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February 18, 2009

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 Conforming Amendments to PCAOB Standards, PCAOB Rulemaking Docket Matter No. 026***

Dear Office of the Secretary:

The Center for Audit Quality (CAQ or the Center) is a public policy organization that seeks to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for reform that are rooted in the profession's core values of integrity, objectivity, honesty, and trust. We also seek to improve the reliability of public company audits and to enhance their relevance for investors in this time of increasing globalization and financial complexity. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board (PCAOB or the Board) may join the CAQ. The CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA) and has approximately 800 U.S. public company audit firms as members, representing tens of thousands of professionals dedicated to audit quality.

We welcome the opportunity to share our views on the PCAOB's Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk (the proposal or proposed standards).

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, appropriately applied, 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. We also appreciate the Board's efforts to consider recommendations made to the profession on potential ways to further improve risk assessment (e.g., the 2000 report by the Panel on Audit Effectiveness, and feedback from the PCAOB's Standing Advisory Group (SAG)). Some of these same recommendations served as the impetus for the AICPA's Auditing Standards Board (ASB) and the International Auditing and Assurance Standards Board (IAASB) to form a joint task force in 2001 that culminated in the development of a common set of risk assessment auditing standards intended to improve audit quality and to support convergence of auditing standards. We support the Board's objective to update its extant interim standards to reflect improvements that firms have made in risk-based audit methodologies and improvements in standards by other standards setters.

In the remainder of our letter, we have organized our overall observations and concerns about the proposal around the following topical areas:

- Convergence of auditing standards
- Importance of auditor application of professional judgment
- Risk assessment process: consistency and integration with Auditing Standard No. 5 (AS 5)
- Organization and content of standards
  - Objectives
  - Appropriate balance between requirements and guidance
  - Inconsistent use of terminology
  - Definitions
  - Use of notes to paragraphs and appendixes
- Considerations related to the finalization of the proposed standards
  - Overall review of interim standards
  - Effective date.

In addition, we have comments and recommendations regarding codification of the PCAOB's standards and increased public involvement in the PCAOB's standards setting process, particularly by the use of task forces with representatives from the profession, other standards setting bodies, and other interested parties as the proposed standards are being developed.

Finally, we have comments that are specific to each of the seven proposed standards and the conforming amendments, which we have included as an Attachment to this letter.

**Convergence of Auditing Standards**

We fully support the Board's consideration of the work of other standards setters, as evidenced by the overall alignment of the proposal's general structure with the corresponding risk assessment standards of the IAASB and the ASB. We also recognize the efforts of the Board to participate in the work of other standard setters by attending and participating in IAASB meetings, inviting the IAASB Chairman to join the SAG meetings, and participating in joint meetings of standards setters.

While we acknowledge the significant steps taken, we urge the PCAOB to advance efforts towards convergence by using the International Standards on Auditing (ISAs) as the base from which to develop standards and adding to or modifying the ISA wording for specific requirements and guidance deemed necessary for the purposes of auditing U.S. public companies.

We believe that doing so has several benefits. For instance, such a process can enhance the effectiveness and efficiency of all standards setters; improve the global understanding of auditing standards both by auditors and by other interested parties; eliminate unnecessary differences among the standards; and clarify the rationale for and understanding of differences that remain, such as those necessitated by an integrated audit performed for legal or regulatory reasons. These benefits will enhance auditors' understanding, implementation, and consistent application of standards on *all* the audits they perform, not just those subject to the Board's oversight. Additionally, appropriate convergence allows firms to avoid unnecessary costs, for example, by allowing for synergies related to training, implementation, and the development and maintenance of quality control systems that accommodate the standards of the various standards-setting bodies.

We acknowledge and strongly support the analysis of significant differences in requirements between the Board's proposed standards and those of the corresponding ISAs. In light of the increasing global acceptance of the ISAs, we believe that, prospectively, the Board should provide a more detailed comparison of its proposed standards and those of the IAASB. This could be achieved, as recommended above, by starting with the comparable ISA in developing the Board's standards. It would facilitate a more robust comparison of the standards and clearly identify where, and why, the Board believes divergence from the ISAs is necessary for audits of issuers.

We strongly support the following remarks made by Board member Bill Gradison at the Board's October 21, 2008 open meeting that encourages the development of comparative information that clearly states how the standards differ between the three standard setters:

“For the first time, the PCAOB is putting out a new standard for comment that includes an extensive comparison of its proposal with the standards promulgated by another standard setter, in this case the Risk Assessment Auditing Standards of the International Auditing and Assurance Standards

Board -the so-called ISAs. I would hope that the PCAOB would continue to put out such comparative information in connection with future proposals for new PCAOB standards. We are fast entering an auditing environment with three differing standards, especially as the PCAOB gradually replaces its interim standards (the pre-2003 ASB standards) and the ASB revises its standards, using the ISAs as the base - that is, "ISAs plus." I don't know whether over the long run having three standards is sustainable, but as long as there are three standards I believe each standard setter has a responsibility to make it as clear as possible how its standards differ from those of the other two standard setters so that practitioners know what is expected of them. Today's Board action is, in my mind, a constructive step in that direction."

Our detailed comments included in the attachment to this letter identify areas in which we believe additional constructive steps toward greater convergence could be achieved without jeopardizing the Board's objective to issue robust standards directed to audits, including integrated audits, of issuers.

#### **Importance of Auditor Application of Professional Judgment**

We acknowledge and agree with the Board's recognition in its release accompanying the proposed standards of the importance to the audit process of auditors exercising sound professional judgment to determine how best to fulfill the requirements of the proposed standards under particular circumstances. We also acknowledge the Board's statement in paragraph A19 of the appendix to Auditing Standard No. 3, *Audit Documentation*, that "...because professional judgment might relate to any aspect of an audit, the Board does not believe that an explicit reference to professional judgment is necessary every time the use of professional judgment may be appropriate." We believe it is important to discuss the integral role of the auditor's professional judgment, particularly within these proposed standards which establish the foundational principles of the audit, and which are dependent on the use of professional judgment to appropriately apply the standards to the unique circumstances of each audit engagement. We believe it is important to recognize that the judgments made regarding the identification and assessment of risks, determination of the nature, timing and extent of audit procedures, and what constitutes sufficient evidence are necessarily dependent on the facts and circumstances known to the auditor during the conduct of the engagement.

We set forth a recommendation below for the Board to develop a new standard based on ISA 200 (Revised and Redrafted), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* (see discussion of Objectives under the "Organization and Content of Standards" topic). In addition to the reasons described below for doing so, an additional benefit would be to incorporate guidance from that ISA that describes the role of and encourages the use of the auditor's professional judgment in fulfilling the objective of obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an

opinion. Professional judgment is essential to the proper conduct of an audit because the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Additionally, with the importance of professional judgment in mind, our comments on the proposed standards identify certain guidance that we believe is unnecessarily prescriptive and could have the unintended consequence of encouraging a checklist mentality rather than the exercise of professional judgment to appropriately scale and tailor the risk assessment process in each audit.

**Risk Assessment Process: Consistency and Integration with Auditing Standard No. 5 (AS 5)**

We believe that in an integrated audit the risk assessment *process* is the same for both the audit of the financial statements and the audit of internal control over financial reporting (ICFR). The fundamental requirements to obtain an understanding of the entity, including its internal control, and its inherent risks as a basis for assessing the risk of material misstatement are applicable in both the financial statement and ICFR audits. Once the risks of material misstatement have been identified, the auditor's *responses* to those risks may differ depending on whether an integrated audit or a financial statement only audit is performed.

