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By email: comments@pcaobus.org

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

RE: PCAOB Rulemaking Docket No. 049: PCAOB Release 2023-001: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2023-001, *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (the Release). We believe that the proposed standard, *General Responsibilities of the Auditor in Conducting an Audit* (AS 1000), would provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand and apply. We recognize and agree that this is an important standard for audit quality and investor protection as reasonable assurance, due professional care, professional skepticism, independence, competence and professional judgment are foundational to the execution of high quality audits; however, we are concerned that some of the language in the proposed standard and related release may need further clarification to enable auditors to consistently apply the standard and to avoid exacerbating the expectation gap between investors and the auditing standards.

The remainder of this letter provides our specific comments on the proposed standard.

Question 1: Are the general principles and responsibilities described in the proposal appropriate for audits performed under PCAOB standards? Are there additional principles or responsibilities that are fundamental to the conduct of an audit under PCAOB standards that merit inclusion in the proposed standard and amendments? If so, what are they and how should they be addressed?

We agree that reasonable assurance, due professional care, professional skepticism, independence, competence and professional judgment are appropriate general principles and responsibilities for audits performed in accordance with PCAOB standards. However, some of the language of the extant standards not retained in AS 1000 provide important clarity and transparency to the meaning of those principles, without which, users may not sufficiently understand the limitations of an audit. (See responses to questions 6 and 7 below.)

Furthermore, the reference in proposed AS 1000.01 to auditors having a 'fundamental obligation to protect investors' may be interpreted to mean that the Board has a view on the legal liability of auditors to third parties that goes beyond that already clearly established by years of jurisprudence. We recommend either removal of the word 'obligation' from the proposed standard or a clear statement from the Board in the release that its language is not intended to express a view or otherwise advocate regarding the scope of legal duty owed by auditors.

The gatekeepers in the financial reporting ecosystem (auditors, attorneys, management and their audit committees) have shared responsibilities in producing high quality financial disclosures that are materially

accurate and decision-useful to investors and maintain the public trust in our capital markets,¹ which in turn, supports investor protection. We believe in addition to clearly articulating the auditor's obligations, having clarity about the shared responsibilities of other key stakeholders in financial statement and disclosure preparation and investor protection is equally important, such that the investors do not place sole reliance on an independent auditors' report for protection. Additionally, there is a common misconception, even among some investors, that auditors prepare the financial statements. The simple statement in the Note to paragraph .13b in AS 1000 that management is 'responsible' for the financial statements without elaboration could be misinterpreted as meaning management is simply 'legally' responsible for the financial statements that are prepared by the company's auditors. The language of the existing standard makes clear that management prepares the financial statements in the first instance. We believe that explicit concept should be retained in the updated standards.

Accordingly, consistent with the release text indicating that the intention of the Board was to retain the distinction between the responsibilities of the auditor and management, we recommend that the Board retains paragraphs .02 and .03 of extant AS 1001, *Responsibilities and Functions of the Independent Auditor*, in the final standard to emphasize the distinction and importance of management's responsibility for preparation of the financial statements. Further, paragraph 5 of AS 1301, *Communications with Audit Committees*, requires auditors to communicate the responsibilities of the auditor and management to the audit committee. While Appendix C of AS 1301 includes elements of the auditor's responsibilities that are to be included in the engagement letter, excluding clearly defined responsibilities of the auditor and management from a final standard will likely result in inconsistent communications with audit committees about those responsibilities. We are concerned such inconsistency will widen the expectation gap between investors' understanding of an audit and the requirements of the standards.

Question 6: Are the proposed requirements related to the auditor's competence clear and comprehensive? If not, why not?

