



May 28, 2010

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 030
Proposed Auditing Standard Related to Communications with Audit Committees, and Related Amendments to Certain PCAOB Auditing Standards

Dear Mr. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2010-001, "*Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*," that includes the proposed standard, "*Communications with Audit Committees*."

We support the Board's objectives reflected in the proposed standard to (1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee; and (2) emphasize the importance of effective, two-way communications between the auditor and the audit committee. A well-informed audit committee may be better able to carry out its role of overseeing the financial reporting process and the external auditor. We support the continued strengthening of existing requirements, as established by the Sarbanes-Oxley Act of 2002, for auditor communications with the audit committee. We offer the following comments for consideration by the Board in finalizing the provisions of the proposed standard.

This letter is organized by first providing general observations and comments on the proposed standard as a whole, followed by comments on specific issues in an Attachment. Our general observations discussed below are organized based on the following:

- Objectives of the Standard
- Interaction of Certain Proposed Requirements with Existing PCAOB Standards
- Management's Responsibility for Communications with the Audit Committee
- Accounting Policies, Practices and Estimates and the Evaluation of the Quality of a Company's Financial Reporting
- Communications Resulting From Interim Reviews
- Release Text



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Objectives of the Standard

The PCAOB has outlined the objectives of the proposed standard to focus the auditor on the following (paragraph 3 of the proposed standard):

- Communicating to the audit committee the responsibilities of the auditor in relation to the audit and establishing a mutual understanding of the terms of the audit engagement with the audit committee;
- Communicating to the audit committee an overview of the audit strategy and timing of the audit;
- Providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process; and
- Evaluating the adequacy of the two-way communications between the auditor and the audit committee to support the objectives of the audit

We generally believe that these objectives are appropriate for promoting effective two-way communications between the audit committee and the auditor.

We note that paragraph 8 of the proposed standard requires the auditor to inquire whether the audit committee is aware of matters that may be relevant to the audit; however, we do not believe that this requirement is adequately emphasized in the auditor objectives. Given the importance of such communications to the audit, we believe that this requirement should be included as part of the objectives of the auditor. Paragraph 9(b) of the International Auditing and Assurance Standards Board's (IAASB) International Standard on Auditing (ISA) No. 260, *Communication with Those Charged with Governance* (ISA 260) and paragraph 7(b) of the Auditing Standards Board's (ASB) Statement on Auditing Standards (SAS) No. 114, *The Auditor's Communication with Those Charged with Governance* (SAS 114) recognize this communication as an objective, and we recommend the Board consider incorporating this as part of the overall objectives to the proposed standard.



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The fourth objective included in the proposed standard is focused on the auditor's *evaluation* of the adequacy of the two-way communications between the auditor and the audit committee. Given that an overarching objective for the PCAOB's proposal is to facilitate more effective two-way communications between the auditor and the audit committee, we recommend the Board consider whether a more appropriate objective would be for the auditor to *promote* effective two-way communications with the audit committee. We believe that such an objective would help emphasize to auditors the important role communications with the audit committee has to the successful conduct of the audit committee's oversight responsibilities as well as to the successful planning and conduct of the audit. We also believe that this objective is consistent with the proposed requirement in the standard for the auditor to evaluate the effectiveness of the two-way communication.

Interaction of Certain Proposed Requirements with Existing PCAOB Standards

We support the Board's consideration of the work of other standard-setters in the standard-setting process and recognize that the requirement in paragraphs 26 through 28 of the proposed standard related to the auditor's evaluation of the adequacy of two-way communications with the audit committee is consistent with the requirements in analogous standards of ISA 260 and SAS 114. However, we note that other PCAOB standards and proposed standards include consideration of the audit committee as part of the auditor's process in identifying and assessing the risks of material misstatement and, for an integrated audit, the auditor's consideration of the effectiveness of a company's internal control over financial reporting. While it would appear that the evaluation required by the proposed standard would be an input into the auditor's procedures under other PCAOB standards and proposed standards, we believe that the Board should consider more clearly linking how the evaluation requirement relates to the consideration of the audit committee in accordance with the other PCAOB standards and proposed standards.