We believe that the Board's proposed risk assessment standards may encourage a "side-by-side," rather than an integrated, approach to risk assessment for auditors performing an integrated audit. We encourage (see comment 1a in the Attachment to this letter) the Board to reconsider ways in which to better integrate its guidance for performing an integrated audit. We understand that the proposed standards are intended to be suitable for audits only of financial statements as well as for audits of financial statements as part of an integrated audit. However, we find that the Board's approach to combining the proposed standards with AS 5 is inconsistent and in some cases confusing.

One major inconsistency is that the top-down approach permeates AS 5 but is not mentioned in the proposed risk assessment standards. We believe that the top-down approach is relevant to the audit of the financial statements even when not performing an integrated audit, and should be addressed by the Board in the proposed standards.

We also believe that the guidance about the auditor's understanding of the components of internal control in the proposed standard *Identifying and Assessing Risks of Material Misstatement* should be better aligned with related guidance in AS 5. In particular, AS 5 paragraphs 34-38, "Understanding Likely Sources of Misstatement," and paragraphs 22-27, "Identifying Entity-Level Controls" are different enough from the guidance on understanding the components of internal control in the proposed standard *Identifying and Assessing Risks of Material Misstatement* that they suggest a parallel, rather than integrated, understanding is necessary to identify and assess risk in the audit of ICFR and the financial statement audit.

In addition, there is considerable redundancy between guidance in the proposed standards and that in AS 5 that we believe should be eliminated. If guidance incorporated from AS 5 is equally relevant to an audit only of financial statements, it should be incorporated into the risk assessment standards and through a conforming amendment removed from AS 5 with a cross-reference to the risk assessment standards. An example of such guidance is the bullet points in paragraph 7 of the proposed standard *Audit Planning and Supervision*, which are incorporated, with very slight modification to broaden their scope to an audit of financial statements, from paragraph 9 of AS 5. In contrast, there is guidance incorporated from AS 5 into the proposed standards that would be relevant only when the auditor is performing an integrated audit. In such circumstances we believe that the guidance should remain in AS 5. An example of such guidance is paragraphs 41-44 of the proposed standard *Evaluating Audit Results*.

### **Organization and Content of Standards**

#### **Objectives**

We support the use in each of the standards of an "objective of the auditor" that is principles based and outcome oriented to assist the auditor in performing the audit in accordance with PCAOB standards. We believe that it is necessary for the PCAOB to consider from the outset how the objectives of individual standards are intended to fit into the overall framework of PCAOB standards. In the ISAs, for example, objectives of individual standards are intended to assist the auditor in planning and performing the audit to achieve the overall objectives of the audit set forth in ISA 200. As stated in paragraph 20 of ISA 200, the auditor should use the objectives in relevant ISAs to: (a) determine whether any audit procedures in addition to those required by the ISAs are necessary in pursuance of the objectives stated in the ISAs; and (b) evaluate whether sufficient appropriate audit evidence has been obtained.

In addition, we believe that the Board should consider adding objectives to each of its standards, not just the seven in the proposal, and similarly link them to an overarching standard that provides context for their use. As such, we recommend that the PCAOB propose and adopt a standard equivalent to ISA 200. Such a standard would:

- Establish the auditor's overall responsibility when conducting an audit
- Set out the overall objectives of the auditor
- Explain the nature and scope of the audit and the inherent limitations of an audit
- Explain the scope, authority, and structure of the PCAOB standards, including language that denotes requirements
- Include a discussion of the use of professional judgment.

This can be achieved in part by using the proposed standard *Audit Risk in an Audit of Financial Statements* as a starting point and, using ISA 200, adding any additional content, as determined necessary by the Board, regarding the responsibilities and

functions of the independent auditor and reasonable assurance in the context of U.S. public company audits.

In addition, we believe that objectives should articulate a statement of purpose. We do not believe it is appropriate or necessary for objectives in individual standards to contain the "must" or "should" terminology governed by the Board's Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*. Such words should be reserved for the requirements that support the objectives of the standards. Accordingly, we recommend that paragraph 3 of the proposed *Audit Planning and Supervision* standard be moved from the "objective of the auditor" section of the proposal and incorporated as requirements under the "planning an audit" and "supervision" sections of the proposal.

Finally, we believe that some objectives proposed by the Board are overly broad (for example, those in *Evaluating Audit Results* and *Audit Evidence*) and the linkage between others should be improved (see *Identifying and Assessing Risks of Material Misstatement* and *The Auditor's Responses to the Risks of Material Misstatement*).

### **Appropriate Balance Between Requirements and Guidance**

While we generally support the brevity of the proposed standards, there are some areas where we believe the proposal would be improved with additional explanatory guidance, some of which is included in extant PCAOB, IAASB or ASB standards. An example is paragraph 19 of the proposed standard *The Auditor's Responses to the Risks of Material Misstatement*, which requires the auditor to perform tests of controls "for each relevant assertion for which substantive procedures alone cannot provide sufficient appropriate audit evidence" but provides no guidance to explain when such circumstances may arise. We believe the Board should consider including guidance about when this is the case. For instance, we believe this is the case under circumstances where a significant amount of information supporting financial statement assertions is electronically initiated, recorded, processed, or reported, as described more fully in paragraphs A120-121 of ISA 315 (Redrafted), *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*. In such cases, the entity's controls over such risks are relevant to the audit and the auditor should obtain an understanding of them. This is also described in paragraphs 119-120 of AICPA AU 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; or in paragraphs 68-69 of the Board's interim standard AU 319, *Consideration of Internal Control in a Financial Statement Audit*.

We also believe that some of the requirements in the proposed standards are unnecessarily prescriptive and will reduce efficiency without an accompanying increase in effectiveness. Such guidance encourages a checklist mentality rather than the appropriate exercise of professional judgment to tailor and scale the risk assessment process in each audit to the circumstances.

An example of an unnecessarily prescriptive requirement is paragraph 52(d) of the proposed standard *Identifying and Assessing Risks of Material Misstatement*, which requires the auditor to make specific inquiries about fraud of "accounting and financial reporting personnel, including, in particular, employees involved in initiating, authorizing, processing, or recording complex or unusual transactions." In AU 316.25 and in paragraph A16 of ISA 240 (Redrafted), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, such personnel are included as an example of others within the entity to whom the auditor may wish to direct fraud inquiries. We agree that the inquiries that are required in paragraphs 52(a), (b), and (c) of management, the audit committee, and internal audit personnel, respectively, are appropriate; however, we believe that the requirement in 52(d) is an inappropriate elevation of guidance that may in some circumstances involve an unnecessarily large number of personnel.

### **Inconsistent Use of Terminology**

*"Should consider," "should evaluate," "should assess" and "should take into account"*

We observe numerous instances in the proposed standards (for example, paragraphs 37, 41 and 63 in *Identifying and Assessing Risks of Material Misstatement* and paragraphs 4 and 25 in *Evaluating Audit Results*) in which the Board changes "should consider" phrases drawn from its interim standards or from the ISAs to "should evaluate" or "should assess" phrases. By changing the verb, there may be an implication that the PCAOB expects a different auditor action. If this is the case, then we suggest that additional guidance be provided to explain what the expected action is. If this is not the case, then we suggest that the Board use the same verb as is used in the other standards to avoid confusion.

In the proposed standards the Board also makes frequent use of a requirement that the auditor "should take into account" a matter (for example, the Note to paragraph 12 in *Identifying and Assessing Risks of Material Misstatement*, paragraphs 5 and 9 in *Consideration of Materiality in Planning and Performing the Audit*, and paragraphs 37 and 48 in *The Auditor's Responses to the Risks of Material Misstatement*). We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.