We believe the proposed requirements related to the auditor's competence need further clarification. While the concepts in paragraph .07 of AS 1000, which refer to 'knowledge, skill, and ability,' align with the Board's proposed QC 1000, *A Firm's System of Quality Control*, the Note to paragraph .07 of AS 1000 includes incremental language beyond the definition of competence within proposed QC 1000. While we agree with the Board's intention to align AS 1000 with the terminology used in proposed QC 1000², we are concerned that such incremental language, particularly the reference to 'expertise,' may create confusion because it goes beyond the proposed requirements in QC 1000. Such divergence could lead to a potential disconnect between what is required of a firm's system of quality control to address quality objectives related to competence, which is defined with reference to 'knowledge, skill, and ability' but not 'expertise,' and the requirements of proposed AS 1000. As further explained below, we believe the alignment to proposed QC 1000 is sufficient and do not believe the additional reference to 'expertise' proposed in AS 1000 is necessary.

For example, the Note to paragraph .07 of proposed AS 1000 indicates that the auditor must have expertise in SEC rules and regulations relevant to the company being audited. Paragraph .04 of extant standard AS 1001 clarifies the professional qualifications required of an independent auditor do not include those of a person trained for or qualified to engage in another profession or occupation, such as a lawyer. If the Board's intention³ is not to change or expand the expectations of 'competence' of an

¹ Paul Munter, *The Importance of High Quality Independent Audits and Effective Audit Committee Oversight to High Quality Financial Reporting to Investors* (October 26, 2021)

² "This approach would align the proposed standard with the terminology of proposed QC 1000" on page 20 of PCAOB Release No. 2023-001 (March, 28, 2023).

³ See e.g. "the auditor's responsibilities under the proposal are consistent with the provisions of AS 1010" on page 20 of PCAOB Release No. 2023-001 (March, 28, 2023).

auditor, then we believe the reference to 'knowledge, skills, and abilities' in paragraph .07 of the proposed standard alone is sufficiently clear and, therefore, recommend that the Board remove the proposed Note.

If the Board decides to retain the language of the Note to paragraph .07 in the final standard, we believe additional clarity is needed to understand who the Board expects to have expertise, as auditors most often involve specialists in areas where they do not individually possess the level of expertise. Consider a situation in which a company enters into a new type of transaction or a new industry that may also be new to the existing engagement team. In this instance, a firm's system of quality control could provide an avenue that allows for the engagement partner to request appropriate support, and the engagement team's experience could be supplemented with a central service team, a specialist or another team member with experience in that type of transaction or industry. This would result in the collective engagement team having sufficient competency to fulfill the requirements of the proposed standard even though some of the individual engagement team members do not. Inclusion of this note introduces confusion about whether compliance with the standard requires the engagement partner or individuals on the engagement team to be experts themselves or if the concept of competence can be achieved by the engagement team or firm as 'an auditor' collectively.

We also believe it would be most appropriate to remove the Note to paragraph .07 in the final AS 1000 standard because AS 1201, *Supervision of the Audit Engagement*, and AS 1210, *Using the Work of a Specialist*, already establishes the supervisory responsibilities of an auditor when an employed or engaged specialist is used in an audit. These standards require the auditor to be able to direct and supervise the work of the specialist and to evaluate whether the work of the specialist provides sufficient appropriate evidence. Accordingly, an auditor would need to possess competencies necessary to fulfill these requirements, but such competencies fall short of being an 'expert' in the underlying subject matter.

Question 7: Are the proposed requirements and related descriptions of the general principles (i.e., reasonable assurance, due professional care, professional skepticism, and professional judgment), clear and comprehensive? If not, why not?

"The audit expectation gap is a phenomenon that has existed for many years. In particular, the audited financial statements beneficiaries' expectations exceed what auditors can reasonably be expected to accomplish..."⁴ The audit expectation gap is also discussed in the Release⁵ and given its prevalence, we strongly support the Board's retention of the concept of reasonable assurance based on the benefits and costs of an audit engagement; however, we are concerned that the removal of certain text from the extant standards may exacerbate this expectation gap.

The extant standards include clarifying language that provides additional context to the meaning of due professional care and reasonable assurance. Paragraph .03 of AS 1015, *Due Professional Care in the Performance of Work*, provides clarifying language around the concept of due professional care. We believe this language clarifies for users of the financial statements the role that an audit plays in investor protection but reminds stakeholders that assurance is not absolute and that while the audit contributes to investor protection, the auditor is not an insurer, nor does the audit report constitute a guarantee.

