

File No. PCAOB-2024-01  
Consists of 869 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the  
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, and amendments to other related PCAOB standards (collectively, the "proposed rules"). The proposed rules are attached as Exhibit A to this rule filing. In addition, the Board is also requesting the SEC's approval, pursuant to Section 103(a)(3)(c) of the Act, of the application of the proposed rules to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934. Section 104 of the Jumpstart Our Business Startups Act provides that any additional rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation." See Exhibit 3.

(b) The proposed rules would rescind (i.e., supersede) the following existing Board auditing standards: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; AS 1015, *Due Professional Care in the Performance of Work*; and AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."* Additionally, the proposed rules would be revising the following Board auditing

standards: AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 2101, *Audit Planning*; and AS 2810, *Evaluating Audit Results*.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the SEC, at its open meeting on May 13, 2024. No other action by the Board is necessary for the filing of the proposed rules.

(b) Questions regarding this rule filing may be directed to Barbara Vanich, Chief Auditor (202/207-9363, vanichb@pcaobus.org); Dominika Taraszkiewicz, Senior Associate Chief Auditor, Office of the Chief Auditor (202/591-4143, taraszkiewicz@d@pcaobus.org); Hunter Jones, Chief Counsel (202/591-4412, jonesh@pcaobus.org); or Connor Raso, Deputy General Counsel (202/591-4478, rasoc@pcaobus.org).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules Change

(a) Purpose

The Board adopted a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* ("new standard," "final standard," or "AS 1000").

The new standard replaces a group of standards originally developed by the American Institute of Certified Public Accountants ("AICPA") and adopted on an interim basis by the PCAOB in 2003. That group of standards established the general principles and responsibilities of the auditor when conducting an audit ("foundational standards"). The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence,

competence, and professional judgment. These principles and related responsibilities provide a foundation for the proper performance of the audit.

Through this standard-setting project, the Board has reaffirmed the general principles and responsibilities of the auditor so that the foundation underlying the standards continues to be sound and appropriate for performing high-quality audits. These principles and responsibilities, enhanced and consolidated into a single auditing standard, together with related amendments, will modernize the auditing standards to better address fundamental aspects of the audit and provide auditors with better direction to protect investors and further the public interest in the preparation of informative, accurate, and independent auditor's reports.

AS 1000 will replace four standards that set forth the general principles and responsibilities of the auditor: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*. AS 1000 combines and updates the general principles and responsibilities of these standards to reflect developments in the auditing environment.

The Board also amended certain other standards that address responsibilities fundamental to the conduct of an audit. These amendments clarify the engagement partner's responsibility to exercise due professional care related to supervision and review of the audit, accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarify the auditor's responsibility to evaluate whether the



financial statements are "presented fairly." Finally, the Board adopted additional amendments to conform to these changes.

After carefully considering the comments the Board received, the Board adopted the amendments substantially as proposed, with revisions that reflect the input of commenters.

Since the PCAOB's adoption of the foundational standards in 2003, the auditing environment has evolved, including:

- Changes to auditing requirements through Board-issued standards;
- New or revised independence requirements issued by the Board; and
- Advancements in technology that are increasing the availability of electronic audit tools and use of audit software.

The new standard and related amendments the Board adopted will modernize PCAOB standards to:

- Reflect changes in the auditing environment;
- Eliminate outdated and inconsistent language; and
- Achieve consistency with Board-issued standards.

AS 1000 and the related amendments modernize, clarify, and streamline the general principles and responsibilities of the auditor and provide a more logical presentation, which should enhance the useability of the standards by making them easier to read, understand, and apply.

The Board clarified the auditor's responsibility to evaluate whether the financial statements are "presented fairly." The Board also clarified the engagement partner's due professional care responsibilities by adding specificity to certain audit performance

principles set out in the standards. Finally, the accelerated documentation completion date reflects changes in the auditing environment, including advancements in technology that have enabled auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment. The new documentation completion date reduces the window of opportunity for improper alteration of audit documentation and also enables the Board to potentially begin the inspection process sooner after completion of an audit, which the Board believes can enhance the Board's efforts to improve audit quality and promote investor protection, ultimately enhancing investor confidence.

The new standard and related amendments will apply to all audits conducted under PCAOB standards.

*See* Exhibit 3 for additional discussion of the purpose of this project.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

Not applicable. The Board's consideration of the economic impacts of the standard and amendments is discussed in Exhibit 1 and in Exhibit 3.

5. Board's Statement on Comments on the Proposed Rules Change Received from Members, Participants or Others

The Board initially released the proposed rules for public comment on March 28, 2023. *See* Exhibit 2(a)(A). The Board received 28 written comment letters relating to its initial proposed rules. In addition, the Board received six comment letters relating to its consideration of proposed amendments on quality control, which were released for public comment on November 19, 2022, and that are relevant to the definition of "applicable

professional and legal requirements" in these proposed rules. *See* Exhibits 2(a)(B) and 2(a)(C).

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

Not applicable.

9. Exhibits

Exhibit A – Text of the Proposed Rules.

Exhibit 1 – Form of Notice of Proposed Rules for Publication in the *Federal Register*.

Exhibit 2(a)(A) – PCAOB Release No. 2023-001 (Proposing Release).

Exhibit 2(a)(B) – Alphabetical List of Comments on the proposed rules in PCAOB Release No. 2023-001.


Exhibit 2(a)(C) – Written comments on the proposed rules in PCAOB Release No. 2023-001 and relevant comments on the rules relating to quality control amendments proposed in PCAOB Release No. 2022-006.

Exhibit 3 – PCAOB Release No. 2024-004 (Adopting Release).

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

By:   
Phoebe W. Brown  
Secretary

May 24, 2024

## EXHIBIT A – TEXT OF THE PROPOSED RULES

The Board adopted AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, amendments to related PCAOB auditing standards, and conforming amendments to its auditing standards, auditing interpretations, and attestation standards.

The text of these proposed rule changes is set forth below.