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For example, a few areas where we believe such clarification would be helpful are outlined as follows:

- Paragraphs 25 and 26 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5), contain explicit requirements for the auditor to evaluate the effectiveness of the audit committee as part of the consideration of entity-level controls, including the control environment and the period-end financial reporting process.
- Paragraph 34 of PCAOB Interim Auditing Standards AU Section 319, *Consideration of Internal Control in a Financial Statement Audit*, requires the auditor to consider the audit committee as part of obtaining an understanding of a company's control environment.
- Paragraphs 23 and 24 of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, require the auditor to consider whether the audit committee "understands and exercises oversight responsibility over financial reporting and internal control" as part of obtaining an understanding of the control environment and identifying and assessing risks of material misstatement.

We believe linking the requirements between the standards (e.g., through annotating the proposed standard to include cross references to existing and proposed standards) would provide the auditor with additional perspective regarding the impact its evaluation of the effectiveness of the audit committee has, including its communications with the auditor, on the planning and conduct of the audit.

Management's Responsibility for Communications with the Audit Committee

While the PCAOB permits the auditor to consider management's communications to the audit committee for certain communications related to accounting policies, practices and estimates, we do not believe that the PCAOB has adequately emphasized that the auditor's role, particularly in areas related to a company's financial reporting, should be focused on providing an objective perspective on management's judgments involved in the preparation of the company's financial statements. In this regard, we believe that the auditor's starting point in determining the nature and extent of its communications with the audit committee should be its consideration of management's communications.



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We are concerned that without such an emphasis throughout the standard, combined with the detailed communication requirements, the auditor may provide significant information that is duplicative to that provided by management or already existing in a company's financial statement disclosures or management's discussion and analysis. This may result in the unintended effect of diluting the information provided, which may reduce the usefulness of the information to the audit committee and potentially encourage more boiler plate communications. All of these possible outcomes would be contrary to the PCAOB's objective of facilitating more effective two-way communications between the auditor and audit committee. The following represent examples within the proposed standard that highlight this concern:

- While the Note at the end of paragraph 12 allows the auditor to consider management's communications to the audit committee when determining the nature and extent of its communications with the audit committee related to a company's accounting policies, practices and estimates, we believe that such a consideration may be appropriate for other matters included within the proposed standard. For example, management may communicate to the audit committee matters related to a company's ability to continue as a going concern (paragraph 16 of the proposed standard) as well as other matters arising from the audit that are significant to the oversight of financial reporting, such as complaints or concerns raised regarding accounting or auditing matters (paragraph 22).
- Paragraph 12(b)(iii) requires the auditor to communicate to the audit committee "a description of the reasons for the changes [to assumptions or processes made to critical accounting estimates]." As currently written, we do not believe that this requirement recognizes that this communication should be management's responsibility.
- Paragraph 12(b)(iv) requires the auditor to communicate to the audit committee "when critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various selections within the range would affect the company's financial statements." However, we are concerned that such a requirement of the auditor may result in a significant increase in information provided to the audit committee at a level of detail that may dilute the impact of such information, as well as may result in significant increases in auditor effort without a corresponding significant benefit to the audit committee. Critical accounting estimates typically involve judgments around a number of assumptions – all of which can affect the range of possible outcomes. We believe the requirement as drafted may also result in auditors



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and management expending significant amounts of time reconciling views around the ranges associated with the corresponding estimates – even after the auditor has already concluded that the recorded amount is reasonable– a process that may not be necessary in each circumstance in order to enhance the discussion of such matters with the audit committee. In addition, in some circumstances, such an exercise to reconcile ranges would be beyond what is required by the auditor in accordance with paragraph 40 of PCAOB Interim Auditing Standards AU Section 328, *Auditing Fair Value Measurements and Disclosures* and paragraph 10 of AU Section 342, *Auditing Accounting Estimates*, when evaluating management’s estimates.