While we recognize that the reference in paragraph .03 to *Cooley on Torts*, a legal treatise, is outdated, we believe its concepts are relevant in providing clarity to investors. Specifically, we request that the Board retain in the final AS 1000 standard the concept that an auditor may undertake an audit in good

⁴ Quick, Reiner, 2020/03/09, *The audit expectation gap: A review of the academic literature*, Maandblad Voor Accountancy en Bedrijfseconomie 94, available at https://www.researchgate.net/publication/339797224_The_audit_expectation_gap_A_review_of_the_academic_literature

⁵ See e.g. "Early research on the audit expectation gap concludes the majority of investors prefer absolute assurance that financial statements are free of material misstatement, in contrast to the profession's standard that an audit should provide reasonable assurance" on page 39-40 of PCAOB Release No. 2023-001 (March, 28, 2023).

faith and with integrity, but is not infallible, in which case the auditor may be liable for negligence, bad faith or dishonesty, but not for pure errors in judgment.

Additionally, paragraphs .10 through .13 of AS 1015 provide clarification on the limitations of an audit (which is designed to provide reasonable assurance) that we believe is important to providing investors with an understanding of the concept of reasonable assurance. We find paragraph .13 of AS 1015 to be the most pertinent in providing such clarity and therefore request that the Board retain those concepts in the final standard to avoid widening the expectation gap. We suggest the Board include the wording in paragraph .13 or similar wording in the final standard.

With respect to the proposed definition of 'professional judgment,' the wording of paragraph .12 suggesting that the proper exercise of professional judgment necessarily leads to an auditor's report being issued 'in accordance with applicable professional and legal requirements' fails to consider the possibility that two auditors exercising professional judgment could reach different conclusions while both are acting reasonably. This could lead to determinations made in hindsight that professional standards were not followed when it is later determined that a professional or legal requirement was not complied with, irrespective of how minor or technical that noncompliance is and without regard to the reasonableness of the auditor's efforts to avoid the noncompliance. We request the Board make clear that the proper standard to evaluate an auditor's exercise of professional judgment remains reasonableness.

Question 9: Is the proposed requirement for the auditor to take into account relevant guidance such as PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB appropriate? If not, why not?

PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards ('relevant guidance') are useful resources for auditors in understanding the context and intent behind the standards. However, we are concerned with the proposed requirement to elevate such 'relevant guidance' to become authoritative. In particular, the scope of such 'relevant guidance' is unclear.

To illustrate, 'Board-issued guidance' is not clearly defined such that firms would be able to understand its scope and apply it consistently. For example, it is unclear whether Board-issued guidance refers solely to the materials within the 'Rules of the Board' section on the PCAOB website or if other information also needs to be captured. If the Board chooses to proceed with elevating the releases accompanying the standards as relevant guidance, we request that the Board clarify in paragraph .15 of the final standard which aspects of release text would be considered as authoritative. This includes clarifying whether this is intended to include the Board's responses to comments, the economic analysis included in release texts, or even documents referenced within footnotes. Based on the current process, the Board's releases do not specify which aspects of the release texts are intended to be 'relevant guidance' under proposed AS 1000 and the final release text does not represent a cumulative view of all previous releases (e.g. rationales included in a concept release are not necessarily carried forward to the final release if the rationale has not changed). For instance, before the final amendments relating to the supervision of audits involving other auditors and dividing responsibility for the audit with another accounting firm was approved, that proposal (Docket 042) went through multiple amendments and supplemental requests for comment. In each release, the text of the release focused on the comments received and changes from the previous version rather than cumulative changes from the original, leading to over 600 pages of release text by the time the final standard was approved. The elements of the cumulative release text related to such standard that the Board considers 'relevant guidance' under the proposed AS 1000 is not clear, and this lack of clarity likely will result in inconsistent application by auditors in practice.

As described in the PCAOB's Standard-Setting Process⁶, due process, including but not limited to public notice and comment as well as subjecting the proposed changes to an economic analysis, is essential for developing high quality auditing standards. Accordingly, if the intention of paragraph .15 of AS 1000 is to make such 'relevant guidance' authoritative, that 'relevant guidance' may not have been through the same level of due process with public notice and comment and economic analysis, as the current auditing standards.