### **AS 1000: *General Responsibilities of the Auditor in Conducting an Audit***

#### **INTRODUCTION**

.01 The auditor has a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports. This responsibility transcends an auditor's relationship with management and the audit committee of the company under audit, providing the foundation for an objective and independent audit. A properly conducted audit and the related auditor's report enhance the confidence of investors and other financial statement users<sup>1</sup> in the company's financial statements and, if applicable, internal control over financial reporting.

Note: The auditor's obligation to protect investors provides important context to the auditor's work when applying the requirements of this and other Public Company Accounting Oversight Board ("PCAOB") standards and rules.

.02 This standard describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the PCAOB. This standard sets out the objectives of the auditor, establishes requirements for the auditor's professional

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<sup>1</sup> This standard uses "investors and other financial statement users" to include a company's existing and potential shareholders, bondholders, lenders, other creditors, and others who use the company's financial statements.

qualifications and the auditor's general responsibilities applicable in all audits, and describes auditing principles relevant to conducting the audit.

## **OBJECTIVES OF THE AUDITOR**

.03 The objectives of the auditor are to:

a. In an audit of financial statements – (1) obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud; and (2) issue an auditor's report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework;

b. In an audit of internal control over financial reporting – (1) obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment; and (2) issue an auditor's report that expresses an opinion on the effectiveness of the company's internal control over financial reporting;

c. Communicate externally in accordance with **applicable professional and legal requirements**;<sup>2</sup> and

d. Satisfy and fulfill the other general principles and responsibilities described in this standard.

## **PROFESSIONAL QUALIFICATIONS OF THE AUDITOR**

### **Independence and Ethics**

.04 The auditor must be independent of the company under audit both in fact and in appearance throughout the audit and professional engagement period.<sup>3</sup> The auditor is not

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<sup>2</sup> The term is defined in Appendix A, *Definition*, and is set in **boldface type** the first time it appears.

<sup>3</sup> See PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term "audit and professional engagement period."

independent with respect to the company under audit if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed within the engagement.<sup>4</sup>

.05 The auditor must satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") under the federal securities laws.<sup>5</sup>

.06 The auditor must comply with applicable ethics requirements, including the ethics rules and standards of the PCAOB.<sup>6</sup>

### **Competence**

.07 The audit must be performed by an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements. Competence consists of having the knowledge, skill, and ability that enable the auditor to perform their assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. Competence is measured both qualitatively and quantitatively.

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<sup>4</sup> See Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01 for the analogous provision on auditor independence. For the purposes of this standard, the phrase "company under audit" has the same meaning as "audit client" under PCAOB Rule 3501(a)(iv).

<sup>5</sup> See, e.g., Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01, and Section 3, Part 5 of PCAOB rules. To the extent that a provision of one rule is more restrictive than that of another rule, the auditor is required to comply with the more restrictive provision. See PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.

<sup>6</sup> See, e.g., Section 3, Part 5 of PCAOB rules; EI 1000, *Integrity and Objectivity*, which requires auditors to maintain integrity and objectivity.

Note: Competence includes knowledge and proficiency in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

.08 The auditor should develop and maintain competence through an appropriate combination of:

- a. Academic education;
- b. Professional experience in accounting and auditing, with proper supervision;<sup>7</sup> and
- c. Training, including accounting, auditing, independence, ethics, and other relevant continuing professional education.

#### **DUE PROFESSIONAL CARE, INCLUDING PROFESSIONAL SKEPTICISM**

.09 The auditor must exercise due professional care in all matters related to the audit.<sup>8</sup>

Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements.<sup>9</sup>

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<sup>7</sup> Paragraphs .05 and .06 of AS 1201, *Supervision of the Audit Engagement*, describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members.

<sup>8</sup> For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care. The lead auditor's responsibilities for planning the audit and supervising the other auditors' work are set forth in AS 2101, *Audit Planning*, and AS 1201.

<sup>9</sup> See also note to AS 1201.05b.



.10 For the engagement partner,<sup>10</sup> due professional care also includes (1) being responsible for the appropriate assignment of responsibilities to,<sup>11</sup> and supervision of,<sup>12</sup> engagement team members;<sup>13</sup> (2) determining that the audit is properly planned<sup>14</sup> and performed to obtain reasonable assurance;<sup>15</sup> (3) evaluating that significant findings or issues are appropriately addressed;<sup>16</sup> (4) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence;<sup>17</sup> and (5) determining that required communications under applicable professional and legal requirements have been made.<sup>18</sup>

.11 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. The auditor's exercise of professional skepticism includes:

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<sup>10</sup> The term "engagement partner," as used in this standard, has the same meaning as defined in Appendix A of AS 1201.

<sup>11</sup> Paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding the assignment of engagement team members.

<sup>12</sup> See AS 1201.

<sup>13</sup> The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

<sup>14</sup> See AS 2101.03, which describes the engagement partner's responsibility for planning an audit.

<sup>15</sup> See paragraph .13 of this standard.

<sup>16</sup> See paragraph .12 of AS 1215, *Audit Documentation*.

<sup>17</sup> See, e.g., paragraphs .09-.10 of AS 1220, *Engagement Quality Review*. See also AS 2810, *Evaluating Audit Results*.

<sup>18</sup> See paragraph .20 of this standard.

- a. Objectively evaluating evidence obtained in an audit (including information that supports and corroborates management's assertions<sup>19</sup> and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;<sup>20</sup>
- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not being satisfied with evidence that is less than persuasive;
- d. Not assuming that management is honest or dishonest; and
- e. Considering potential bias on the part of management and the auditor.

## **PROFESSIONAL JUDGMENT**

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances.<sup>21</sup>

Note: Professional judgment is applied in the context of conducting an audit with due professional care in accordance with applicable professional and legal requirements.

## **CONDUCTING AN AUDIT**

- .13 The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to:
- a. Obtain reasonable assurance about whether:

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<sup>19</sup> See AS 1105, *Audit Evidence*, for management's assertions regarding the financial statements and internal control over financial reporting.

<sup>20</sup> See AS 1105, which explains what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.

<sup>21</sup> References to judgment of the auditor in other PCAOB standards have the same meaning as "professional judgment." See, e.g., AS 1215.07 and AS 1220.02.

