



CENTER FOR CAPITAL MARKETS  
COMPETITIVENESS

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March 2, 2010

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

Re: PCAOB Rulemaking Docket Matter No. 026

Dear Members and Staff of the Public Company Accounting Oversight Board:

The United States Chamber of Commerce (“Chamber”) is the world’s largest business federation representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21<sup>st</sup> century economy.

The CCMC recognizes the vital role of external audits in the sound operation of our capital markets and supports efforts to maintain and improve audit effectiveness. Auditors’ assessment of and responses to risk are fundamental to the audit process, and so we appreciate the opportunity to comment on the Public Company Accounting Oversight Board’s (“PCAOB”) *Proposed Auditing Standards Related to the Auditor’s Assessment of and Response to Risk*. Our comments focus on the following issues:

1. standard-setting approach and due process
2. convergence of auditing standards
3. disclosure
4. implementation of auditing standards

The PCAOB is re-proposing for public comment seven auditing standards related to risk. The PCAOB’s initial draft was proposed on October 21, 2008 and the

CCMC provided comments thereto.<sup>1</sup> While the current iteration of the proposal is an improvement many of the issues previously raised in the CCMC's comment letter of February 18, 2009 remain unresolved.<sup>2</sup> These issues include those related to convergence, fraud, materiality, auditor judgment, and revision of the Interim Standards.

Accordingly, the CCMC requests that these proposals be withdrawn and reevaluated in order to be improved for the purposes of sound financial reporting policy. Properly crafted and implemented standards for risk assessment and response will provide certainty for both investors and businesses. The implementation of deficient standards will foster uncertainty and the unintended economic consequences may result in material losses for investors and businesses.

The CCMC's concerns are listed with greater specificity below.

### **1. Standard-Setting Approach and Due Process**

In our letter of February 28, 2009, we noted that at the October 2008 Standing Advisory Group ("SAG") meeting, the PCAOB staff stated an intention to develop a concept release for public comment and feedback in early 2009 regarding the PCAOB's plans for addressing its review of the Interim Standards. The concept release was to include a schedule and procedures for the review. No such concept release has been forthcoming. The CCMC continues to strongly recommend that this concept release be developed, exposed for public comment, and finalized *before* the Board and staff revise the current Interim Standards. The concept release should include these proposed standards, especially considering the pervasive implications of risk assessment and response for the audit process. Without an overarching plan and framework for revising the Interim Standards or transparency on either,<sup>3</sup> piecemeal and ad hoc changes in existing standards will likely produce inconsistencies in the audit process and undermine audit quality. Such changes can result in confusion and the lack of comprehension regarding the interrelationship of standards and their application due to the different drafting styles and conventions.

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<sup>1</sup> See comment letter from the United States Chamber of Commerce's Center for Capital Markets Competitiveness, dated February 18, 2009, on PCAOB rulemaking docket matter No. 026, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* ("February 18, 2009 comment letter").

<sup>2</sup> The CCMC requests that this letter be read in conjunction with the February 18, 2009 comment letter.

<sup>3</sup> The CCMC has expressed concern about the lack of transparency in the Board's standard-setting process. For example, see CCMC letter to Acting Chairman Daniel L. Goelzer dated October 7, 2009.

Additionally, as pointed out in the February 18, 2009 comment letter, the PCAOB's current proposal produces incongruities when viewed under the parameters of the existing standards. For instance, AU Section 316 is just one illustration. The risk standards currently being proposed by the Board move the requirements related to the auditor's responsibilities in the area of fraud out of the fraud standard and blend them in with other audit requirements. The CCMC disagrees with this approach because AU Section 316 will no longer represent a fraud standard or even a sufficiently comprehensive audit standard in relation to its title. Given the importance of auditor's responsibilities related to fraud to investors and other users of financial statements, it is a mistake to leave AU Section 316 so sparse. This mistake is compounded with the lack of transparency around the PCAOB's future standard-setting plans in this regard.

The CCMC is also concerned about the short period for comment on the current proposal which is 250 pages long and covers seven standards that involve complex inter-relationships as a group and must be considered in the context of other audit standards. Such a short comment period suggests more fundamental problems with the PCAOB's due process for setting auditing standards.<sup>4</sup> Because the comment period encompasses one of the busiest times in the financial reporting arena, realities dictate a lack of analysis and submission of thoughtful comments to the PCAOB. This frustrates the ability of all stakeholders to collaboratively formulate the best standards possible.

Furthermore, the PCAOB has failed to take appropriate steps to facilitate a process that will lead to the submission of robust and diverse comments. It has already been noted that this is the second proposal regarding these standards. It would benefit commenter's to be able to compare the two proposals and existing standards in a transparent matrix that could be published on the PCAOB's website. We encourage the PCAOB to integrate such steps into its standard setting process to allow commenter's to better understand a proposal and the inter-relationships that may exist with current standards and other proposals. Additionally, the questions posed in the release text for comment do not lend themselves to broad public input without a better articulation by the PCAOB of the issues it seeks to address, along with their pros and cons, relevant considerations, and potential consequences.

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<sup>4</sup> The CCMC expressed similar concerns to the Securities and Exchange Commission ("SEC") regarding a proposal on Proxy Access, see June 20, 2009 letter to the SEC on Facilitating Shareholder Director Nominations. The proposal was eventually released for a second comment period.

Finally, the CCMC believes that a lack of transparency with the PCAOB's standard setting process deprives the public of an understanding of the PCAOB's proposals and overall direction in achieving effective audit policy goals. Ostensibly, the PCAOB attempts to solve this issue by using release text in conjunction with proposing or adopting a standard. The CCMC is concerned, as we have written before, that release text is often used, without public explanation or input, to modify the standard or undermine its intent. Release text has merit, particularly in exposure drafts of proposed standards, as it can facilitate better public input. Nonetheless, since release text in any final standard will be referenced by plaintiff attorneys, PCAOB inspectors, and other regulators as a touchstone for the PCAOB's intent, we encourage the PCAOB to be very cautious and transparent in crafting release text for adopted standards.