Lastly, if the proposed requirement is retained in the final AS 1000 standard, we encourage the Board to provide additional implementation guidance to enable consistent application of the guidance by auditors. For instance, it is important to clarify the Board's expectations about which elements of Board-issued guidance, including release text accompanying proposed and final standards, an auditor is to document how they 'took into account' that guidance. In addition, we believe the Board should clarify whether its intention was to indicate that on a prospective basis such relevant guidance including interpretations, Board-issued guidance, and releases would be considered authoritative guidance or whether the body of existing Board-issued guidance emanating since the Board's inception would be considered authoritative.

Question 10: Are the proposed amendments to clarify the meaning of "present fairly" appropriate? If not, why not?

The proposed amendments in footnote 17A to paragraph .30 and .30A in AS 2810, *Evaluating Audit Results*, which require the auditor to consider whether the financial statements are 'misleading,' may lead to inconsistency in audit execution as the current proposal does not include an objective framework against which the auditor should evaluate those financial statements. Currently, the auditors' report expresses an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. If, as stated in the Release, the "auditor's evaluation of fairness goes beyond an evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework," there is no longer an objective or consistent benchmark to be applied. Paragraph .03 of AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles,"* recognized this point in the text, stating "without that framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements." Removing this objective benchmark may result in inconsistencies in practice between engagements and firms, which would be detrimental to investor protection.

Additionally, such expansion in auditor responsibility may create a conflict between auditor judgment, management judgment and the requirements of authoritative accounting standards (e.g. standards issued by Financial Accounting Standards Board). There could be situations where the existing authoritative accounting guidance is considered misleading by the reporting entity and the individual auditor, notwithstanding the extensive due process surrounding the establishment of the standards. As an example, a reporting entity may decide that its financial statements would be misleading unless it measures its crypto assets at fair value with changes in fair value recognized in earnings each reporting period even though the crypto assets are considered intangible assets under GAAP, thereby precluding such measurement. The reporting entity may then place its auditor in the position of either qualifying its opinion for a departure from GAAP or accepting the departure from GAAP and issuing an unqualified opinion under the premise that without the departure the financial statements would otherwise be misleading. Individual auditors are likely to hold divergent views about such situations. We acknowledge that not all situations are addressed explicitly in relevant financial reporting frameworks and require judgment by financial statement preparers and auditors. However, in circumstances where a lack of guidance or unclear guidance resulted in misleading financial reporting even while complying with the

⁶ See e.g. "For each standard-setting project, the PCAOB solicits public comment on potential changes to standards before adopting changes...", the PCAOB's website, at [The Standard-Setting Process | PCAOB \(pcaobus.org\)](https://www.pcaobus.org/standard-setting-process).

relevant authoritative financial reporting standards, we believe the capital markets have been best served through an orderly process of involving the relevant authoritative standard-setter to effectuate changes to the existing standards with sufficient and appropriate due process to ensure consistency and comparability in financial reporting.

As currently proposed, the Board did not remove the reference to the applicable financial reporting framework within the auditors' report as required by AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. This leads to a disconnect where the reference to an undefined concept of 'fairness' in the proposed standard, goes beyond compliance with the known financial reporting framework, and creates a risk that investors and other financial statements users will place overreliance on the auditors' report. Accordingly, we request that the Board retain in the final AS 1000 standard language similar to paragraph .03 of extant AS 2815 to state that the independent auditor's judgment concerning fairness of the overall presentation of financial statements should be applied within the framework of the applicable financial reporting framework.

Question 11: Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?

The proposed amendments related to engagement partner responsibilities are generally clear and appropriate. However, we recommend that the Board reconsider the requirement specific to the proposed amendment to paragraph .05, Note 2, of AS 1201, *Supervision of the Audit Engagement*. It states, "the engagement partner's review should include review of documentation of significant findings or issues (see AS 1215.12) and review of documentation subject to review by the engagement quality reviewer (see paragraphs .09-.10 and .14-.15 of AS 1220, *Engagement Quality Review*)."