(1) In an audit of financial statements, the financial statements are free of material misstatement,<sup>22</sup> whether due to error or fraud;<sup>23</sup>

(2) In an audit of internal control over financial reporting, material weaknesses exist as of the date specified in management's assessment; and

b. Provide the auditor with a reasonable basis for forming an opinion.<sup>24</sup>

Note: In an audit of financial statements, the financial statements, including their preparation, are management's responsibility and the auditor's responsibility is to express an opinion on the financial statements. In an audit of internal control over financial reporting, management is responsible for establishing and maintaining effective internal control over financial reporting and for assessing the effectiveness of internal control over financial reporting, and the auditor's responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting.

.14 Reasonable assurance is not absolute assurance, but a high level of assurance. It is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence.<sup>25</sup> The auditor

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<sup>22</sup> The term "misstatement," as used in this standard, has the same meaning as defined in Appendix A of AS 2810.

<sup>23</sup> See AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, for requirements regarding the auditor's consideration of materiality in planning and performing an audit. See AS 2401, *Consideration of Fraud in a Financial Statement Audit*. See also paragraph .05 of AS 2405, *Illegal Acts by Clients*.

<sup>24</sup> In circumstances when the auditor is not able to obtain sufficient appropriate audit evidence to provide a reasonable basis for forming an opinion, PCAOB standards require the auditor to disclaim an opinion or withdraw (or resign) from the engagement. See AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, for a financial statement audit and paragraphs .90 through .98 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and Appendix C of AS 2201, for an audit of internal control over financial reporting.

<sup>25</sup> See paragraphs .03-.04 of AS 1101, *Audit Risk*. In a financial statement audit, audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated, *i.e.*, the financial statements are not presented fairly in conformity with the applicable financial reporting framework.

obtains reasonable assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected.

.15 The auditor must comply with applicable professional and legal requirements in conducting an audit.

Note: When complying with PCAOB standards, the auditor should also take into account PCAOB auditing interpretations<sup>26</sup> applicable to the audit.

.16 The auditor must prepare audit documentation in connection with each engagement conducted in accordance with the standards of the PCAOB.<sup>27</sup> Audit documentation facilitates the planning, performance, and supervision of the engagement and is the basis for reviewing the quality of the work performed in an audit because it provides the engagement partner and other reviewers with written documentation of the evidence supporting the auditor's significant conclusions.<sup>28</sup> AS 1215 also sets forth requirements for the assembly and retention of audit documentation.<sup>29</sup>

### **Auditor Communications**

.17 The auditor's report must contain:

a. In an audit of financial statements, an expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed; and

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<sup>26</sup> PCAOB auditing interpretations refer to the PCAOB publications entitled "Auditing Interpretations" as currently in effect.

<sup>27</sup> See, e.g., AS 1215; AS 1301, Communications with Audit Committees; and AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion.

<sup>28</sup> See generally AS 1215.

<sup>29</sup> See AS 1215.14-.20.

b. In an audit of internal control over financial reporting, an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed.

Note: The auditor's report also contains other elements, such as those included in the basis for opinion or basis for disclaimer of opinion sections, and, if applicable, critical audit matters.<sup>30</sup>

.18 The auditor should express an unqualified opinion only when the auditor has performed the audit in accordance with the standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that:

a. In an audit of financial statements, the financial statements, taken as a whole, are presented fairly,<sup>31</sup> in all material respects, in conformity with the applicable financial reporting framework,<sup>32</sup>

b. In an audit of internal control over financial reporting, the company maintained, in all material respects, effective internal control over financial reporting.<sup>33</sup>

.19 When the auditor conducts an audit in accordance with the standards of the PCAOB, some circumstances require that the auditor depart from an unqualified opinion on the

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<sup>30</sup> See AS 3101 and AS 3105. AS 3101.18 also includes a list of other PCAOB standards with requirements that, in certain circumstances, the auditor include explanatory language (or an explanatory paragraph) in the auditor's report, while not affecting the auditor's opinion on the financial statements. For example, an explanatory paragraph is required when there is substantial doubt about the company's ability to continue as a going concern.

<sup>31</sup> AS 2810.30-.31 describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

<sup>32</sup> See AS 3101 for requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements. The auditor should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

<sup>33</sup> See AS 2201.85-.98 for the form and content of the auditor's report when the auditor conducts an audit of internal control over financial reporting.

company's financial statements or internal control over financial reporting, and state the reasons for the departure from the unqualified opinion.<sup>34</sup>

.20 The auditor must communicate externally in accordance with applicable professional and legal requirements.<sup>35</sup>

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<sup>34</sup> See AS 3105 for reporting requirements related to departures from unqualified opinions and other reporting circumstances. See also AS 2201.90-.98 and Appendix C of AS 2201, for special reporting situations in an audit of internal control over financial reporting.

<sup>35</sup> See, e.g., AS 1301; PCAOB Rule 3211, Auditor Reporting of Certain Audit Participants.

**APPENDIX A – Definition**

.A1 For purposes of this standard, the term below is defined as follows:

.A2 Applicable professional and legal requirements –

(1) Professional standards, as defined in PCAOB Rule 1001(p)(vi);

(2) Rules of the PCAOB that are not professional standards; and

(3) To the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system, rules of the SEC, other provisions of U.S. federal securities law, ethics laws and regulations, and other applicable statutory, regulatory, and other legal requirements.

## Amendments to Related PCAOB Auditing Standards

### Amendments to AS 1201

I. AS 1201 is amended by adding footnote 1B and deleting footnote 6 to paragraph .03 to read as follows:

.03 The **engagement partner**<sup>1A</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members<sup>1B</sup> (including engagement team members outside the engagement partner's firm). The engagement partner also is responsible for compliance with PCAOB standards, including standards regarding: using the work of specialists,<sup>2</sup> internal auditors,<sup>4</sup> and others who are involved in testing controls;<sup>5</sup> and dividing responsibility with another accounting firm.<sup>5A</sup> Paragraphs .05–.06 of this standard describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members. Paragraphs .07–.15 of this standard further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth in this standard.<sup>6A</sup>

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<sup>1B</sup> See also paragraph .10 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for an additional description of due professional care as it relates to the engagement partner.

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[<sup>6</sup>] [Footnote deleted.]