Accordingly, we recommend that the Board revise the proposed standard to:

- recognize that the communication of accounting policies, practices and estimates is management’s responsibility, and that management would be in the best position to communicate such matters to the audit committee;
- require the auditor to discuss with the audit committee the adequacy of management’s communication or, to the extent that such information is included in annual report disclosures, then require the auditor to discuss with the audit committee the adequacy of such disclosures; and
- require the auditor to communicate to the audit committee those accounting policies, practices and estimates where management omitted or inadequately described those matters, or where the auditor is unable to ascertain whether management’s communications were adequate.

Accounting Policies, Practices and Estimates and the Evaluation of the Quality of a Company’s Financial Reporting

Paragraphs 12 and 13 of the proposed standard require the auditor to communicate information related to a company’s accounting policies, practices and estimates. We have provided comments related to paragraphs 12 and 13 in our general observations under “Management’s Responsibility for Communications with the Audit Committee,” and “Release Text,” and specific comments in our Attachment. Although we understand the Board’s intent in including the communication requirements of paragraphs 12 and 13, we believe the requirements, as currently written, are difficult to comprehend and apply and may lead to the unintended consequence of inconsistent application by different auditors. For example, the requirements in paragraph 12 focus on information related to a company’s accounting



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policies and practices, however, there are references to “significant accounting policies,” “accounting policies, practices, and estimates” and “critical accounting estimates.” Paragraph 13 focuses on the auditor’s evaluation of the quality of a company’s financial reporting, however, there are also references to both “significant accounting policies and practices” and “critical accounting policies and practices.” While the terms “critical accounting estimate” and “critical accounting policies and practices” are defined in the proposed standard, it is difficult to understand the intended differences in communication requirements between these items and “significant accounting policies and practices” and “accounting policies, practices and estimates.” We recommend the Board consider revising the organization of paragraphs 12 and 13 to improve the structure and increase the clarity of the Board’s communication requirements.

Communications Resulting From Interim Reviews

Item (e) in page 4 of Appendix 2 of the proposed standard details amendments to paragraph 34 of PCAOB Interim Auditing Standards AU Section 722, *Interim Financial Information* (AU 722) to conform this guidance to requirements in the proposed standard. The proposed amendment states the following:

“When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in Proposed Auditing Standard, *Communications with Audit Committees*, as they relate to interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee. For example, the accountant should communicate a description of the process used by management to develop the critical accounting estimates; a change in a significant accounting policy affecting the interim financial information; misstatements that, either individually or in the aggregate, could have a significant effect on the entity’s financial reporting process; and uncorrected misstatements aggregated by the accountant that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole. Management may communicate, as part of its communications to the audit committee, certain matters identified in paragraph 12 of Proposed Auditing Standard, *Communications with Audit Committees*, regarding accounting policies, practices and estimates, in which case the accountant should determine whether all the matters were adequately described and, if not, the accountant should communicate any omitted or inadequately described matters to the audit committee.”



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As currently written, we believe the amendments imply that *any* matters described in the proposed standard, as they relate to interim financial information, would be required to be communicated to the audit committee at each interim period. We believe this would result in the communication of matters that are duplicative to those made by the auditor through its annual communication requirements and could be repetitive from period to period. This may also result in the unintended effect of diluting the information provided, which may reduce the usefulness of the information to the audit committee and potentially encourage more boiler plate communications. The following represent examples within the proposed standard that highlight this concern:

- The proposed amendment above includes an example related to the auditor’s communication of a description of management’s process to develop critical accounting estimates. We believe that such communication, at each interim period, would result in redundant and/or unnecessary auditor communications to the audit committee.
- Paragraph 12(b)(iv) requires the auditor to communicate to the audit committee “when critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various selections within the range would affect the company’s financial statements.” In addition to our concerns noted above under “Management’s Responsibility for Communications with the Audit Committee,” given the limited scope of procedures performed as part of an interim review, we believe the auditor may be unable to provide the audit committee with observations at the same level of detail as compared to communications that are based on information obtained in conjunction with the annual audit. This would be especially true in the case of an initial interim review.