### **Definitions**

We encourage the Board to develop and follow a consistent approach with respect to defining terms. Some of the proposed standards (for example, *Identifying and Assessing Risks of Material Misstatement*) define terms in a Definitions section similar to the redrafted ISAs. Others define terms informally within the text of the standard (for example, the definition of fraud risk in paragraph 4(c) of *The Auditor's Responses to the Risks of Material Misstatement*). AS 5 demonstrates a third approach with a Glossary of defined terms appended to the standard. We believe that these differences in approach make the standards more difficult to use and could lead to misunderstanding. We



recommend that the Board consistently define terms in a special Definitions section of each standard, as appropriate, and create an overall Glossary of Terms for PCAOB standards that would contain all defined terms.

### **Use of Notes to Paragraphs and Appendixes**

We do not understand the purpose of including Notes in various paragraphs. We recommend that guidance that is in Notes be placed in existing or new paragraphs. We also recommend that there should be limited use of appendixes within a standard (necessary guidance should be included in the full text of the standard), and that no requirements be included in any appendix.

### **Considerations Related to the Finalization of the Proposed Standards**

#### **Overall Review of Interim Standards**

We support the Board's intent, announced at its October 2008 SAG meeting, to issue a concept release for public comment in early 2009 addressing the Board's action plan for review of its interim standards. Due to the foundational nature of the proposed standards, we suggest that the Board consider feedback on that concept release in connection with making revisions to these proposed standards prior to adoption.

#### **Effective Date**

The Board did not propose an effective date. In developing an effective date, we encourage the Board to consider the importance of providing firms sufficient time to incorporate the standards into their audit methodologies and training programs prior to implementation. We also believe that it is necessary for the Board to expose the proposed implementation date for public comment prior to adoption of the standards.

### **Codification of the PCAOB's Standards**

We acknowledge the Board's stated efforts to write standards that will serve as a foundation for future standards setting. However, we have difficulty envisioning how these standards will be integrated with the Board's other interim standards and with Auditing Standards 1-6. It may become increasingly cumbersome to navigate and apply the proposed standards with the extant standards without a codification.

Adoption of these proposed standards introduces a third "style" of standard that is inconsistent with the Board's other standards without a clear vision for integrating the standards in the future. For example, some standards have objectives and others do not; some standards have terms defined in a Glossary that is appended to the standard, others have terms defined in a Definitions section of the standard, and others have terms that are defined informally within the text of the standard. The IAASB and the ASB both have undertaken projects (the IAASB's is nearing completion; the ASB's is in progress) to redraft all their auditing standards in a consistent manner with the intent of encouraging

greater understanding, and more consistent application, of their standards by auditors to promote audit quality. We encourage the Board to undertake a similar project to introduce greater consistency and clarity in its standards.

### **Public Involvement in the Standards-Setting Process**

We strongly encourage the Board to increase the depth and accelerate the timing of public involvement, including the auditing profession, in its standards-setting process. We believe that this can be done effectively without compromising the independence of the Board's standard setting process. We acknowledge the important role that the Board's SAG and its inspection process play in informing the Board's agenda. We also strongly support the remarks of Board Member Dan Goelzer, at the PCAOB's October 21, 2008 open meeting at which the proposed standards were approved for exposure, that the Board might consider additional steps to promote transparency of its process. Mr. Goelzer suggested potential actions such as publishing a revised proposal, opening a second comment period and holding additional public forums or Board discussions to consider the comments. The Board could also improve the transparency of the standard setting process by providing direct word-for-word comparisons of proposed standards and new standards to current interim standards so as to highlight how the proposal is intended to change current audit practice, and having the Board more publicly debate/discuss the various issues when considering the standards.

We believe the Board could improve its standard setting process by establishing external task forces with significant expertise, including members of the auditing profession, to participate in developing and updating its auditing standards. This would provide the Board with an opportunity for periodic public input from interested persons or organizations in the development stage, prior to the formal publication of a proposed standard for public comment. We believe that such a process would enhance the timeliness and efficiency of the development process. We further encourage Board members or staff to participate in joint task forces with the IAASB and the ASB. We believe that such initiatives would complement, not diminish, the role of the SAG and the other forums that currently inform the Board's agenda and standard setting activities. Some advantages of such an approach include:

- The ability to vet alternatives with various constituents while preserving the ability to obtain broader input on such issues prior to the public exposure of a document,
- The possibility to achieve greater convergence of the Board's standards with global and U.S. non-public company auditing standards, and
- An enhanced understanding of the rationale for differences that are not eliminated in standards.

\* \* \* \*

Enclosed with this letter is an Attachment that provides more detailed comments specific to each of the proposed standards and the conforming amendments. These detailed comments are intended as a complement to the issues outlined and described above.

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,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

Enclosure

cc: PCAOB  
Mark W. Olson, Chairman  
Daniel L. Goelzer, Member  
Willis D. Gradison, Member  
Steven B. Harris, Member  
Charles D. Niemeier, Member  
Thomas Ray, Chief Auditor and Director  
of Professional Standards

cc: SEC  
Chairman, Mary Schapiro  
Commissioner Luis Aguilar  
Commissioner Kathleen L. Casey  
Commissioner Troy Paredes  
Commissioner Elisse B. Walter  
James Kroeker, Acting Chief Accountant  
Shelly Parratt, Acting Director of the  
Division of Corporation Finance

**ATTACHMENT  
COMMENTS ON PROPOSED STANDARDS**

Below are more detailed comments specific to each of the seven proposed standards and the conforming amendments to PCAOB standards. To facilitate your review, we have matched the detailed comment to the related topical area in the body of our letter. In some instances, however, a comment does not relate back directly to a topical area, in which case none is noted

	<b>Appendix 1: Audit Risk in an Audit of Financial Statements</b>	<b>Topical Area</b>
1a	<p>Paragraph 1 – As stated in paragraph 1 and its accompanying note, this proposed standard establishes requirements and provides direction regarding the auditor’s consideration of audit risk in an audit of financial statements. The paragraph note states that AS 5 establishes requirements and provides direction regarding the auditor’s consideration of risk in an audit of internal control over financial reporting (ICFR). This suggests that there are two separate and distinct processes for considerations of risk in an integrated audit.</p> <p>We believe many of the risk assessment activities are the same for both the audit of ICFR and the audit of the financial statements. An auditor’s risk assessment includes obtaining an understanding of the entity and its environment, including its internal control, and assessing the risks of material misstatement. These fundamental requirements are applicable in both the audit of ICFR and financial statement audits. Once the risks of material misstatement have been identified, the auditor’s responses to those risks may differ depending on whether an integrated audit or financial statement only audit is performed. We believe this is the intention of the Board; however, the drafting of paragraph 1 and the accompanying note create a different impression.</p> <p>We encourage the Board to reconsider ways in which to better integrate its guidance for performing an integrated audit.</p>	<b>Integrated Audit Guidance</b>
1b	<p>Paragraph 2 – In describing the objective of the auditor paragraph 2 states “The objective of the auditor is to conduct the audit of the financial statements in a manner that reduces audit risk to an appropriately low level.” This objective relates to the overall objective of the auditor when performing an audit, and does not specifically relate to the subject matter or title of this standard which is <i>Audit Risk in an Audit of Financial Statements</i>. Although the topics included in this proposed standard relate to the overall audit, we note that important guidance related to the overall audit is not included, such as a description of reasonable assurance and the inherent limitations of an audit. As discussed above in our overall comments we suggest this proposed standard be incorporated into an overall</p>	