In practice, information required to be reviewed by an engagement quality control reviewer under AS 1220, *Engagement Quality Review*, will often be information previously reviewed by an engagement partner. However, we recommend that the Board not link engagement partner review requirements to documentation subject to review by the engagement quality reviewer because the entire audit file is 'subject' to the engagement quality reviewer's review, as the engagement quality reviewer applies independent judgment about the nature and extent of documentation to review to fulfill their responsibilities under AS 1220. Further, engagement quality reviewers may judgmentally decide to review documentation beyond that required by AS 1220, which may not be documentation an engagement partner believes is necessary to fulfill their responsibilities under AS 1201. If the Board believes engagement partner review of the information specified in paragraphs .09-.10 and .14-.15 of AS 1220 is required, we recommend that the Board make that more explicit in the final standard. This will result in both the engagement partner and engagement quality reviewer applying judgment against a consistent performance standard while allowing for differences in judgment about the specific elements of documentation that are necessary to review.

In addition, the proposed note to paragraph .05, together with the language in the release text, suggests it should be the lead engagement partner that completes the review of the documentation "subject to the engagement quality reviewer's review." While we agree the lead engagement partner retains ultimate responsibility for the audit, they may delegate the review of certain elements of documentation to other engagement partners from a practicality standpoint. Consider an example of a multi-tiered audit as presented in AS 1201 *Supervision of the Audit Engagement* (amended for FYE on or after December 15, 2024), where the lead auditor seeks assistance from one or more other auditors. If the engagement quality reviewer determines the need to review documentation in an other auditor's file that was reviewed by a second other auditor, we believe the lead auditor should retain the ability to rely on the review conducted by the second other auditor (with appropriate supervision) without having to directly review the other auditor's documentation "subject to the engagement quality reviewer's review." Similarly, if a lead audit engagement partner seeks assistance from an other engagement partner, the lead engagement

partner (while retaining ultimate responsibility) should be able to rely on the other partner's review of documentation that may be selected by the engagement quality reviewer for review to comply with AS 1220, assuming appropriate supervision is provided. We believe the potential practical application challenges illustrated in the scenarios above could be addressed by not linking engagement partner review requirements to documentation subject to review by the engagement quality reviewer.

Question 13: Is the proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention from 45 days to 14 days from the report release date appropriate? If not, why not?

We support the acceleration of the documentation completion date and agree with the Board's rationale related to this proposed change as discussed in the Release.

Question 25: Would requiring compliance on June 30 the year after approval by the SEC present challenges for auditors? If so, what are those challenges, and how should they be addressed?

We request that the Board provide clarification as to whether AS 1000 and the related proposed amendments would be effective for audits of companies with a year-end beginning on or after June 30 of the year after approval by the SEC or periods ending on or after June 30 of the year after approval by the SEC. We believe if it were to apply to periods ending on or after June 30 the year after approval, certain audits may need to comply with both the extant standards for a portion of the audit and AS 1000. Therefore, we suggest that the Board align the compliance requirement to a fiscal period based on the beginning date of a fiscal year.

Additionally, if the Board's intention is to elevate the relevant guidance discussed in question 9 above, this will require significant time and resources to implement effectively, as referenced in the release text⁷. Firms will need to thoroughly analyze existing relevant guidance, make any necessary updates to methodology, and develop and deploy training in a timely manner to positively impact audit quality. As a global network firm, this will also need to be implemented and deployed consistently across the network. For these reasons, we believe the effective date should be at least 12 months after approval by the SEC.

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We appreciate the Board's consideration of our comments and observations and would be pleased to discuss our comments with the Board and its staff at your convenience. We look forward to continuing our engagement with the Board and its staff in support of our shared commitment to investor protection and audit quality.

Sincerely,

KPMG LLP

KPMG LLP

⁷ See e.g. "To the extent that auditors are not taking into account relevant guidance applicable to the audit, as proposed in paragraph .15 of the proposed standard, those firms would also incur one-time and ongoing costs related to methodology and periodic training for relevant guidance" on page 40 of PCAOB Release No. 2023-001 (March, 28, 2023).