We recommend the Board reconsider the proposed amendments to paragraph 34 of AU 722 by narrowing the communication requirements to only those matters that are considered significant, and/or those matters that have significantly changed when compared to the communications made by the auditor as part of the annual audit. Additionally, because certain communication requirements in paragraphs 12 and 13 of the proposed standard require communications that require a significant level of detail, we recommend the Board allow the auditor to communicate matters at a level of detail commensurate with the scope of procedures performed by the auditor as part of its review of interim financial information.



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Release Text

As we have noted in our comment letter on the Board's Release No. 2009-007, "*Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk, and Related Amendments to PCAOB Standards*," we are supportive of the Board's efforts to increase the transparency of the standards-setting process, including efforts to provide its perspective on the differences between its proposed standards and those of the IAASB and ASB, as well as its consideration of comments received. However, we are concerned that in some situations, it appears that in addition to providing insight into the Board's decision-making process, the Board is also attempting to interpret aspects of the standard in the release text. Interpreting standards through release text can result in potential confusion over the requirements within the related standard and result in inconsistent application by the auditor. In addition, given that the release text is not ultimately part of the final standard, any interpretive guidance contained within it may not be given the same consideration by the auditor and other interested parties. As a result, we encourage the Board, to the extent it believes clarifications need to be made within the release text accompanying a standard, to provide such guidance within the final standard as opposed to the accompanying release text.

We have included the following examples where it appears the Board is interpreting aspects of the standard within the release text:

- *Overview of the Audit Strategy and Timing of the Audit* – Paragraph 10(d) of the proposed standard requires the auditor to communicate the "roles, responsibilities, and locations of firms participating in the audit." The corresponding section within the release text on page 9 makes clear that the Board believes this communication should include participation of *affiliated* or *network* firms. We note that since this expectation is not explicit in the proposed standard, it could be misunderstood such that only firms that are outside of a firm's network need to be disclosed pursuant to this requirement.
- *Establish a Mutual Understanding of the Terms of the Audit* – Page 6 of the release text indicates that the engagement letter is required to be "*provided annually*" yet in paragraph 6 of the proposed standard, there is no indication that the engagement letter is required to be provided annually. We acknowledge that paragraph 25 of the proposed standard requires that all communications pursuant to the standard should be made annually; however, the release text could be interpreted such that the use of "evergreen" letters is precluded. We suggest that the



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Board clarify its intent in order to minimize any potential misunderstanding. See an additional specific comment in our Attachment.

- *Issues Arising from the Audit* – Paragraph 12(a)(ii) of the proposed standard requires the auditor to communicate the “anticipated applications by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on a company’s financial reporting.” Page 8 of Appendix 3 notes that the auditor may include in this discussion any views it has developed related to the potential impact of the application of such pronouncements on a company’s financial reporting process, including changes to processes or systems, that would not otherwise be disclosed by the company in the financial statements. Page 10 of the release text clarifies that this communication requirement is intended to go beyond the requirements for management under SEC Staff Accounting Bulletin No. 74, *Disclosure Regarding Accounting Standards Issued but Not Yet Adopted* (SAB 74). However, the language within the proposed standard appears to be consistent with the requirements of SAB 74, which we believe is appropriate. We recommend that the proposed standard be consistent with, and not exceed, the requirements of SAB 74. This would allow the audit committee and the auditor to determine the appropriate depth of discussion of the potential impact accounting and regulatory pronouncements may have on a company’s financial reporting process.

