PCAOB
Public Company Accounting Oversight Board

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November 9, 2012

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-67807; PCAOB-2012-01

Dear Ms. Murphy:

On August 28, 2012, the Public Company Accounting Oversight Board (the "Board") filed with the Commission Auditing Standard No. 16, *Communications with Audit Committees,* related amendments to its interim auditing standards, and transitional amendments to AU sec. 380, *Communication With Audit Committees* (the "proposed rules"). The Commission published the proposed rules for comment in the Federal Register on September 17, 2012[1] and has received five comment letters in response. The Board is filing this letter for the limited purpose of responding to certain comments in one of those letters.

In its letter, the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("CCMC") states:

> Given that the proposal contains highly prescriptive mandatory communications requirements between an auditor and an audit committee, it is unclear why the PCAOB believes that it will be less costly for [emerging growth companies]. The assumption that smaller companies, typically with shorter operating histories, will have less to talk about with their auditors in complying with the standard simply because they are smaller is unsupported, and in our view not necessarily accurate.[2]

The proposed rules would require the auditor to communicate certain information about the audit to the audit committee of the company under audit.

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1 77 Fed. Reg. 57408 (Sept. 17, 2012).

2 Letter from Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Oct. 5, 2012) ("CCMC letter").

As the Board noted in its filing with the Commission, the Board sought "to develop a standard that is scalable based on a company's size and complexity, thereby avoiding unnecessary costs for audits of small or less complex companies, including smaller or less complex companies that are [emerging growth companies]."[3] The proposed rules are accordingly designed to allow auditors to tailor the required communications to the size and level of complexity of the company's operations, accounting practices, and audit issues.

PCAOB standards reflect the fact that a company's size and complexity can affect the risks of material misstatement and, therefore, auditing challenges and audit strategies.[4] The Board has noted in its standards that many smaller companies are less complex and that less complex companies often have the following attributes –

- Few business lines,
- Less complex business processes and financial reporting systems,
- Centralized accounting functions,
- Extensive involvement by senior management in the day-to-day activities of the business, and
- Few levels of management, each with a wide span of control.[5]

The proposed rules recognize that the number and nature of matters communicated by the auditor to the audit committee may be different in audits of smaller or less complex companies than in larger or more complex ones. As one example, a smaller or less complex company may not have operations or offices located in multiple locations. In those circumstances, an auditor may not need to use the work of other independent public accounting firms and would not need to communicate to the audit committee information concerning other independent public accounting firms and the basis for the auditor's determination that it can serve as principal auditor. Similarly, the auditor's communication to the audit

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3 77 Fed. Reg. at 57447.

4 See, e.g., Auditing Standard No. ("AS") 9, *Audit Planning*, at 9.7 Note; AS 12, *Identifying and Assessing Risks of Material Misstatement*, at 12.10; AS 13, *The Auditor's Responses to the Risks of Material Misstatement*, at 13.19 and 13.25 Note. See also, AS 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit of Financial Statements*, at 13.

5 See, e.g., AS 9, at 9.7 Note.

committee of its audit strategy for a smaller or less complex company may require less time and effort than for a large or complex company. As described in the Board's filing, in the aggregate there should be fewer matters to communicate in audits of smaller or less complex companies – including those that are emerging growth companies - than in audits of larger or more complex companies.[6]

The CCMC letter also questioned the substance of the statement in the Board's filing that "some inspection observations indicate that auditors have not made all required audit committee communications, possibly because they are not aware of the varying sources of communication requirements contained throughout the Board's standards and rules."[7] In that regard, the CCMC letter states:

> there is no quantification of the number of inspections in which this finding was made, no indication of whether the communication failures were material or inconsequential, and no indication whether the oversight was isolated or systemic. Most importantly for the JOBS Act finding, there was no indication whether any of these communication failures involved the audit of an EGC.[8]

As described in the Board's filing with the Commission, the Board adopted the proposed rules because the current auditing standards do not reflect changes to the federal securities laws and related SEC rules and are not aligned with more recent PCAOB auditing standards, including standards governing the auditor's risk-based approach to the audit. In addition to the proposed rule's requirements, based on observations from its inspections, the Board also provided in an appendix to the standard a listing of other PCAOB rules and

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6 When describing the characteristics of entities that identified themselves as emerging growth companies, the Board noted in its filing with the Commission that such entities appear to represent diverse industries and range in size and complexity. The Board further noted that 78 of 196 emerging growth companies identified themselves as "development stage entities" and that 119 of the emerging growth companies reported revenue less than $50 million. 77 Fed. Reg. at 57446.

7 77 Fed. Reg. at 57441.

8 CCMC letter, at 6.

standards related to the audit that require communication of specific matters between the auditor and the audit committee.

Observations from Board inspections have shown that firms of varying sizes[9] have not made all required communications to the audit committees of companies under audit, including companies that would be considered emerging growth companies were they to conduct initial public offerings today. The listing in the proposed rules, however, imposes no new obligations and merely provides a convenient reference to other, existing communication requirements.

We hope that the Commission finds this letter useful as it considers the Board's proposed rule filing. Please contact the undersigned at (202) 207-9192 if there is any additional information that the Board can provide.

Sincerely,

Martin F. Baumann

Martin F. Baumann
Chief Auditor and Director of
Professional Standards

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9 As described in the Board's filing with the Commission, large and small accounting firms audit emerging growth companies. Of the 196 entities that had identified themselves as emerging growth companies, 103 were audited by larger, annually inspected firms and 93 were audited by smaller, triennially inspected firms. 77 Fed. Reg. at 57446.