	objectives standard and that additional information about an audit be incorporated into such a standard.	
1c	Paragraph 5 – The proposed standard defines the risk of material misstatement as referring to “the risk that the financial statements are materially misstated due to error or fraud.” This definition differs from the ISA and ASB definitions which describe the risk of material misstatement as “the risk that the financial statements are materially misstated <i>prior to the audit</i> .” Including the words “prior to the audit” makes it clear that the risk of material misstatement is the entity’s risk. We recommend adding the words “prior to the audit” to the definition of risk of material misstatement.	<b>Convergence</b>
1d	Paragraph 6 – The proposed standard does not sufficiently describe the types of risks of material misstatement at the financial statement level and how to identify such risks. In order to provide sufficient guidance to auditors regarding the risk assessment process, we believe the PCAOB should include in this standard additional guidance similar to that included in ISA 315 paragraphs A98-A101 related to identification and assessment of risks of material misstatement at the financial statement level.	
1e	Paragraphs 9 and 10 are inconsistent with each other and with paragraph 13 of the proposed <i>Audit Evidence</i> standard. The first sentence in paragraph 10 suggests that the auditor’s ability to reduce detection risk is limited to the performance of substantive procedures alone, rather than all audit procedures. Paragraph 9 refers to “procedures performed by the auditor” and to “audit procedures.” In the proposed <i>Audit Evidence</i> standard, paragraph 13 states that audit procedures can be classified as falling into three categories: risk assessment procedures, tests of controls and substantive procedures. Because the first sentence in paragraph 10 implies that detection risk is only reduced through the performance of substantive procedures, and the concept of how to reduce detection risk is sufficiently explained in paragraph 9, we believe the first sentence in paragraph 10 should be deleted.	

	<b>Appendix 2: Audit Planning and Supervision</b>	<b>Topical Area</b>
2a	Paragraph 3—We recommend the Board move paragraph 3 of the proposed standard from the "objective of the auditor" section of the proposal and incorporate it as requirements under the "planning an audit" and "supervision" sections of the proposal.	<b>Organization</b>
2b	Paragraph 3—We recommend the Board review its standards for consistency in the use of "must" and "should." For example, AS 5 paragraph 9 states that "the auditor should properly plan the audit of internal control over financial reporting and properly supervise any assistants," but paragraph 3 of the proposed standard states that "the auditor must adequately plan the audit and properly supervise the members of the engagement team."	<b>Organization</b>

2c	Paragraph 7—This paragraph includes a list of matters and states the auditor "... should evaluate whether the following are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures." However, this list includes items related to auditor judgment and audit planning (the first, fifth and ninth bullets) that would not have a bearing on the company's financial statements or ICFR, but rather they would be relevant to the auditor's risk assessment and planning activities. As such, we recommend revising the paragraph accordingly.	<b>Organization</b>
2d	Paragraph 7—Included in the list of matters in paragraph 7 is "preliminary judgments about the effectiveness of internal control over financial reporting." Unlike the bullet point related to materiality in paragraph 7, this bullet is not clear that it refers to the auditor's judgments. We recommend the Board modify this bullet item to clarify that it pertains to the <u>auditor's</u> preliminary judgments.	
2e	Paragraph 7—We acknowledge that the matters in paragraph 7 are largely equivalent to those listed in AS 5, paragraph 9. To eliminate redundancy and unnecessary inconsistencies, we suggest conforming amendments be made to AS 5 to eliminate this requirement from AS 5 in order to eliminate repetitious guidance.	<b>Integrated Audit Guidance</b>
2f	Paragraph 9b—This paragraph states that in establishing the overall audit strategy, the auditor "should...determine the significant factors that affect the direction of the engagement team." We understand this to mean a supervisor's direction or supervision of the team, but the wording is not as clear as it could be. In addition, the comparable guidance in paragraph 7 of ISA 300 (Redrafted), <i>Planning an Audit of Financial Statements</i> , requires that the auditor "shall... consider the factors that are significant in directing the engagement team's efforts." The use of the phrase "should consider" provides the auditor with clear expectations of the specific thought process and action required. We suggest re-wording this phrase to "should...consider the factors that are significant in directing the engagement team's efforts."	<b>Organization</b>
2g	Paragraph 10—This paragraph states "the auditor should develop a written audit plan." The term "written" can be misleading in the age of electronic workpaper documentation. In addition, this creates an unnecessary inconsistency with the standards of IAASB and ASB, neither of which includes the word "written" in relation to the audit plan. We recommend the Board replace the phrase "develop a written audit plan" with "develop and document an audit plan".	
2h	Paragraph 11—We support the Board providing guidance for multi-location engagements. Appendix B of AS 5 also contains multiple location scoping guidance, which we believe can be helpful in an audit of financial statements as well as an audit of ICFR. We encourage the Board to incorporate the multiple location guidance from Appendix B of AS 5 into the proposed standards. Alternatively, the Board should clearly state how	<b>Integrated Audit Guidance</b>

	the proposed guidance differs from, or is the same as, the multi-location considerations related to the audit of internal control, and how the auditor should use it in combination with the guidance in AS 5.	
2i	Paragraph 11—This paragraph lists factors an auditor “should evaluate” regarding the selection of a particular location or business unit when multiple locations exist. This represents a change from the “should consider” requirement drawn from its interim standards to a “should evaluate” requirement. We ask the Board to clarify its expectation of auditors with respect to “should evaluate” in its proposed standard as distinct from “should consider” guidance in its interim standards, both in terms of the specific thought process or action required of the auditor, including the related documentation.	<b>Organization</b>
2j	Paragraph 12—This paragraph uses the term “fraud risk”, but does not define this term. It is defined in other proposed standards. We recommend the Board replace the phrase in paragraph 12 “... or the discovery of a previously unidentified fraud risk” with the phrase “...or the discovery of a previously unidentified risk of material misstatement due to fraud (“fraud risk”).”	<b>Integration of Fraud Guidance</b>
2k	Paragraphs 13-15—These three paragraphs address the auditor’s responsibility to evaluate whether specialized skill or knowledge is needed in assessing risks, applying audit procedures, or evaluating the results. We have the following comments pertaining to the guidance in this area: <ul style="list-style-type: none"> <li>As noted in Appendix 9 of the proposal, the Board extended this responsibility from a similar requirement in AU 311.10 regarding specialized information technology (IT) skill or knowledge. Appendix 9 indicates the Board acknowledged the requirement was necessary because of the prevalent use of individuals with specialized skill or knowledge in areas other than IT, such as forensic specialists, valuation specialists, and actuarial specialists. However, these examples are not included in the proposed standard. We believe it would be helpful to auditors to include these examples in Paragraph 13.</li> <li>Paragraphs 14 and 15 address the use of a specialist to evaluate the effect of IT on the audit. We support the inclusion of this guidance, carried forward from AU 311.10 and AU 319.31-32. We recommend the Board also incorporate a reference to the extant guidance in AU 336, <i>Using the Work of a Specialist</i>, to address more comprehensively the auditor’s consideration of using individuals with specialized skills and knowledge, other than accounting and auditing.</li> </ul>	
2l	Paragraphs 18-20 – These paragraphs provide an example of using multiple “should” statements when it is not necessary. Paragraph 18 establishes the requirement by stating “the engagement partner should supervise other engagement team members....” Paragraphs 19 and 20 provide detail on how the requirements stated in paragraph 18 should be fulfilled but do so through additional “should” statements. We believe the	<b>Organization</b>