We appreciate the Board’s careful consideration of our comments, and fully support the Board’s efforts with regards to the overall improvements to the audit committee communication requirements. If you have any questions regarding our comments or other information included in this letter, please do not hesitate to contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com or Glen L. Davison, (212) 909-5839, gdavison@kpmg.com.

Very truly yours,

KPMG LLP

cc: PCAOB Members and SEC Commissioners



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#	COMMENT
<i>Significant Issues Discussed with Management Prior to the Auditor’s Appointment or Retention</i>	
1	<p>Paragraph 4 of the proposed standard requires that the auditor discuss with the audit committee “any significant issues discussed with management in connection with the appointment or retention of the auditor, including discussions regarding the application of accounting principles and auditing standards.” We also note that page 18 of the release text provides that the communications pursuant to this requirement are not intended to include only discussions that occur around the time of the auditor’s reappointment, but could include discussions throughout the audit engagement period. An auditor typically has discussions with management throughout the engagement period related to the application of accounting principles and auditing standards. Given the communication requirements currently included in the proposed standard related to accounting policies, practice and estimates, it is unclear whether this requirement is intended to provide any incremental communications and if so, the nature of those communications. Without additional clarity, we are concerned that the auditor may be required to provide additional information regarding accounting or auditing matters that may not be meaningful to the audit committee’s oversight, potentially complicating communications and detracting from the effectiveness of the two-way communications. As such, we believe the Board should clarify the intent of this requirement and at a minimum, clarify that the auditor should communicate any discussions related to these matters that the auditor deems significant and that have occurred since the auditor’s last appointment.</p>
<i>Establish a Mutual Understanding of the Terms of the Audit</i>	
2	<p>Paragraph 5 of the proposed standard states that a mutual understanding of the terms of the audit should be established including communicating the objective of the audit, the responsibilities of the auditor and the responsibilities of management within the audit engagement letter. Given the important role that the audit committee plays in the oversight of a company’s financial reporting, we suggest that the Board also require that the responsibilities of the audit committee be documented within the audit engagement letter. Outlining the audit committee’s responsibility within the audit engagement letter, in addition to the responsibilities of the auditor and of management, would help establish a mutual understanding of all parties’ roles and how they relate to the audit of the company’s financial statements.</p>
<i>Overview of the Audit Strategy and Timing of the Audit</i>	
3	<p>Paragraph 8 of the proposed standard requires the auditor to “inquire of the audit committee whether it is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters.” Additionally, this paragraph references paragraph 53(b)(3) of the Proposed Auditing Standard, <i>Identifying and Assessing Risks of Material Misstatement</i>, which “requires the auditor to inquire of the audit committee, or its chair, whether the audit committee is aware of tips or complaints regarding</p>

	<p>the company’s financial reporting...”</p> <p>We believe the Board should emphasize that this requirement is not limited to matters that arise from complaints or concerns raised regarding accounting or auditing matters for which the audit committee is aware. We believe this could be accomplished by modifying the requirement as follows: “The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit including, <i>but not limited to, non-compliance of laws and regulations, knowledge of illegal acts or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters.</i>”</p>
4	<p>Paragraph 10(a) of the proposed standard requires the auditor to communicate “whether persons with specialized skill or knowledge are needed to apply the planned audit procedures or evaluate the audit results.” We note that audit teams routinely include internal tax and information technology specialists as part of the audit team. It is not clear whether these individuals were intended to be included in this communication. However, we do not believe that including these individuals would provide the audit committee with meaningful information given the prevalence of such individuals on the audit team and recommend the Board consider excluding them from the requirement.</p>
5	<p>Paragraph 10(d) of the proposed standard requires the auditor to communicate the roles, responsibilities, and locations of firms participating in the audit. As written, the requirement is unclear as to whether firms “participating in the audit” is intended to exclude insignificant locations that are not considered in the scoping of a group audit (e.g. locations that are insignificant to the audit but where the auditor conducts a statutory audit). We note that currently the audit committee is required to pre-approve the scope of services provided by the auditor and generally would be aware of such situations pursuant to its approval process. As such, providing all locations pursuant to this requirement could result in unnecessary duplication and could potentially be burdensome (especially for larger engagements with multiple locations). Therefore, we believe the Board should consider whether the proposed requirement should include only those locations that were included within scope for the audit.</p>
6	<p>Paragraph 10(e) of the proposed standard requires the auditor to communicate the basis for the auditor's determination that he or she can serve as principal auditor. For the majority of audits, this conclusion does not require significant judgment and as such, could encourage boiler plate communications to the audit committee that do not enhance its oversight responsibilities. We recommend the Board consider requiring such communications only in situations where more than insignificant portions of the audit are performed by other auditors. We note that paragraph 49 of ISA No. 600, <i>Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)</i> provides useful guidance for communicating the principal auditor’s involvement with other auditors that appear to be consistent with the objective of the proposed communication requirement.</p>