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II. AS 1201 is amended by adding a note to paragraph .04 to read as follows:

.04 The engagement partner may seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in this standard with respect to the supervisory responsibilities assigned to them.

Note: When the engagement partner seeks assistance, the engagement partner nevertheless retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner's responsibility.

III. AS 1201 is amended by revising footnote 7 of paragraph .05a.; revising the note to paragraph .05b.; and adding Note 1 and Note 2 to paragraph .05c., to read as follows:

.05 The engagement partner and, as applicable, other engagement team members performing supervisory activities, should:

a. Inform engagement team members of their responsibilities,<sup>7</sup> including:

<sup>7</sup> Paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding the appropriate assignment of engagement

team members. *See also* AS 1000.10, for an additional description of due professional care as it relates to the engagement partner.

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b. Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards;<sup>9</sup>

Note: In applying due professional care in accordance with AS 1000, each engagement team member has a responsibility to bring to the attention of appropriate persons, disagreements or concerns the engagement team member might have with respect to accounting and auditing issues that he or she believes are of significance to the financial statements or the auditor's report regardless of how those disagreements or concerns may have arisen.

c. Review the work of engagement team members to evaluate whether:

- (1) The work was performed and documented;
- (2) The objectives of the procedures were achieved; and
- (3) The results of the work support the conclusions reached.<sup>10</sup>

Note 1: The review and evaluation must be completed prior to the report release date (*see* AS 1215.06 and .15).

Note 2: Notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner, as the individual primarily responsible for the engagement and its performance, must review documentation sufficient to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner's attention pursuant to paragraph .05b, were appropriately addressed; (iii) the conclusions expressed in the auditor's report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. The engagement partner's review should include review of documentation of significant findings or issues (see AS 1215.12) and review of documentation required to be reviewed by the engagement quality reviewer pursuant to the requirements of paragraphs .09-.10 and .14-.15 of AS 1220, *Engagement Quality Review*.

IV. AS 1201 is amended by revising footnote 12 to paragraph .06 to read as follows:

.06 To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, the engagement partner and other engagement team members performing supervisory activities should take into account:

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d. The knowledge, skill, and ability of each engagement team member.<sup>12</sup>

<sup>12</sup> See also AS 2301.05a.

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V. AS 1201 is amended by revising footnote 1 to paragraph .C4 to read as follows:

.C4 Pursuant to paragraph .05a(3) of this standard, the engagement partner and, as applicable, other engagement team members performing supervisory activities should inform the specialist about matters that could affect the specialist's work. This includes, as applicable, information about the company and its environment, the company's processes for developing the related accounting estimate, the company's use of specialists in developing the estimate, relevant requirements of the applicable financial reporting framework, possible accounting and auditing issues, and the need to apply professional skepticism.<sup>1</sup>

<sup>1</sup> See paragraph .11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism.

### **Amendments to AS 1215**

VI. AS 1215 is amended by revising paragraph .02 to read as follows:

.02 *Audit documentation* is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer (e.g., engagement partner or other reviewers) with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work,

the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

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VII. AS 1215 is amended by revising paragraph .03 and adding footnote 1B to read as follows:

.03 Audit documentation is reviewed by members of the engagement team<sup>1A</sup> performing the work and might be reviewed by others. Reviewers might include, for example:

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e. Internal and external inspection teams that review documentation to assess audit quality and compliance with applicable professional and legal requirements<sup>1B</sup> and the auditor's own quality control policies and procedures.

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<sup>1B</sup> "Applicable professional and legal requirements" is defined in paragraph .A2 of AS 1000, *General Responsibilities of the Auditor in Conducting and Audit*.

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VIII. AS 1215 is amended by revising paragraph .06 and adding paragraph .06A to read as follows:

.06 The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.<sup>2</sup> Audit documentation must clearly demonstrate that the work was in fact performed, who performed the

work, the person or persons who reviewed the work, and the date of such review. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions.

.06A Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person or persons who reviewed the work and the date of such review.

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IX. AS 1215 is amended by adding a footnote 2A to paragraph .07 to read as follows (and by revising the numbering of footnotes 2A, 2B, and 2C to paragraph .12 to read as footnotes 2B, 2C, and 2D, respectively):

.07 In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;

- Extent of judgment<sup>2A</sup> required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;

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<sup>2A</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000.

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X. AS 1215 is amended by revising paragraph .11 to read as follows:

.11 Certain matters, such as auditor independence, staff competence and training, and acceptance and continuance of engagements, may be documented in a central repository for the public accounting firm ("firm") or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

XI. AS 1215 is amended by revising paragraph .15 to read as follows:

.15 Prior to the report release date, (i) the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report, and (ii) the engagement partner and other engagement team members performing supervisory activities must have completed their reviews of audit documentation. A

complete and final set of audit documentation should be assembled for retention (i.e., archived) as of a date not more than 14 days after the report release date (*documentation completion date*). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 14 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 14 days from the date the engagement ceased.

### **Amendments to AS 2101**

XII. AS 2101 is amended by adding a note to paragraph .03 to read as follows:

.03 The **engagement partner**<sup>1</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate **engagement team** members (which may include engagement team members outside the engagement partner's firm) in fulfilling this responsibility. Engagement team members who assist the engagement partner with audit planning also should comply with the relevant requirements in this standard.

Note: When the engagement partner seeks assistance, the engagement partner nevertheless retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner's responsibility.

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XIII. AS 2101 is amended by adding a footnote 4J to paragraph .07 to read as follows:



.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor's previous experience with the company, and changes in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, the auditor should evaluate whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures:

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- The auditor's preliminary judgments<sup>4J</sup> about materiality,<sup>5</sup> risk, and, in integrated audits, other factors relating to the determination of material weaknesses;

<sup>4J</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XIV. AS 2101 is amended by revising footnote 10 to paragraph .09 to read as follows:

.09 In establishing the overall audit strategy, the auditor should take into account:

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d. The nature, timing, and extent of resources necessary to perform the engagement.<sup>10</sup>

<sup>10</sup> See, e.g., paragraph .16 of this standard, and AS 2301.05a.