	<p>initial “should” statement in paragraph 18 is appropriate and sufficient to impose the requirement.</p> <p>We recommend that paragraphs 19 and 20 be presented as application guidance for paragraph 18. For instance, paragraph 19 should be revised to begin with “Elements of supervision include....” and paragraph 20 should be revised to state “the level of supervision of other engagement team members depends on many factors including...” We recognize the proposed standard retains extant requirements regarding supervision from AU 311 of the interim standards. We believe our suggestions would help streamline the proposed standard, thereby increasing an auditor’s understanding, implementation, and execution of the proposed standard.</p>	
2m	<p>Paragraph 21—The first sentence of paragraph 21 states that the partner and team members “should make themselves aware” of certain procedures to be followed when there are differences of opinion among the team. This phrase is unclear as to what the auditor should actually do. We recommend the Board be more specific in its requirements.</p>	<b>Organization</b>

	<b>Appendix 3: Identifying and Assessing Risks of Material Misstatement</b>	<b>Topical Area</b>
3a	<p>Paragraph 3 - We recommend that the Board adopt an objective similar to the following from ISA 315 in order to provide the important linkage between identifying and assessing risks and designing and implementing responses to those risks:</p> <p>“The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion level, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.”</p>	<b>Convergence</b>
3b	<p>Paragraph – 4 – The definition of significant risk in the proposed standard is different than that of the ISAs. The definition in the proposed standard does not refer to “identified and assessed” risks, but rather just refers to “risks.” The resulting implications are unclear. We believe the definition of significant risk should use the phrase “identified and assessed” risk. The entire concept of a “significant risk” in the auditor’s risk assessment process is that the auditor identifies and then assesses that risk, and then plans the audit procedures according to the “identified and assessed” risks.</p>	<b>Convergence</b>
3c	<p>Paragraph 4b - We recommend that the Board acknowledge the necessary use of professional judgment in determining significant risks. We believe the definition of significant risks provided in paragraph 4b of the proposed standard should include language similar to that used in paragraph 109 of ISA 315, which states “the auditor should determine which of the risks</p>	



	identified are, <u>in the auditor’s judgment</u> , risks that require special audit consideration” (emphasis added).	
3d	<p>Paragraphs 8 -19 - The proposed standard does not appear to acknowledge consistently that there may be significant differences based upon size or complexity of companies with respect to understanding the company and its environment and the related factors noted in paragraphs 8 through 19. While the proposed standard acknowledges that there may be differences between smaller and larger companies with respect to the company’s measurement and review of its financial performance (for example, see note to paragraph 17) we believe there also may be significant differences in the other areas discussed in the proposed standard.</p> <p>Accordingly, we recommend that the Board’s final standard broadly acknowledge that the procedures performed by the auditor in identifying and assessing risks of material misstatement may vary between smaller, less complex entities and larger, more complex entities.</p>	
3e	<p>Paragraph 10 – The proposed standard does not acknowledge that ongoing matters, in addition to significant changes, may affect the identification and assessment of risks of material misstatement. We recommend that the proposed standard be revised to acknowledge that ongoing matters (i.e., those matters that may have been significant in a prior year and are present in the current year) should be considered in the risk identification and assessment process.</p>	
3f	<p>Paragraph 12 - When considered along with paragraphs 8, 9a and 9b, this paragraph results in an obligation on the auditor to obtain an understanding of each of the items in the list. This is an example where the proposed standard imposes a number of requirements relative to items the auditor “should consider,” “should consider performing,” or where the auditor’s understanding of an area “includes” a number of listed items. It is unclear whether the use of these terms imposes a documentation requirement on the auditor. We believe that providing examples of items that may be considered by the auditor (similar to paragraph 15 of the proposed standard) allows the auditor to appropriately tailor his or her audit approach.</p> <p>In addition, the Note to this paragraph states that the auditor “should take into account” information obtained from this understanding when determining the existence of related parties. We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.</p>	
3g	<p>Paragraph 16 - We do not believe the proposed standard is clear with respect to the auditor’s responsibility in identifying and assessing risks relative to company performance measures. Although as stated in paragraph 16 of the proposed standard, the purpose is to identify those performance measures that affect the risks of material misstatement, the second bullet of paragraph 17 seems to shift the auditor’s focus to those measures the company uses as controls. We recommend that the Board</p>	

	more precisely define the auditor’s responsibilities with respect to these matters.	
3h	Paragraph 19 – We believe the Board should describe what is meant by “degree of transparency of the application of accounting policies” or delete that bullet.	
3i	<p>Paragraph 34 - There are a number of instances where the proposed standard highlights differences between the required audit procedures to be performed in an integrated audit compared to an audit of only financial statements. In particular, the note to paragraph 34 states that “For purposes of evaluating the effectiveness of internal control over financial reporting, the auditor’s understanding of control activities encompasses a broader range of accounts and disclosures than that which is normally obtained in an audit of financial statements only.” This statement pertains only to an integrated audit and should be deleted from the proposed standard. We recommend the Board clarify that the process of identifying and assessing risks of material misstatement is the same in an integrated audit and in an audit of financial statements only.</p> <p>The proposed standard does not emphasize the use of a top-down approach to identifying and responding to risks of material misstatement. As noted in AS 5, “A top-down approach begins at the financial statement level and with the auditor’s understanding of the overall risks to internal controls over financial reporting. The auditor then focuses on entity-level controls and works down to significant accounts and disclosures and their relevant assertions. This approach directs the auditor’s attention to accounts, disclosures, and assertions that present a reasonable possibility of material misstatement to the financial statements and related disclosures.” We believe the use of a top-down approach is fundamental to the process of identifying and assessing risks of material misstatement. We recommend that the Board acknowledge the importance of the use of a top-down approach in identifying and assessing the risks of material misstatement.</p> <p>Paragraphs 34 - 38 of AS 5 provide for certain basic risk assessment activities to be undertaken to identify risks at the assertion level. The proposed standard does not contemplate the risk assessment activities noted in paragraphs 34 through 38 of AS 5. We recommend that the Board acknowledge the importance of the use of the risk assessment activities noted in paragraphs 34 through 38 of AS 5 in identifying and assessing the risks of material misstatement.</p>	<b>Integrated Audit Guidance</b>
3j	Paragraph 41 – The proposed standard states that “The auditor should assess whether information obtained in other engagements performed by the auditor is likely to be important for identifying risks of material misstatement.” It is unclear whether the second use of the term “the auditor” in this sentence refers to the audit engagement partner, or the audit firm. As a result, it is unclear whether the auditor has a responsibility to assess information obtained in any other engagements performed by the	

	audit firm, including any non-audit services provided. We recommend the Board use language similar to that found in paragraph 8 of ISA 315, which states “Where the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.”	
3k	Paragraph 56 (c) – The proposed standard states that the auditor should “evaluate the types of potential misstatements...” We recommend that the PCAOB incorporate the concept of asking “what could go wrong?” consistent with paragraph 30 of AS No. 5. We believe the consistent use of this terminology would enhance clarity and promote uniformity of application.	
3l	Appendix A – The reasons for this guidance appearing in an Appendix rather than the standard itself are unclear. Paragraphs A1 and A4-A6 contain presumptively mandatory responsibilities for the auditor. If the appendix is intended to hold the same authority as the standard, it should be incorporated into the standard, particularly those paragraphs that contain presumptively mandatory responsibilities. We recommend that the Board incorporate the Appendix A guidance into the body of the standard, or remove the presumptively mandatory requirements therein.	<b>Organization</b>

