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COMPETITIVENESS

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 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 21st 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 response 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. Convergence of auditing standards
2. Fraud
3. Materiality
4. Auditor judgment
5. Revision of Interim Standards

The CCMC strongly believes that these proposals are incomplete in their scope, do not reflect the circumstances presented by the ongoing financial crisis, and should be re-evaluated so as to properly achieve the objectives of the PCAOB. Accordingly, the CCMC recommends that the PCAOB withdraw these proposals, reevaluate, and reintroduce them at an appropriate time for public comment.

1. Convergence of Auditing Standards

The release text for the proposed standards notes that the International Auditing and Assurance Board ("IAASB") has updated its auditing standards regarding risk assessment. However, the release text does not mention that the Auditing Standards Board ("ASB") has done likewise. Further, the ASB and the IAASB have committed to converging their two sets of standards. Nevertheless, the PCAOB fails to take into account or promote the need for international convergence of auditing standards.

The CCMC, along with a number of other groups both domestic and international, support efforts to converge auditing standards. For example, the release from the G8 Summit of Business Leaders in Paris (December 3 and 4, 2008) *Ready for the Future*, in which the Chamber participated, includes the following recommendation:

> ***The appropriate national authorities need to launch an international convergence of standards for auditing of accounts***
> *While there has been the establishment and growing acceptance of a global accounting standard, this represents only one part of financial reporting policy. There is a similar need to ensure that a global standard for auditing of accounts in order to guarantee an appropriate level of scrutiny and thoroughness to ensure transparent high-quality information for investors and preparers alike. Such a system will also aid cross-border consultation and collaboration amongst appropriate regulators.*

The PCAOB 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. The PCAOB has missed the opportunity to advance the convergence of international auditing standards. While much focus and attention has been paid to the globalization of accounting standards, it is just as important for financial reporting policies to operate effectively, that a similar effort be undertaken for auditing standards. The Madoff and Satyam scandals clearly illustrate that failures in financial reporting have world-wide implications. From an audit standpoint, this means auditing standards that are global in scope. Although the PCAOB considered the IAASB standards in developing its own proposed standards, they have failed to make the case that public company audits in the U.S. are sufficiently unique, that they require their own auditing standards, or that the PCAOB's proposed standards, if they differ from the IAASB's in both form and content, are somehow better.

Accordingly, the CCMC urges the Board to do more than just consider the IAASB's standards. Rather, the CCMC would respectfully request that these proposals be withdrawn and recast with an eye towards international convergence of auditing standards. The PCAOB should work with all interested parties to start this process. Since this has been a stated goal since its inception; the CCMC stands by to work with the PCAOB to assist in this effort.

2. Fraud

In the proposed language on fraud, the PCAOB provides some discussion of the recommendations of the Public Oversight Board Panel on Audit Effectiveness (PAE). However, the PCAOB fails to mention that the current PCAOB Interim Auditing Standard, AU Section 316, *Consideration of Fraud in a Financial Statement Audit*, was promulgated, among other reasons, in response to the recommendations of the PAE to focus the auditor's attention on and improve the response to the risk of fraudulent financial reporting. While recognizing that materially misstated financial statements due to fraud are rare events, the PAE noted that auditors need to be alert that fraud can exist as to any client and must avoid complacency in the face of its rarity. AU Section 316 mandated new and specific requirements to address fraud risk.

The PCAOB exposure draft proposes several revisions in both the form and content of the existing fraud standard. While keeping most, but not all, of the requirements the same, it moves many of the requirements out of the fraud standard (AU Section 316) and folds them into other sections. This revision is justified in the release text under the rationale that the inspection process has identified instances where auditors performed the procedures mechanically or failed to respond appropriately to any identified fraud risk factors. Unfortunately, a change in form is unlikely to adequately address this concern from inspections and may, instead, have the opposite effect. A change in form will not cause any meaningful change in audit firm methodologies. If auditors currently view the consideration of fraud as an isolated, mechanical process rather than an integral part of the audit, they will likely continue to do so. It is the rarity of fraud that is the heart of the problem, not where the guidance is located in auditing standards.

Moreover, in a few instances, the proposed standards change the existing fraud guidance and, therefore, actually run the risk of undermining the very problem that the PAE sought (and the PCAOB seeks) to address. For example, the "brainstorming" requirement in AU Section 316 is specifically intended to highlight the need for auditors to recognize and address potential fraud risks on every engagement. The proposed standards revise this activity and turn it into "a discussion among engagement team members regarding risks of material misstatement" whether from error or fraud. While unintentional, by generalizing this discussion, the proposed standard will likely dilute the import of this discussion with respect to fraud.