**Amendments to AS 2810**

XV. AS 2810 is amended by adding footnote 9A to paragraph .17 to read as follows:

.17 *Evaluation of the Effect of Uncorrected Misstatements.* The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors.<sup>7</sup> (See Appendix B.)

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Note: As a result of the interaction of quantitative and qualitative considerations in materiality judgments,<sup>9A</sup> uncorrected misstatements of relatively small amounts could have a material effect on the financial statements. For example, an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility<sup>10</sup> that it could lead to a material contingent liability or a material loss of revenue.<sup>11</sup> Also, a misstatement made intentionally could be material for qualitative reasons, even if relatively small in amount.

<sup>9A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XVI. AS 2810 is amended by revising the first Note and adding footnote 17B to paragraph .30 to read as follows:

.30 The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.<sup>17B</sup>

Note: The applicable financial reporting framework provides the basis for the auditor's judgment regarding the presentation of financial position, results of operations, cash flows, and disclosures in financial statements.

Note: The auditor should look to the requirements of the U.S. Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.

<sup>17B</sup> AS 2820, *Evaluating Consistency of Financial Statements*, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.

XVII. AS 2810 is amended by adding a new paragraph .30A and footnotes 17C and 17D to read as follows:

.30A When evaluating whether the financial statements (including the accompanying notes) present fairly the financial position, results of operations, and cash flows, in all material respects, in conformity with the applicable financial reporting framework, the auditor should evaluate whether:<sup>17C</sup>

a. The financial statements are informative of matters that may affect their use, understanding, and interpretation; and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading;<sup>17D</sup>

b. The accounting principles selected and applied by the company's management are appropriate in the circumstances; and

c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements.

<sup>17C</sup> The concept of materiality is inherent in the auditor's judgment. That concept involves qualitative as well as quantitative factors (*see* AS 2105).

<sup>17D</sup> Regulation S-X Rule 4-01(a), 17 C.F.R. § 210.4-01(a), requires issuers to include in financial statements any further material information as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading.

XVIII. AS 2810 is amended by revising and moving footnote 18 and deleting a Note to paragraph .31 to read as follows:

.31 As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>18</sup> Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the

accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

<sup>18</sup> See AS 3105.24–.27 for auditor reporting considerations related to inadequate disclosures.

## Other Amendments to PCAOB Standards

I. AS 1101 is amended by revising footnote 3 to paragraph .03 to read as follows:

.03 To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement<sup>2</sup> due to error or fraud. Reasonable assurance<sup>3</sup> is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence.

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<sup>3</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of reasonable assurance.

II. AS 1105 is amended by adding footnote 1A to paragraph .B2 to read as follows:

.B2 If in the auditor's judgment<sup>1A</sup> additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results.

<sup>1A</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

III. AS 1220 is amended by adding footnote 1B to paragraph .02 to read as follows:

.02 The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments<sup>1B</sup> made by the engagement team<sup>1A</sup> and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.<sup>1</sup>

<sup>1B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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IV. AS 1220 is amended by revising footnote 6 to paragraph .12 to read as follows:

.12 In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care<sup>6</sup> the review required by this standard, he or she is not aware of a significant engagement deficiency.

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<sup>6</sup> See AS 1000.09 and .11 for a discussion of the concept of due professional care.

V. AS 2201 is amended by revising footnote 5 to paragraph .03 to read as follows:

.03 The auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting. Because a company's internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance<sup>5</sup> about whether material weaknesses exist as of the date specified in management's assessment. A material weakness in internal control over financial reporting may exist even when financial statements are not materially misstated.

<sup>5</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of the concept of reasonable assurance in an audit.

VI. AS 2201 is amended by revising paragraph .04 to read as follows:

.04 AS 1000 is applicable to an audit of internal control over financial reporting. That standard requires that the auditor be independent, comply with independence and ethics requirements, be competent, and exercise due professional care, including professional skepticism. This standard establishes the fieldwork and reporting standards applicable to an audit of internal control over financial reporting.

VII. AS 2201 is amended by adding footnote 7B to paragraph .09 to read as follows:

.09 The auditor should properly plan the audit of internal control over financial reporting and properly supervise the engagement team<sup>7A</sup> members. When planning an integrated audit, the auditor should evaluate whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures –



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- The auditor's preliminary judgments<sup>7B</sup> about materiality, risk, and other factors relating to the determination of material weaknesses;

<sup>7B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000.

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VIII. AS 2301 is amended by deleting footnote 1 to paragraph .05a and revising footnote 3 to paragraph .05d to read as follows:

.05 The auditor should design and implement overall responses to address the assessed risks of material misstatement as follows:

a. *Making appropriate assignments of significant engagement responsibilities.* The knowledge, skill, and ability of engagement team<sup>1A</sup> members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.

<sup>[1]</sup> [Footnote deleted.]

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d. *Evaluating the company's selection and application of significant accounting principles.* The auditor should evaluate whether the company's selection and application of significant accounting principles, particularly those related to subjective measurements and complex transactions,<sup>3</sup> are indicative of bias that could lead to material misstatement of the financial statements.

<sup>3</sup> AS 2110.12-.13 discuss the auditor's responsibilities regarding obtaining an understanding of the company's selection and application of accounting principles. *See also* paragraphs .66-.67A of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, and paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*.

IX. AS 2301 is amended by revising footnote 4 to paragraph .07 to read as follows:

.07 Due professional care requires the auditor to exercise professional skepticism.<sup>4</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence. The auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence.<sup>5</sup> Examples of the application of professional skepticism in response to the assessed fraud risks are (a) modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor,<sup>5A</sup> or examination of documentation from independent sources.

<sup>4</sup> *See* paragraphs .09 and .11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of due professional care and professional skepticism.

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X. AS 2305 is amended by adding footnote 2 to paragraph .09 to read as follows:

.09 The auditor's reliance on substantive tests to achieve an audit objective related to a particular assertion<sup>1</sup> may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedure or procedures to use to achieve a particular audit objective is based on the auditor's judgment<sup>2</sup> on the expected effectiveness and efficiency of the available procedures. For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient. (See paragraph .11 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.)