	<b>Appendix 4: The Auditor’s Responses to the Risks of Material Misstatement</b>	<b>Topical Area</b>
4a	<p>Paragraph 1 - The description in paragraph 1 omits a crucial element in responding to risk – the notion of the auditor’s <i>identification and assessment</i> of the risk of material misstatement. We understand that the Board considered this matter and concluded that obtaining sufficient appropriate evidence to support the auditor’s opinion requires the auditor to adequately respond to the risks of material misstatement. However, we do not believe that this approach appropriately makes the connection between the assessment of risk and the audit response.</p> <p>For instance, in each audit the auditor performs risk assessment procedures to determine where risks of material misstatement exist, and based on this assessment the audit response is designed and implemented to obtain sufficient appropriate evidence. The effectiveness with which this assessment is performed logically affects any audit response. By eliminating this connection between assessment and response, the standard would not explicitly require a linkage between the auditor’s responses and the assessed risks of material misstatement. We believe that the notion of linkage is a fundamental concept of the audit risk process that enhances the quality of an audit. We recommend that the standard include the concept of linkage, that is, the auditor should design and implement appropriate responses based on the <i>identified and assessed</i> risks of material misstatements, which is</p>	<b>Convergence</b>

	consistent with ISA 330 (Redrafted), <i>The Auditor's Responses to Assessed Risks</i> .	
4b	Paragraph 3 - We recommend rephrasing the objective included in paragraph 3 of the proposed standard to better reflect an outcome based approach that provides both specificity and a link between the requirements of the standard and the objective of the auditor. As such, we suggest using wording similar to ISA 330, which states "The objective of the <i>auditor is to obtain sufficient appropriate audit evidence</i> about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks."	<b>Convergence</b>
4c	We support the addition of guidance to assist auditors in achieving the objective of this standard and suggest including selected sections of the guidance from the publication, <i>Staff Views – An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit Of Financial Statements: Guidance for Auditors of Smaller Public Companies</i> , Chapter 1, <i>Scaling the Audit for Smaller, Less Complex Companies</i> . In particular, this publication contains guidance that describes the attributes of smaller companies that have less complex operations which affect the particular risks and controls implemented to address those risks. Some examples are: the use of entity level controls to achieve control objectives; consideration of the risk of management override; implementation of segregation of duties and alternative controls; the use of IT; the maintenance of financial reporting competencies; and the nature and extent of available documentation to support operating effectiveness of controls.	
4d	Paragraphs 14 – 16 - Paragraphs 14 and 15 of the proposed standard focus on testing controls specific to an audit of internal control only. Additionally, paragraph 16 focuses on evidence about the effectiveness of controls in an audit of internal control. We recommend removing this guidance from the proposed standard and retaining it solely in AS 5.	<b>Integrated Audit Guidance</b>
4e	Paragraph 18 - Footnote 14 to paragraph 18 provides guidance about the "period of reliance" with respect to testing controls in a financial statement audit. Given the importance of this concept, we believe this guidance should be included within the body of the standard and that implementation guidance about how this concept would be applied should be provided. The application guidance in ISA 330, paragraph A32, provides an example of how evidence pertaining only to a point in time may be sufficient for the auditor's purpose and explains that controls over the entity's physical inventory counting at the period end may be an example of such a control.	
4f	Paragraph 19 - This paragraph states that tests of controls should be performed in the audit of the financial statements for each relevant assertion for which substantive procedures alone cannot provide sufficient appropriate audit evidence. The circumstance when such a situation might occur is not described. To clarify the intent of this presumptive requirement we suggest including an example similar to that contained in ISA 330, paragraph A24, which states that "In some cases...the auditor may find it	

	impossible to design effective substantive procedures that by themselves provide sufficient appropriate evidence at the assertion level. This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system.” Paragraph 19 also indicates that assessing completeness and accuracy is limited to substantive analytical procedures, but the auditor may need to test completeness and accuracy of data when performing other types of procedures, including tests of details. As such, this paragraph should be revised accordingly.	
4g	Paragraphs 14-39 - The guidance related to testing controls contained in paragraphs 14 through 39 is partially directed towards a financial statement audit (paragraphs 17-20), partially directed towards an internal control audit (paragraphs 14-16), and certain paragraphs seem to apply to both situations (paragraphs 21-39). As presented, it is confusing and difficult to follow. It is particularly confusing, as much of this guidance is already included in AS 5. In order to clarify how controls should be tested in a financial statement audit, the proposed standard should not repeat guidance already included within AS 5, but instead incorporate the paragraphs that apply to audits of financial statements in this standard. Additionally, a codification should be provided so that practitioners can easily follow the standards and meet the performance requirements. A codification would clarify what is applicable for financial statement audits and what is applicable for integrated audits.	<b>Integrated Audit Guidance Codification</b>
4h	Paragraph 37 - When controls have been tested in prior audits, paragraph 37 provides guidance about the factors to be considered to determine the evidence needed in the current year audit to support the auditor’s control risk assessment. However, the factors listed are both specific factors related to subsequent years’ audits and factors that should be considered whether or not the control was tested previously. We note that this paragraph does not reference the concept of risk in a similar manner as the guidance provided in paragraphs 46 and 47 of AS 5. It also seems to exclude some relevant risk factors that are included within these paragraphs, for example, the nature and materiality of the misstatements that the control is intended to prevent or detect and the degree to which the control relies on the effectiveness of other controls. To appropriately describe the relationship of risk to the evidence to be obtained we recommend including the guidance contained in paragraphs 46 and 47 of AS 5 in this standard and separately describing the overall risk factors related specifically to subsequent years’ audits.  In addition, this paragraph states that when controls have been tested in past audits, the auditor “should take into account” certain factors to determine the evidence needed in the current year audit. We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.	<b>Integrated Audit Guidance</b>
4i	Paragraph 41 - The last sentence of the note to paragraph 41 states “Also, when performing a dual-purpose test, the auditor should evaluate the results of the test in forming conclusions about both the <i>assertion and the</i>	

	<i>effectiveness of the control</i> ” (emphasis added). However, when discussing dual-purpose tests, this note should discuss forming a conclusion about the “objective of the <i>substantive test</i> and effectiveness of the control,” not the “ <i>assertion</i> and the effectiveness of the control.”	
4j	Paragraph 48 - This paragraph states that the auditor “should take into account” a number of factors when determining whether it is appropriate to perform substantive procedures at an interim date. We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.	