<i>Accounting Policies, Practices, and Estimates</i>	
7	<p>Paragraph 12(a)(ii) of the proposed standard requires auditor communication of “the anticipated application by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting.” We believe it is unclear what “regulatory pronouncements” is referring to. As stated previously in our general observations, we believe mirroring the auditor’s communication requirements with those provided in SAB 74 is appropriate.</p>
8	<p>Paragraph 12(a)(iii) of the proposed standard requires the auditor to communicate the methods used by management to account for significant and unusual transactions. Paragraph 7 of PCAOB Interim Auditing Standards AU Section 380, Communications with Audit Committees (AU 380) states, “the auditor should also determine that the audit committee is informed about the methods used to account for significant unusual transactions.” Additionally, recently issued PCAOB Staff Audit Practice Alert No. 5, Auditor Considerations Regarding Significant Unusual Transactions, uses the terminology “significant unusual transactions.” We believe the Board should use terminology within the proposed standard that is consistent with existing PCAOB standards and guidance.</p>
9	<p>Paragraphs 13(a) and 13(b) of the proposed standard propose communication requirements related to both a company’s significant accounting policies and practices and critical accounting policies and practices. Paragraph 7 of AU 380 requires the auditor to communicate certain information related to significant accounting policies. SEC Rule 2-07 of Regulation S-X (SX 2-07) requires the auditor to communicate all critical accounting policies and practices. We believe that the Board intended the communication requirements in paragraph 13(a) and 13(b) to be consistent with, and not exceed, the requirements of AU 380 and SX 2-07 based on the Board’s discussion on page 10 and 11 of the release text. Specifically, the Board stated on page 11 of the release text that the “proposed standard includes requirements that are consistent with those in SX 2-07.” However, the following is an example of a communication requirement that appears to be incremental to SX 2-07:</p> <ul style="list-style-type: none"> <p>• Paragraph 13(b)(iii) of the proposed standard requires the auditor to communicate “How current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical related to a company’s critical accounting policies and practices.” We believe that this proposed requirement is incremental to the requirements of SX 2-07 as it relates to the auditor’s consideration of “anticipated future events” that may affect the assessment of whether certain policies and practices are considered critical. Also, without additional guidance related to how an auditor should anticipate future events and determine whether they are relevant and / or likely to impact a company’s current policies or practices, we are concerned that the auditor, management and the audit committee may spend unnecessary time and effort discussing matters that may not be meaningful and / or relevant to the audit committee’s oversight responsibilities.</p>