<sup>2</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XI. AS 2315 is amended by adding footnote 2A to paragraph .02 to read as follows:

.02 The auditor often is aware of account balances and transactions that may be more likely to contain misstatements.<sup>2</sup> He considers this knowledge in planning his procedures, including audit sampling. The auditor usually will have no special knowledge about other account balances and transactions that, in his judgment,<sup>2A</sup> will need to be tested to fulfill his audit objectives. Audit sampling is especially useful in these cases.

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<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XII. AS 2401 is amended by revising paragraph .01 to read as follows:

.01 Paragraph .13 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, requires the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence to obtain reasonable assurance about whether the financial statements are free of material misstatement whether due to error or fraud.<sup>1</sup> This section establishes requirements and provides direction relevant to fulfilling that responsibility, as it relates to fraud, in an audit of financial statements.<sup>2</sup>

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XIII. AS 2401 is amended by revising paragraph .04 to read as follows:

.04 Although this section focuses on the auditor's consideration of fraud in an audit of financial statements, it is management's responsibility to design and implement programs and controls to prevent, deter, and detect fraud.<sup>3</sup> Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. Management, along with those who have responsibility for oversight of the financial reporting process (such as the audit committee, board of trustees, board of directors, or the owner in owner-managed entities), should set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud. When management and those responsible for the oversight of the financial reporting process fulfill those responsibilities, the opportunities to commit fraud can be reduced significantly.

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XIV. AS 2401 is amended by revising paragraph .12 and footnote 7 to read as follows:

.12 As indicated in paragraph .01, the auditor has a responsibility to plan and perform the audit to obtain sufficient appropriate audit evidence for the auditor to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error.<sup>7</sup> However, absolute assurance is not attainable and thus even a properly planned and performed audit may not detect a material misstatement resulting from fraud. A material misstatement may not be detected because of the nature of audit evidence or because the characteristics of fraud as discussed above may cause the auditor to rely unknowingly on audit evidence that appears to be valid, but is, in fact, false and fraudulent. Furthermore, audit procedures that are effective for detecting an error may be ineffective for detecting fraud.

<sup>7</sup> For a discussion of the concept of reasonable assurance, *see* AS 1000.14.

XV. AS 2401 is amended by revising paragraph .13 to read as follows:

.13 Due professional care requires the auditor to exercise professional skepticism. *See* AS 1000.09 and .11. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the fraud risks. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. In exercising professional skepticism in gathering and evaluating evidence, the auditor

should not be satisfied with less-than-persuasive evidence and avoid assumptions that management is honest or dishonest.

XVI. AS 2405 is amended by revising paragraph .05 to read as follows:

.05 The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. For example, tax laws affect accruals and the amount recognized as expense in the accounting period; applicable laws and regulations may affect the amount of revenue accrued under government contracts. However, the auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statements assertions rather than from the perspective of legality *per se*. The auditor's responsibility to detect and report misstatements resulting from illegal acts having a direct and material effect on the determination of financial statement amounts is the same as that for misstatements due to error or fraud as described in paragraph .13 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XVII. AS 2410 is amended by revising footnote 2 to paragraph .02 to read as follows:

.02 The objective of the auditor is to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements.<sup>2</sup>

<sup>2</sup> See, e.g., paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*.

XVIII. AS 2501 is amended by revising footnote 23 to paragraph .27 to read as follows:

.27 Events and transactions that occur after the measurement date can provide relevant evidence to the extent they reflect conditions at the measurement date.<sup>23</sup>

<sup>23</sup> Evaluating audit evidence from events or transactions occurring after the measurement date, as contemplated in this standard, is a substantive test that differs from the other auditing procedures performed under paragraph .12 of AS 2801, *Subsequent Events*.

XIX. AS 2501 is amended by revising footnote 28 to paragraph .30 to read as follows:

.30 AS 2810 requires the auditor to evaluate the results of audit procedures performed on accounting estimates. This includes:

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d. Evaluating the presentation of the financial statements, including the disclosures and whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>28</sup>

<sup>28</sup> See AS 2810.30-31.

XX. AS 2505 is amended by revising footnote 7 to paragraph .13 to read as follows:

.13 A lawyer's refusal to furnish the information requested in an inquiry letter either in writing or orally (*see* paragraphs .09 and .10) would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion (*see* paragraphs .05 and .06 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*).<sup>7</sup> A lawyer's response to such an inquiry and the procedures set forth in paragraph .05 provide the auditor with sufficient evidential matter to satisfy himself concerning the accounting for and reporting of pending and threatened litigation, claims and assessments. The auditor obtains sufficient evidential matter to

satisfy himself concerning reporting for those unasserted claims and assessments required to be disclosed in financial statements from the foregoing procedures and the lawyer's specific acknowledgement of his responsibility to his client in respect of disclosure obligations (*see* paragraph .09g). This approach with respect to unasserted claims and assessments is necessitated by the public interest in protecting the confidentiality of lawyer-client communications.

<sup>7</sup> A refusal to respond should be distinguished from an inability to form a conclusion with respect to certain matters of judgment (see paragraph .14). Also, lawyers outside the United States sometimes follow practices at variance with those contemplated by this section to the extent that different procedures from those outlined herein may be necessary. In such circumstances, the auditor should exercise professional judgment in determining whether alternative procedures are adequate to comply with the requirements of this section.

XXI. AS 2601 is amended by adding footnote 2A to paragraph .32 to read as follows:

.32 The service auditor should consider conditions that come to his or her attention that, in the service auditor's judgment,<sup>2A</sup> represent significant deficiencies in the design or operation of the service organization's controls that preclude the service auditor from obtaining reasonable assurance that specified control objectives would be achieved. The service auditor should also consider whether any other information, irrespective of specified control objectives, has come to his or her attention that causes him or her to conclude (a) that design deficiencies exist that could adversely affect the ability to initiate, record, process, or report financial data to user organizations without error, and (b) that user organizations would not generally be expected to have controls in place to mitigate such design deficiencies.



<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXII. AS 2605 is amended by adding footnote 6A to paragraph .19 to read as follows:

.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor divides responsibility for the audit with another public accounting firm,<sup>6</sup> this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments<sup>6A</sup> about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor.