## 2. Convergence of Auditing Standards

The CCMC, along with a number of other groups both domestic and international, support efforts to converge auditing standards.<sup>5</sup> Financial reporting convergence for global standards even received significant attention during the G-20 summit in Pittsburgh.

We appreciate that the PCAOB has included (as Appendix 10) a comparison of the proposed auditing standards to the objectives and requirements of the analogous standards of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants. However, in many instances, the comparisons fall short of explaining whether the PCAOB views its proposed standards as being different from those of the IAASB and ASB and, if so, the rationale for such differences and what is intended to be accomplished by the PCAOB's proposal.

In addition, by taking this approach, the PCAOB again fails to acknowledge the globalization of the economy and the unique needs these changes have imposed upon businesses and investors alike. Commonalities in the dissemination, reliability, and evaluation of financial information assist in the sound operation of markets. With this

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<sup>5</sup> For example, see letters from the United States Chamber of Commerce's Center for Capital Markets Competitiveness on PCAOB rulemaking docket matter No. 026, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (February 18, 2009), on PCAOB rulemaking docket matter No. 025, *Proposed Auditing Standard on Engagement Quality Review*, and on SEC File Number PCAOB-2009-02, *Auditing Standard No. 7 – Engagement Quality Review*.

proposal, the PCAOB has missed another opportunity to advance the convergence of international auditing standards.

The CCMC again calls for the PCAOB to make audit convergence a priority and to take up the leadership mantle in making this goal a reality.

### 3. Disclosure

The proposed standards include an expanded list of new requirements related to disclosure in the planning and conduct of public company audits. As such, the proposed standards sprinkle guidance throughout auditing standards that would collectively supersede AU Section 431, *Adequacy of Disclosure in Financial Statements*. The release text explains the PCAOB believes that enhancing the requirements for evaluating disclosures can prompt auditors to be more thoughtful and thorough in their approach to testing and evaluating disclosures. Unfortunately, the PCAOB has not provided clarity around the nature and substance of these enhancements or the need for each. As such, it is difficult to determine the PCAOB's intent.

This is troubling because the PCAOB's proposals are not conditioned upon the existence of a framework or guidance on the nature of audit judgments around disclosures under generally accepted accounting principles ("GAAP"). Yet such judgments on disclosure, by their nature, are integrated with the auditor's consideration of accounting requirements under GAAP. In addition, the PCAOB seems to be emphasizing qualitative aspects of disclosures.<sup>6</sup> Unstated is whether the PCAOB is somehow expecting auditors to assess whether companies have disclosed qualitative information in a transparent and understandable manner – a topic of discussion at the October 14-15, 2009 SAG meeting, but a topic which the PCAOB noted at the time went well beyond existed auditing standards.

Importantly, these issues only reinforce the need for the PCAOB to take action on the recommendation of the SEC's Advisory Committee on Improvements to Financial Reporting ("CIFiR") for the PCAOB to "develop and articulate guidance related to how the PCAOB, including its inspections and enforcement divisions,

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<sup>6</sup> One example of the confusion created by this emphasis is the note that has been added to paragraph 7 (pp. A3-2-3) of the proposed standard on *Consideration of Materiality in Planning and Performing an Audit*, which singles out related party transactions as an example of circumstances where qualitative factors could render quantitatively immaterial accounts or disclosures material.

would evaluate the reasonableness of judgments made based on PCAOB auditing standards.” As accounting judgments encompass disclosures, it is likewise noteworthy that CIFIIR recommended the PCAOB’s statement of policy should acknowledge that the PCAOB would look to the SEC’s statement of policy to the extent the PCAOB would be evaluating the appropriateness of accounting judgments as part of auditor’s compliance with PCAOB auditing standards.”<sup>7</sup> Having such a policy statement on auditor judgments would provide a framework for the PCAOB to consider any necessary revisions to the Interim Standards such as these being proposed related to risk. Also, it would provide a context for others to consider and comment on any such proposed revisions.

#### 4. Implementation of Auditing Standards

The release text of the proposals states that the PCAOB expects the final standards related to the auditor’s assessment of and response to risk will be effective for audits of fiscal years beginning on or after December 15, 2010. This is a very ambitious target date given that the PCAOB needs to consider comments, revise the proposed standards, hold an open PCAOB meeting to adopt any final standards, and then send the adopted standards to the Securities and Exchange Commission (“SEC”) for public comment and Commission approval before they can become effective. Moreover, the effective date for implementing the standards needs to have adequate lead-time to give audit firms an opportunity to make any necessary revisions in their audit methodologies and guidance and adequately train their people. Audit quality is not improved by rushing the implementation process.

The implications for the audit process of these standards on the auditor’s assessment of and response to risk are pervasive. As a result, they likewise involve significant considerations relative to audit methodologies and auditor training around the world. Thus, the example provided by AS No. 7, *Engagement Quality Review*, where the standard was approved by the SEC *after* its effective date, does not provide an appropriate model for implementing these foundational standards. The CCMC encourages the PCAOB and the SEC to work together and consider realistic effective dates for the implementation of these, as well as other, new PCAOB auditing standards.

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<sup>7</sup> *The Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission*, August 1, 2008, p. 93.

## 5. Conclusion

For the foregoing reasons, the CCMC believes that it is in the best interests of financial reporting policy that this proposal be withdrawn, re-evaluated and improved. We stand ready to work with you in that worthwhile endeavor.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Tom Quadman', with a long horizontal flourish extending to the right.

Tom Quadman