of audit procedures to perform at particular locations or business units. Otherwise, the paragraph confuses the concepts of materiality and tolerable misstatement.

8. Are the revised provisions regarding reassessment of materiality appropriate in light of the auditor's responsibility to plan and perform audit procedures to detect misstatements that, individually or in combination, would result in material misstatement of the financial statements?

We agree with establishing a requirement to reassess materiality. In paragraph 11, however, we believe the Board should consider removing item (b), as this item is basically a subset of item (a). We also believe that the “significance” of the matters that would require reassessment should be enhanced. For example, we do not believe the intent of the requirement is to force a routine reassessment, as it is likely that the financial statement amounts (the size) of any company will be different at year end versus the interim date when planning occurred. Rather, we believe the intent is to remind auditors of the need to reassess materiality when the relative size of the company changes substantially, and had the auditor been aware of this change when the audit was planned, a different level of materiality would have been established.

Appendix 4 - Identifying and Assessing Risks of Material Misstatement

The following includes our responses to the Board's specific questions.

9. Does the new proposed standard adequately describe the auditor's responsibilities for performing risk assessment procedures that are sufficient to provide a reasonable basis for the identification and assessment of risks of material misstatement due to error or fraud and to design further audit procedures?

Generally, we believe the proposed standard adequately describes the auditor's responsibilities for performing risk assessment procedures. However, in addition to the comments in the CAQ letter, we believe the following matters need to be clarified:

- The auditor's responsibilities for disclosures in paragraph 13. The requirement for the auditor to “identify the necessary disclosures” in order to identify and assess the risks of material misstatement related to omitted or incomplete disclosures seems to overlap management's responsibilities. The auditor should be required to understand the disclosures that are to be expected in the financial statements based on the auditor's understanding of the entity and its environment, rather than “identify” them.
- The intent of the requirement in the note to paragraph 56(c). Risks at the financial statement level can affect many assertions because such risks are pervasive to the financial statements as a whole. Generally, risks at the financial statement level increase the risk of material misstatement at the assertion level, but cannot be associated with a particular assertion. As such, the auditor responds to risks at the financial statement level with an overall response. We believe this requirement inappropriately infers that the auditor should, and can, associate the risks at the financial statement level with particular assertions in order to assess risks at the assertion level. We believe this is a significant and unnecessary difference from the ISA that is not highlighted as such.
- The Board's views in Appendix 10 as to the sufficiency of risk assessment procedures. As currently drafted, Appendix 10 seems to infer that the risk assessment procedures

in the ISA are insufficient in comparison to PCAOB standards (page A10-9). Although additional risk assessment procedures are necessary for issuers, we fail to see the difference between the highlighted requirements. We have the same observations with regard to the required understanding of internal control (page A10-10) and the auditor's responses to risks (page A10-18). In this regard, we suggest the Board specifically describe the areas in which performance is expected to differ.

10. Are the auditor's responsibilities regarding the additional procedures for understanding the company and its environment in paragraph 11 clear?

We have no comments other than those expressed by the CAQ.

11. Are the proposed requirements regarding obtaining an understanding of internal control over financial reporting appropriate in light of the auditor's responsibilities for identifying and assessing the risks of material misstatement?

Overall, we believe the proposed requirements regarding obtaining an understanding of internal control over financial reporting are appropriate. The CAQ letter provides several comments to enhance the proposal. We reiterate the CAQ comment related to the requirement in paragraph 33 for the auditor to obtain an understanding of control activities. The Board should include additional guidance, similar to that contained in the ISA, to clarify the extent of the auditor's understanding.

12. Are the proposed requirements regarding the discussion among engagement team members about risks of material misstatement appropriate given the auditor's responsibilities for identifying and assessing the risks of material misstatement?

We believe the proposed requirements regarding the discussion among the engagement team members about risks of material misstatement are appropriate, including the required discussion in paragraph 49 (and the related evaluation in paragraph 68) about how fraud might be perpetrated or concealed by omitting or presenting incomplete disclosures. We suggest, however, that the Board include application guidance that describes such fraud risks in more detail, particularly, how the omission of disclosures, or presenting incomplete disclosures, could be intentional to perpetrate or conceal fraud and deceive financial statement users.