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<sup>6A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXIII. AS 2610 is amended by adding footnote 7A to paragraph .11 to read as follows:

.11 The successor auditor should request that the client authorize the predecessor auditor to allow a review of the predecessor auditor's working papers. The predecessor auditor may wish to request a consent and acknowledgment letter from the client to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized.<sup>6</sup> It is customary in such circumstances for the predecessor auditor to make

himself or herself available to the successor auditor and make available for review certain of the working papers. The predecessor auditor should determine which working papers are to be made available for review and which may be copied. The predecessor auditor should ordinarily permit the successor auditor to review working papers, including documentation of planning, internal control, audit results, and other matters of continuing accounting and auditing significance, such as the working papers containing an analysis of balance sheet accounts, those relating to contingencies, related parties, and significant unusual transactions. Also, the predecessor auditor should reach an understanding with the successor auditor as to the use of the working papers.<sup>7</sup> The extent, if any, to which a predecessor auditor permits access to the working papers is a matter of judgment.<sup>7A</sup>

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<sup>7A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXIV. AS 2710 is amended by revising paragraph .05 and adding footnote 3 to paragraph .05 to read as follows:

.05 If, while reading the other information for the reasons set forth in paragraph .04, the auditor becomes aware of information that he believes is a material misstatement of fact that is not a material inconsistency as described in paragraph .04, he should discuss the matter with the client. In connection with this discussion, the auditor should consider that he may not have the expertise to assess the validity of the statement, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment<sup>3</sup> or opinion between

the auditor and client. If the auditor concludes he has a valid basis for concern he should propose that the client consult with some other party whose advice might be useful to the client, such as the client's legal counsel.

<sup>3</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXV. AS 2805 is amended by revising footnote 1 to paragraph .02 to read as follows:

.02 During an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit. Written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.<sup>1</sup>

<sup>1</sup> AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, describes the auditor's general responsibilities, including the responsibility for exercising professional skepticism, which includes not being satisfied with evidence that is less than persuasive and not assuming that management is honest or dishonest.

XXVI. AS 3101 is amended by revising paragraph .01, moving footnote 2 to paragraph .01 to paragraph .02, deleting footnote 3 to paragraph .01, and revising footnote 4 to paragraph .02, to read as follows:

.01 This standard establishes requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements<sup>1</sup> (the "auditor's unqualified report").

<sup>1</sup> This standard uses the term "financial statements" as used by the U.S. Securities and Exchange Commission ("SEC") to include all notes to the statements and all related schedules. *See* Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; *see, e.g.,* AS 2110, *Identifying and Assessing Risks of Material Misstatement*.

.02 The auditor is in a position to express an unqualified opinion on the financial statements when the auditor conducted an audit in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") and concludes that the financial statements, taken as a whole,<sup>2</sup> are presented fairly, in all material respects,<sup>4</sup> in conformity with the applicable financial reporting framework.<sup>5</sup>

<sup>2</sup> "Taken as a whole" applies equally to a complete set of financial statements and to an individual financial statement with appropriate disclosures.

[<sup>3</sup>] [Footnote deleted.]

<sup>4</sup> Paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*, describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

<sup>5</sup> The auditor should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

XXVII. AS 3101 is amended by adding footnote 20B to paragraph .11 to read as follows:

*Determination of Critical Audit Matters*

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.<sup>20B</sup> Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

<sup>20B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXVIII. AS 3105 is amended by revising paragraph .50 to read as follows:

.50 During the audit of the current-period financial statements, the auditor should be alert for circumstances or events that affect the prior-period financial statements presented (*see* paragraph .52) or the adequacy of informative disclosures concerning those statements. (*See* AS 2810.30-31.) In updating his or her report on the prior-period financial statements, the auditor should consider the effects of any such circumstances or events coming to his or her attention.

XXIX. AS 3305 is amended by revising paragraph .03 and adding footnote 1A to paragraph .03 to read as follows:

.03 An independent auditor's judgment<sup>1A</sup> concerning the overall presentation of financial statements should be applied within an applicable financial reporting framework (*see* AS 2810, *Evaluating Audit Results*). Normally, the framework is provided by generally accepted accounting principles, and the auditor's judgment in forming an opinion is applied accordingly. In some circumstances, however, a comprehensive basis of accounting other than generally accepted accounting principles may be used.

<sup>1A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXX. AS 3305 is amended by revising paragraph .09 to read as follows:

.09 When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other comprehensive basis of

accounting as he or she does to financial statements prepared in conformity with generally accepted accounting principles. Therefore, the auditor's opinion should be based on his or her judgment regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in AS 2810.30A.

XXXI. AS 4105 is amended by deleting footnote 1A and revising paragraph .01 to read as follows:

.01 The purpose of this section is to establish standards and provide guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of *interim financial information* (as that term is defined in paragraph .02 of this section). AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, requires that the auditor be independent, comply with independence and ethics requirements, be competent, and exercise due professional care, including professional skepticism. The same professional qualifications and general principles are applicable to a review of interim financial information conducted in accordance with this section. This section provides guidance on the application of the field work and reporting standards to a review of interim financial information, to the extent those standards are relevant.

XXXII. AS 4105 is amended by adding footnote 5A to paragraph .07 to read as follows:

.07 The objective of a review of *interim financial information* pursuant to this section is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform

with generally accepted accounting principles. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with the standards of the PCAOB. A review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) obtaining corroborating evidence in response to inquiries; or (d) performing certain other procedures ordinarily performed in an audit. A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit.

Paragraph .22 of this section provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles. Likewise, the auditor's responsibility as it relates to management's quarterly certifications on internal control over financial reporting is different from the auditor's responsibility as it relates to management's annual assessment of internal control over financial reporting. The auditor should perform limited procedures quarterly to provide a basis for determining whether he or she has become aware of any material modifications that, in the auditor's judgment,<sup>5A</sup> should be made to the disclosures about changes in internal control over financial reporting in order for the certifications to be accurate and to comply with the requirements of Section 302 of the Act.



<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000.