	<b>Appendix 5: Evaluating Audit Results</b>	<b>Topical Area</b>
5a	<p>Paragraph 2 – We agree with the PCAOB’s approach to include in the proposed standard requirements relating to evaluating the results of the audit, which have previously existed in a variety of standards. However, we note that the inclusion of the broader array of requirements has resulted in an objective in the proposed standard that may be perceived as broader, less specific, and weaker than the objective in ISA 450 (Revised and Redrafted), <i>Evaluation of Misstatements Identified During the Audit</i>. Furthermore, when taken together, the objectives of the ISAs in the group of standards from which the requirements are drawn are more comprehensive than the single objective in the proposed standard.</p> <p>The objectives in the ISAs provide context to the auditor in determining whether additional work is necessary to achieve the individual objectives. A broad objective, like the one in the proposed standard, does not provide such context.</p> <p>We suggest the Board incorporate the specific objectives related to each of the individual components in paragraph 5. We also believe that the objective should reference the requirement for the auditor to determine whether he or she has obtained sufficient appropriate audit evidence, similar to the statement in paragraph 1. We believe that these suggestions will strengthen the objective, and also provide appropriate context to the requirements.</p>	<b>Organization</b>
5b	Paragraph 3a – We are concerned that the proposed definition of “error” differs from the definition in the accounting literature. We do not believe a separate definition is necessary in the auditing literature. We believe the difference between fraud and error can be clearly delineated in the definition of “misstatement” as proposed below.	
5c	Paragraph 3b – The term “misstatement” appears to be defined using the concept of materiality. As currently written, the first sentence of the definition may be understood by some to be a statement of fact, or may be understood to be a definition of “material misstatement.” To clarify, we	<b>Convergence</b>

	<p>believe the term should be defined absent of a reference to itself and absent of the concept of materiality. A separate definition of material misstatement could be provided. We suggest the terms “misstatement” and “material misstatement” be defined as follows:</p> <p style="padding-left: 40px;">Misstatement - A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that should have been reported in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.</p> <p style="padding-left: 40px;">Material Misstatement - A misstatement that, individually or in combination with other misstatements, causes the financial statements not to be presented fairly in conformity with the applicable financial reporting framework.</p>	
5d	<p>Paragraphs 4 and 25 – The requirements in the related paragraphs in the ISAs (paragraph 27 of ISA 330 and paragraph 12 of ISA 700) state that the auditor “shall consider.” The Board has chosen to change the guidance to “shall evaluate” in paragraph 4 and “shall assess” in paragraph 25. By changing the verb, there may be an implication that the PCAOB expects a different auditor action. If this is the case, then we suggest that additional guidance be provided to explain what that expected action is. If this is not the case, then we suggest that the PCAOB use the same verb as is used in the other standards to avoid confusion.</p>	
5e	<p>Paragraph 8 – The proposed standard includes requirements pertaining to the performance of analytical procedures in the overall review of the financial statements. We concur with these requirements. However, we request additional clarification with respect to the requirement in paragraph 8, which states “The nature, timing, and extent of the analytical procedures that should be performed during the overall review depend on the nature of the company and its industry.” Although this may be true, the performance of analytical procedures in the final review stage of the audit tend to be similar to the analytical procedures performed during risk assessment. The ISAs also state that such analytical procedures “...may be similar to those that would be used as risk assessment procedures.” Without such clarification, the requirement in paragraph 8 may lead to inconsistency in practice with respect to the type of analytical procedures performed to meet the aim of the requirements in paragraphs 6 and 7, even when AU Section 329, <i>Analytical Procedures</i>, will be revised to only address substantive analytical procedures.</p>	<b>Convergence</b>

5f	Paragraph 13 – This paragraph could be enhanced by further clarifying that “clearly trivial” is not another expression for “not material” (ISA 450, paragraph A2). Although this paragraph is consistent with extant standards and the concept of “clearly trivial” is well understood by auditors in practice, we believe the ISAs provide added clarity from a standards-setting perspective.	<b>Convergence</b>
5g	Paragraph 14 - The use of the term “identified misstatements” can be misinterpreted. Although we believe this term is meant to include known or factual misstatements, it is a new term in the literature that is not defined and does not specifically correlate with extant standards or the ISAs. The auditor can “identify” known or factual misstatements, as well as other potential or likely misstatements, such as those relating to projections of sampling applications and judgments relating to estimates. We urge the Board to consider using either “known and likely misstatements,” or “factual, judgmental and projected” misstatements, or “accumulated misstatements.” It is important to distinguish between these types of misstatements, as the auditor’s response differs. In this regard, it may also be helpful to define the terms used.	<b>Convergence</b>
5h	Paragraphs 16 and 18 – These paragraphs could be strengthened by requiring the auditor to request management to correct misstatements accumulated during the audit. These requirements would promote accurate financial reporting. In addition, from our perspective, the ISAs create a stronger standard by including such requirements (ISA 450, paragraphs 8 and 12).	<b>Convergence</b>
5i	Paragraph 19 - The proposed standard uses the words “ <u>detected</u> in prior years” instead of “ <u>related</u> to the prior year” as used in ISA 450, paragraph 11. We believe this changes the meaning since there may be misstatements detected in the current year and related to the prior year, which would be encompassed in the ISA language, but not the PCAOB language. We also believe the requirement does not accurately capture the requirements in the Securities and Exchange Commission’s Staff Accounting Bulletin 108, <i>Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements</i> , which provides guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. We believe the ISA was drafted to be framework neutral and therefore, does not clearly address the iron-curtain versus the roll-over method. PCAOB standards, however, should be clear in this regard.	<b>Convergence</b>
5j	Paragraphs 28 and 29 – These paragraphs are included under the heading <i>Assessing Bias in Accounting Estimates</i> specifically for purposes of assessing the qualitative aspects of the company's accounting practices. Paragraph 28 deals with whether a misstatement exists in an accounting estimate, and not bias. This paragraph, on its own, is insufficient for determining whether a misstatement in an accounting estimate exists. As written, it might more appropriately be included in the section	



	<p>“Accumulating and Evaluating Identified Misstatements.”</p> <p>With respect to paragraph 29, we understand that this requirement is similar to existing requirements. However, we believe the IAASB has made, in ISA 700, <i>Forming an Opinion and Reporting on Financial Statements</i>, further improvements in the area of the consideration of bias in the financial statements that should be considered by the PCAOB. Although the proposed suite of risk assessment standards addresses bias throughout, we believe such standards lack application guidance with respect to the indicators of management bias and its effect on the audit. It would be helpful to provide additional examples of management bias. It would also be helpful to clarify that, in addition to the fact that a misstatement due to fraud may exist, the indicators of bias may affect the auditor’s conclusion as to whether the auditor’s risk assessment and related responses remain appropriate, and whether the financial statements as a whole are free from material misstatement. Such guidance is particularly important in light of the requirement in paragraph 25 for the auditor to “assess” bias. We prefer the language in the ISAs, which requires the auditor to review the judgments and decisions made by management to identify whether there are indicators of possible management bias because the auditor action is clearer.</p>	
5k	<p>Paragraph 32 – We believe that this requirement would be more appropriately placed in Appendix 3, <i>Identifying and Assessing Risks of Material Misstatement</i>. Paragraph 30 already addresses the requirement to evaluate whether the accumulated results of auditing procedures and other observations affect the assessment of fraud risks and the need to modify the audit procedures to respond to those risks. We propose moving paragraph 32 into the aforementioned standard and including a footnote reference to that standard in paragraph 30. The reference to Appendix A in paragraph 32 could also be moved to paragraph 30. We further suggest replacing the phrase “earlier in the audit” in paragraph 30 with the phrase “throughout the audit.”</p>	<b>Integration of Fraud Guidance</b>
5l	<p>Paragraph 37 – This paragraph addresses the auditor’s responsibility when the auditor has not obtained sufficient appropriate audit evidence. We believe this requirement can be enhanced by relating it to the financial statements being audited. To be consistent with the ISAs (ISA 700, paragraph 17), the introductory phrase should read as follows: “If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement...”</p>	<b>Convergence</b>
5m	<p>Paragraphs 41 - 44 – These paragraphs unnecessarily repeat requirements and guidance already included in AS 5. Since these paragraphs relate to integrated audits, we suggest deleting them from the proposed standard.</p>	<b>Integrated Audit Guidance</b>