	<p>We recommend that the Board clarify that paragraphs 13(a) and 13(b) are intended to be consistent with, and not exceed, the requirements of AU 380 and SX 2-07. However, if the Board intends to prescribe communication requirements that exceed the existing requirements of AU 380 and SX 2-07, the Board should provide further clarification regarding any communications that are incremental to existing requirements.</p>
<p><i>Management Consultations</i></p>	
<p>10</p>	<p>Question #12 in the release text regarding paragraph 15 of the proposed standard asks whether this requirement should be expanded to require the auditor to communicate his or her views on management’s consultations with non-accountants such as consultants or law firms on accounting or auditing matters. We do not believe the proposed standard should be expanded to include management consultations with non-accountants. Such a requirement may imply that the auditor has more knowledge about consultations management undertakes than is the case. This could result in the unintended consequence of auditor’s performing procedures to determine whether such consultations have occurred in order to communicate them to the audit committee. We do not believe that such an effort, combined with the fact that such communications may not be relevant to the audit, will provide a commensurate benefit to the audit committee’s oversight.</p>
<p><i>Going Concern</i></p>	
<p>11</p>	<p>Paragraph 16 of the proposed standard requires the auditor to communicate certain matters related to the consideration of a company’s ability to continue as a going concern. We support the intended objectives of this requirement. As written, however, we believe there are some inconsistencies in the proposed construction of the paragraph that may lead to confusion in complying with the requirement. As such, we propose the following alternative construction for your consideration:</p> <p>“If the auditor believed, prior to considering management’s plans intended to mitigate conditions and events that indicate there could be substantial doubt about a company’s ability to continue as a going concern, there was substantial doubt about a company’s ability to continue as a going concern for a reasonable period of time, the auditor should communicate the following:</p> <ul style="list-style-type: none"> • The conditions and events that caused the auditor to believe that there was substantial doubt about the entity’s ability to continue as a going concern; • The auditor’s consideration of management’s plans to overcome the conditions and events, management’s ability to implement the plans, and whether such plans mitigated the auditor’s doubt;

- The effects, if any, on the financial statements, and on the adequacy of the related disclosure; and
- The effects, if any, on the auditor’s report.”

We believe that this alternative construction reflects the auditor’s performance requirements pursuant to PCAOB Interim Auditing Standards AU Section 341, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (AU 341), and will lead to more consistent application of this communication requirement. If the Board determines not to revise paragraph 16 as we propose, we recommend that the Board address, at a minimum, the following specific concerns related to the requirements in paragraph 16:

1. Paragraph 16(a) requires the auditor to communicate to the audit committee conditions or events that indicate there could be substantial doubt about the company’s ability to continue as a going concern and the conditions and events that mitigated the auditor’s doubt (to the extent that those concerns were mitigated). We are concerned that the threshold “could” may result in an unintentional change from the current requirement in AU 341 for the auditor to obtain information if the auditor believes that there is substantial doubt about the entity’s ability to continue as a going concern.
2. Paragraph 16(b)(i) requires the auditor to communicate the “auditor’s assessment of management’s plans to overcome the conditions and events and management’s ability to implement the plans.” We recommend that the word assessment be changed to consideration to be consistent with AU 341.
3. Remove “if any” in paragraph 16(b)(iii). If the auditor has concluded there is substantial doubt about the company’s ability to continue as a going concern for a reasonable period of time, we believe that there would be an effect on the auditor’s report.

Corrected and Uncorrected Misstatements

12

Question #15 in the release text asks whether the proposed standard should require all corrected misstatements, including those detected by management, be communicated to the audit committee. Management may identify a number of adjustments to its financial statements as part of the financial statement close process and correct the financial statements accordingly. We are concerned that an auditor may not have knowledge of all of such “misstatements” due to the nature of a company’s financial statement close process and the timing of the auditor’s procedures. Establishing such a requirement would likely result in auditors expending significant efforts to identify misstatements that were previously captured by the company’s internal controls, and do not believe that the knowledge of such misstatements would significantly enhance the audit committee’s oversight.