In addition, the PCAOB has a number of other ways to address any concerns over mechanistic approaches to performing fraud-related audit requirements. For example, the Department of the Treasury Advisory Committee on the Auditing Profession (ACAP) urged the PCAOB to create "a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding fraud prevention and detection, and further the development of best practices regarding fraud prevention and detection." The CCMC strongly supports the ACAP's recommendation and encourages the PCAOB to begin the process of establishing the center.

One additional fraud-related concern the CCMC has is the proposed revisions dilute AU Section 316. Even though most existing requirements remain and are simply moved to other sections, given the importance that market participants place on auditors' responsibilities in the area of fraud, it is at least a tactical mistake to leave AU Section 316 so sparse. Investors, other financial statement users, and those less familiar with auditing standards would expect to locate auditors' responsibilities for fraud in the section devoted to that topic. Thus, the proposed standards may unnecessarily raise issues and create difficulties for the auditing profession and market participants alike.

3. Materiality

Section AU 312, *Audit Risk and Materiality in Conducting an Audit,* is also diluted through the deletion of guidance that is useful to auditors. The CCMC encourages the PCAOB to reconsider this decision and restore this guidance. In addition, the CCMC is disappointed that the PCAOB passed up the opportunity to improve guidance for auditors on materiality.

To illustrate our concerns, the CCMC encourages the PCAOB to restore the statement from AU Section 312.20: "The auditor plans the audit to obtain reasonable assurance of detecting misstatements that he or she believes could be large enough, individually or in the aggregate, to be *quantitatively* material to the financial statements." The CCMC believes the PCAOB should provide additional guidance on how auditors should map to quantitative materiality for the financial statements as a whole from statements in FASB Concept Statement No. 2 on the "total mix" of information. Furthermore, the first footnote in the proposed standard on *Consideration of Materiality in Planning and Performing an Audit* should caution that the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin (initially known as SAB No. 99, codified as Topic 5M) provides guidance on qualitative materiality for evaluation purposes, not planning. The PCAOB should also provide additional guidance to auditors on tolerable misstatement. Allocating materiality for the purposes of assessing risks of material misstatement and planning and performing audit procedures is a task that is unique to auditors. It is a difficult assignment that requires judgment and the exposure draft provides no guidance to help auditors make these judgments. (And, AU 350.18, referenced in footnote 4, does not fill the breach.)

4. Auditor Judgment

Finally, while the CCMC recognizes the importance of judgment and supports audit standards based on judgment, we also believe that audit effectiveness would benefit from additional PCAOB guidance on auditor judgment. This view was previously expressed in the CCMC's letter to Chairman Mark Olson dated October 9, 2008. Our review of these proposed standards related to risk only reinforces this belief. In this regard, the CCMC notes that the final report of the SEC's Advisory Committee on Improvements to Financial Reporting ("CIFiR") Report recommended that the PCAOB "develop and articulate guidance related to how the PCAOB, including its inspections and enforcement divisions, would evaluate the reasonableness of judgments made based on PCAOB auditing standards." Further, "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."[1]

The CCMC strongly supports the CIFiR recommendation. Moreover, given the over-arching nature of auditor judgments, the PCAOB should articulate and expose for public comment this policy statement before making substantial revisions in existing Interim Auditing Standards. Such a policy statement would provide a framework for the PCAOB to consider any necessary revisions to the Interim Standards and it would provide a context for others to consider and comment on any such proposed revisions.

5. Revision of Interim Standards

Finally, the CCMC notes that at the October 2008 PCAOB Standing Advisory Group meeting, the staff disclosed the PCAOB's intent 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 is to include a schedule and procedures for the review. The CCMC strongly recommends that this concept release be exposed for public comment and finalized before the PCAOB and the staff begins the process of revising the current Interim Standards.

Conclusion

The globalization of the economy, the ongoing financial crisis, as well as the Madoff and Satyam scandals all point to the need to strengthen the auditing process. Such a goal is important for the continued viability of the audit profession, as well as the reliability of information used by participants to allocate capital efficiently in the

[1] Page 93, *The Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission,* August 1, 2008

marketplace. While we acknowledge the sincerity and dedication of the PCAOB in proposing the standards discussed herein, the CCMC believes that these proposals are lacking in the current environment and wanting in the advancement of the audits that underpin sound financial reporting. Accordingly, the CCMC respectfully submits that these proposal be withdrawn and reevaluated in order for more suitable standards to be proposed at the appropriate time.

Sincerely,

Richard Murray
Chairman,
U.S. Chamber of Commerce
Center for Capital Markets Competitiveness