	<b>Appendix 6: Consideration of Materiality in Planning and Performing an Audit</b>	<b>Topical Area</b>
6a	Paragraph 3 – The Note to Paragraph 3 states “When performing audit procedures, the auditor should be alert for misstatements that could be qualitatively material...However, it ordinarily is not practical to design audit procedures to detect misstatements that are material based solely on qualitative factors.” The term “ordinarily” suggests that there are situations where it may be practical to base materiality solely on qualitative factors. We suggest removing the word “ordinarily” because we do not believe there would be any situation in which it would be practical to design audit procedures to detect misstatements that are material based solely on qualitative factors, with no regard to quantitative materiality.	
6b	Paragraph 5 - The Note to this paragraph states that the auditor “should take into account” effects of known or expected changes in the company’s financial statements when establishing materiality. We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.	
6c	Paragraphs 8 and 9 require the auditor to determine the amount of “tolerable misstatement.” Paragraph 12 of ISA 320 (Revised and Redrafted), <i>Materiality in Planning and Performing an Audit</i> , uses the term “performance materiality” for essentially the same concept, as does an exposure draft of the ASB. Since these terms seem to have the same meaning, we recommend the PCOAB replace the term “tolerable misstatement” with “performance materiality” to avoid confusion.	<b>Convergence</b>
6d	Paragraph 9 - This paragraph states that the auditor “should take into account” information about misstatements that were accumulated in audits of prior periods in determining tolerable misstatement, and planning and performing audit procedures. We ask the Board to clarify both the auditor action and the documentation that the Board expects of the auditor as a result of this presumptively mandatory responsibility.	

	<b>Appendix 7: Audit Evidence</b>	<b>Topical Areas</b>
7a	Paragraph 1 – This paragraph states “This standard establishes requirements and provides direction regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.” Unlike paragraph 1 in ISA 500 (Redrafted), <i>Audit Evidence</i> , the PCAOB does not expressly state that the standard “explains what constitutes audit evidence.” Divergence from the ISA is unnecessary. To make it clear that this standard explains what constitutes audit evidence, and to be consistent with the ISA, the Board should add this language to paragraph 1.	<b>Convergence</b>

7b	<p>Paragraph 3 – The objective in paragraph 3 is overly broad. As written it relates to the entire audit, rather than this standard. The focus of this proposed standard is on designing and performing audit procedures to obtain sufficient appropriate audit evidence, and this should be reflected in the objective of the standard. Accordingly, we recommend revising this paragraph by using the language in paragraph 4 of ISA 500 which states “the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.” We acknowledge that paragraph 4 of the PCAOB’s proposed standard is similar to paragraph 4 of ISA 500; however, it seems unnecessary to diverge from the ISA on the objective of audit evidence, as this should be a universal concept.</p>	<b>Convergence</b>
7c	<p>Paragraph 6 – This paragraph states that audit evidence <b>must</b> be relevant and reliable. This paragraph (and those that define relevance and reliability) does not acknowledge that there are degrees of relevance and reliability. This could be accomplished by deleting the second sentence of paragraph 6. This sentence is not needed in paragraph 6 as relevance and reliability are explained in paragraphs 7 and 8 and deleting this sentence would be more consistent with paragraph 5(b) of ISA 500. Alternatively, the second sentence of paragraph 6 could be revised to state “To be appropriate, the accumulated audit evidence must be both sufficiently relevant and reliable” and the following from ISA 500, paragraph A26 could be added “The quality of audit evidence is affected by the relevance and reliability of the information upon which it is based.”</p>	<b>Convergence</b>
7d	<p>Paragraph 12 – This paragraph implies that the guidance is different for a financial statement audit and an integrated audit. We do not believe this is the intention of the Board. Different assertions are not used based on the type of audit. We believe that the reason for the auditor basing his or her work on different assertions would be the same under either a financial statement audit only or an integrated audit. We suggest clarifying this paragraph.</p>	<b>Organization</b>
7e	<p>Paragraph 27 - The proposed standard does not acknowledge that “selective examination of specific items, particularly if those items are selected based on the auditor’s belief that they are more likely to contain a misstatement, may provide the auditor with some audit evidence concerning the remainder of the population.” (See language in proposed AU 318, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>, paragraph A26). We recommend this language be added to the standard.</p>	<b>Convergence</b>
7f	<p>This standard is silent on use of evidence from previous audits. ISA 500 application material acknowledges that information from previous audits may be included in audit evidence. See paragraphs A1, A11, and A26 of ISA 500. The PCAOB should acknowledge that information from previous audits may be used as possible audit evidence</p>	<b>Convergence</b>

	<b>Appendix 8: Proposed Conforming Amendments to PCAOB Standards</b>	<b>Topical Areas</b>
8a	<p>The PCAOB is proposing to re-title AU section 329, <i>Analytical Procedures</i>, to <i>Substantive Analytical Procedures</i>, to more accurately reflect the content of the amended standard. We support this amendment, and ask the PCAOB to consider whether AU section 316, <i>Consideration of Fraud in a Financial Statement Audit</i>, may also need to be renamed to more accurately reflect the proposed focus on the auditor’s responsibility with respect to fraud and more detailed requirements and direction regarding the auditor’s responses to fraud risks. This would be in contrast to the current focus of AU 316, which addresses the auditor’s overall responsibility related to fraud.</p>	
8b	<p>Appendix 9 states that “AU sections 350.23 through 350.38 have been amended to explain more specifically how the principles in the standard for determining sample sizes when nonstatistical sampling approaches are used.” To this effect, Appendix 8 proposes to add paragraph .23A and to add a sentence to the end of paragraph .38 of AU section 350, <i>Audit Sampling</i>, that reads “Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.”</p> <p>We believe this proposed sentence implies that auditors would be required 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. We suggest adding footnote 5 from the AICPA’s AU350.23 to clarify that that is not the intent. We also suggest that the PCAOB remove the phrase “or larger than” from the proposed sentence because that phrase would suggest that a non-statistical sample size would have to be at least the same size as a statistical sample (that is it would create a “floor”), which would also drive the auditor to calculate a statistical sample in all cases.</p>	
8c	<p>Appendix 8 proposes to replace paragraph .25 of AU section 350, <i>Audit Sampling</i>, with a requirement using the terminology “should evaluate.” Extant PCAOB standards use the term “should consider” in the first sentence of this paragraph. By changing the verb, there may be an implication that the PCAOB expects a different auditor action. If this is the case, then we suggest that additional guidance be provided to explain what the expected action is. If this is not the case, then we suggest that the Board use the same verb as is used in AU section 350.25.</p>	
8d	<p><u>General Comments on Conforming Changes</u></p> <p>We note that the Board has replaced the term “competent” with the term “appropriate” throughout the extant standards using the conforming amendments. While we agree with this change, the resulting phrase is “sufficient appropriate evidential matter.” We believe that the conforming amendments should be revised to replace the entire phrase with “sufficient</p>	

	appropriate audit evidence,” which would be consistent with the phrase used in the proposed standards and the related ISAs. We also suggest that the Board make consistent conforming amendments, as necessary, to the Board’s other standards (e.g., AS 5).	
8e	<u>AU 316 Conforming Amendments</u> Paragraph 77, items c & d are deleted from extant standard but not included in proposed standards (when the auditor believes misstatement is a result of fraud... <i>c</i> . Discuss the matter and the approach for further investigation with an appropriate level of management that is at least one level above those involved, and with senior management and the audit committee. <i>d</i> . If appropriate, suggest that the client consult with legal counsel.) This guidance should not be deleted	
8f	Para 78 - (withdrawing from engagement) has been deleted; there does not appear to be an equivalent in the proposed standards. Again, this guidance should not be deleted from the standard	