<p>13</p>	<p>Paragraph 18 of the proposed standard requires the auditor to communicate the implications that corrected misstatements might have on the financial reporting process. It appears that this requirement relates to the auditor’s consideration of the impact a misstatement may have on an auditor’s consideration of a company’s internal control over financial reporting. Given the communication requirements related to significant deficiencies and material weaknesses for integrated audits in AS 5, and PCAOB Interim Auditing Standards AU Section 325, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AU 325) for non-integrated audits, we recommend the Board clarify how the proposed requirement relates to those included in AS 5 and AU 325.</p> <p>Additionally, we believe the Board should restrict this requirement to those corrected misstatements that are considered significant. Otherwise, the auditor might be required to communicate numerous insignificant misstatements simply because management chose to record them in the current period. We believe this could be accomplished by modifying the requirement as follows: “The auditor also should communicate those <i>significant</i> corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications such <i>significant</i> corrected misstatements might have on the financial reporting process.”</p>
<p>14</p>	<p>The Note accompanying paragraph 18 states, “The auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.” We recommend the Board include references to Staff Accounting Bulletin No. 99, <i>Materiality</i> and Staff Accounting Bulletin No. 108, <i>Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements</i> as part of this communication requirement.</p>
<p><i>Departure from the Standard Auditor’s Report</i></p>	
<p>15</p>	<p>Paragraph 19 of the proposed standard states, “When the auditor expects to modify the opinion in the auditor’s report or to include an explanatory paragraph in the report, the auditor should communicate with the audit committee the reasons for the modification or explanatory paragraph and the proposed wording of the report.” We believe the Board should consider excluding from the communication requirements those standard report modifications related to consistency explanatory paragraphs (e.g. situations where the auditor’s report discloses the adoption of a new accounting principle). We do not believe such matters should be subject to specific communication requirements given that such matters are subject to other communication requirements contained within the proposed standard and will be clearly disclosed in the financial statements (which are subject to audit committee review).</p>
<p><i>Difficulties Encountered in Performing the Audit</i></p>	
<p>16</p>	<p>Paragraph 21(b) of the proposed standard states the auditor should communicate significant difficulties encountered during the audit including an unnecessarily brief time within which</p>

	to complete the audit. We suggest the Board consider using “inappropriately” rather than “unnecessarily” in the above requirement. We believe such a change would more clearly articulate the situations in which an auditor should provide such a communication to the audit committee.
<i>Form and Content of Communications</i>	
17	Question #16 in the release text regarding paragraph 23 of the proposed standard asks whether the proposed standard should require that all or just certain matters be communicated to the audit committee in writing. We believe the current requirement strikes the appropriate balance by allowing the auditor to tailor his or her communications with the audit committee to the particular facts and circumstances and therefore, do not believe that a requirement for all communications to be in writing is appropriate.
<i>Adequacy of the Two-Way Communications</i>	
18	Paragraph 27 of the proposed standard requires that “If the auditor determines that the two-way communications have not been adequate, the auditor should evaluate the effects, if any, on his or her assessment of the risks of material misstatement and on his or her ability to obtain sufficient appropriate audit evidence, and should take appropriate action.” This requirement relates to an auditor’s action as a result of his/her interactions with the audit committee as opposed to a communication requirement. As such, we recommend the Board consider whether it would be more appropriate to incorporate any such additional guidance within other PCAOB standards that focus on the auditor’s assessment of and response to risk.
19	<p>Paragraph 28 of the proposed standard states that the auditor should consider taking the following actions if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved:</p> <ul style="list-style-type: none"> a. Communicating with the full board of directors; b. Modifying the auditor’s opinion on the basis of a scope limitation; or c. Withdrawing from the engagement. <p>In situations in which the auditor determines that the two-way communications are not effective, we believe it would be rare that the auditor would not inform the company’s full board of directors. Therefore, we recommend the Board elevate the requirement to communicate with the full board of directors to “should” as opposed to “should consider” to more appropriately describe the auditor’s requirement, while retaining the requirement for the auditor to consider modifying its auditor’s opinion and withdrawing from the engagement if it is not satisfied with the response from a board of directors.</p>