Appendix 5 - The Auditor's Responses to the Risks of Material Misstatement

With respect to Appendix 10 as it relates to Appendix 5, we have the following observations:

- We believe that the highlighted difference with the ISA regarding the performance of substantive procedures (page A10-22) is misleading. ISA 300, *The Auditor's Responses to Assessed Risks*, requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This is the ISA requirement that should be included in Appendix 10 as a comparison to the PCAOB's requirement to perform substantive procedures for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk.

- We believe that the highlighted difference with the proposed SASs relating to the consideration of confirmations (page A10-23) is incorrect. We bring to the Board's attention that the proposed SASs also include, similar to the ISAs, a requirement to consider whether external confirmation procedures are to be performed as substantive audit procedures. This is a conforming amendment in the proposed SAS, *External Confirmations*.

The following includes our responses to the Board's specific questions.

13. Are the proposed requirements for overall responses and responses involving the nature, timing, and extent of audit procedures appropriate given the auditor's responsibility to opine with reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework?
We believe the proposed requirements for overall responses and responses involving the nature, timing, and extent of audit procedures are appropriate.
14. Does the new proposed standard clearly describe when tests of controls are necessary in an audit of financial statements only?
For the most part, the proposed standard clearly describes when tests of controls are necessary in an audit of financial statements only. We suggest, however, the Board clarify paragraphs 29 and 30 by referencing paragraph 16, which requires tests of controls during the period of reliance. The language in paragraphs 29 and 30 is similar to the requirements of an internal control audit, when the auditor obtains evidence about the operating effectiveness of controls to the "as of" date. In a financial statement only audit, we believe a reference to paragraph 16 would clarify that the auditor would only consider what additional evidence is necessary concerning the operation of controls when the auditor plans to rely on controls for the remaining period.

Appendix 6 - Evaluating Audit Results

The following includes our responses to the Board's specific questions.

15. Does the new proposed standard clearly describe the auditor's responsibilities for accumulating and evaluating misstatements?
We believe the proposed standard clearly describes the auditor's responsibilities for accumulating and evaluating misstatements, except for paragraph 19. This paragraph seems misplaced as the auditor should consider individual misstatements and their effect on the assessed risk of material misstatement at the time they are identified to determine whether additional procedures are necessary. The requirement in this paragraph seems to place an unnecessary and burdensome documentation requirement on the auditor after the misstatements are accumulated. This is unnecessary because the auditor is required to document changes in risk assessments in response to audit findings.

16. Does the new proposed standard appropriately describe the auditor's responsibilities for evaluating the presentation of the financial statements, including evaluating bias, in light of the auditor's responsibility to opine with reasonable assurance on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework?

We believe the proposed standard appropriately describes the auditor's responsibilities for evaluating the presentation of the financial statements, including evaluating bias.

Appendix 7 - Audit Evidence

The following includes our response to the Board's specific question.

17. Does the new proposed standard describe clearly how the auditor should determine the financial statement assertions to use for both integrated audits and audits of financial statements only?

Generally, we believe the proposed standard clearly describes the typical financial statement assertions, which are consistent with Auditing Standard No. 5. However, paragraph 12 differs from the guidance in the ISA and implies the use of "different" assertions. Although we understand the intent of paragraph 12, based on our understanding of the ISAs, we suggest the Board instead state that the auditor may express the assertions differently.

Proposed Amendments to PCAOB Standards

The proposed amendments to AU section 316, *Consideration of Fraud in a Financial Statement Audit*, are extensive. For future releases, we request the Board to consider the nature and extent of the revisions in determining whether it is necessary to release a new proposed standard or to fully illustrate the revisions in a marked document. We believe this would enhance the transparency of the amendments, as well as a respondent's ability to provide meaningful comments.

The following includes our response to the Board's specific question.

18. Are there provisions in the to-be-superseded standards that should be retained?

We do not believe there are any provisions in the to-be-superseded standards that should be retained.

We would be pleased to discuss our comments and recommendations with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