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XXXIII. AS 6105 is amended by revising paragraph .07 to read as follows:

.07 The reporting accountant should exercise due professional care in performing the engagement and should have the competence to conduct such an engagement. The reporting accountant should also plan the engagement adequately, supervise the work of assistants, if any, and accumulate sufficient information to provide a reasonable basis for the professional judgment described in the report. The reporting accountant should consider the circumstances under which the written report or oral advice is requested, the purpose of the request, and the intended use of the written report or oral advice.

XXXIV. AS 6105 is amended by adding footnote 5A and revising paragraph .08 to read as follows:

.08 To aid in forming a judgment,<sup>5A</sup> the reporting accountant should perform the following procedures: (a) obtain an understanding of the form and substance of the transaction(s); (b) review applicable accounting principles (*see AS 2810, Evaluating Audit Results*); (c) if appropriate, consult with other professionals or experts; and (d) if appropriate, perform research or other procedures to ascertain and consider the existence of creditable precedents or analogies.

<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXV. AS 6115 is amended by revising paragraph .21 to read as follows:

.21 The engagement to report on whether a previously reported material weakness continues to exist must be performed by an auditor who has the competence as an auditor to conduct such an engagement. In all matters related to the assignment, an independence in mental attitude must be maintained. Due professional care must be exercised in the performance of the engagement and the preparation of the report.

XXXVI. AS 6115 is amended by adding footnote 3A to paragraph .38 to read as follows:

.38 AS 2201.18-.19 should be applied in the context of the engagement to report on whether a previously reported material weakness continues to exist. There may, therefore, be some circumstances in which the scope of the audit procedures to be performed in this engagement will be so limited that using the work of others will not provide any tangible benefit to the company or its auditor. Additionally, the auditor should perform any walkthroughs himself or herself because of the degree of judgment<sup>3A</sup> required in performing this work.

<sup>3A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXVII. AI 11 is amended by adding footnote 3A to paragraph .04 to read as follows:

.04 *Interpretation*—During the audit, an auditor may encounter complex or subjective matters potentially material to the financial statements. Such matters may require special skill or knowledge and in the auditor's judgment<sup>3A</sup> require using the work of a specialist to obtain appropriate evidential matter.

<sup>3A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXVIII. AI 18 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 In describing the nature, timing, and extent of the tests applied, the service auditor also should indicate whether the items tested represent a sample or all of the items in the population, but need not indicate the size of the population. In describing the results of the tests, the service auditor should include exceptions and other information that in the service auditor's judgment<sup>1A</sup> could be relevant to user auditors. Such exceptions and other information should be included for each control objective, whether or not the service auditor concludes that the control objective has been achieved. When exceptions that could be relevant to user auditors are noted, the description also should include the following information:

<sup>1A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XXXIX. AI 23 is amended by adding footnote 1C to paragraph .06 to read as follows:

.06 Thus, the auditor would examine the outside firm's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis and apply appropriate tests to the intervening transactions. The independent auditor ordinarily may reduce the extent of the work on the physical count of inventory because of the work of an outside inventory firm, but any restriction on the auditor's judgment<sup>1C</sup> concerning the extent of his or her contact with the inventory would be a scope restriction.

<sup>1C</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XL. AI 24 is amended by adding footnote 12 and revising paragraph .61 to read as follows:

.61 *Interpretation*—Financial statements prepared on a statutory basis are financial statements prepared on a comprehensive basis of accounting other than GAAP according to AS 3305.04. AS 3305.09 states that "When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other

comprehensive basis of accounting as those applied to financial statements prepared in conformity with generally accepted accounting principles. Therefore, the auditor's opinion should be based on his or her judgment<sup>12</sup> regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in paragraphs .30A-.31 of AS 2810, *Evaluating Audit Results*.

<sup>12</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLI. Attestation Standard No. 1 is amended by revising paragraph 6 to read as follows:

6. An auditor who performs an examination engagement pursuant to this standard must:

a. Have competence in attestation engagements;<sup>10A</sup>

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d. Exercise due professional care, including the application of professional skepticism,<sup>11/</sup> in planning and performing the examination and the preparation of the report.

Note: Due professional care imposes a responsibility on each engagement team<sup>11A/</sup> member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>11B/</sup> exercised by those assisting in the engagement, including preparing the report. Due professional care concerns what the auditor does and how well the auditor does it. Due

professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>11C/</sup>

<sup>10A/</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

<sup>11/</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. See paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>11A/</sup> The term "engagement team," as used in this standard for examination engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

<sup>11B/</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as "professional judgment" as described in AS 1000.

<sup>11C/</sup> The term "applicable professional and legal requirements," as used in this standard, has the same meaning as defined in Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

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XLII. Attestation Standard No. 2 is amended by revising paragraph 5 to read as follows:

5. An auditor who performs a review engagement must:

a. Have competence in attestation engagements;<sup>7A/</sup>

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d. Exercise due professional care, including the application of professional skepticism,<sup>8/</sup> in planning and performing the review and preparation of the report.

Note: Due professional care imposes a responsibility on each engagement team<sup>8A/</sup> member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>8B/</sup> exercised by those assisting in the engagement, including preparing the report. Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>8C/</sup>

<sup>7A/</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

<sup>8/</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. See paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>8A/</sup> The term "engagement team," as used in this standard for review engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

<sup>8B/</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as "professional judgment" as described in AS 1000.

<sup>8C/</sup> The term "applicable professional and legal requirements," as used in this standard, has the same meaning as defined in of Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. *See, e.g.*, Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

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XLIII. AT 101 is amended by revising paragraphs .19 to read as follows:

.19 The first general standard is—The engagement shall be performed by a practitioner having competence in the attest function.<sup>fn 6</sup>

<sup>fn 6</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

XLIV. AT Section 101 is amended by revising paragraph .40 and adding footnote 7A and footnote 7B to read as follows:

.40 Due professional care concerns what the practitioner does and how well the practitioner does it. Due professional care means acting with reasonable care and diligence;



exercising professional skepticism;<sup>fn 7A</sup> acting with integrity; and complying with applicable professional and legal requirements.<sup>fn 7B</sup> The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report.

<sup>fn 7A</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. *See* paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>fn 7B</sup> The term "applicable professional and legal requirements," as used in this standard, has the same meaning as defined in Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. *See, e.g.*, Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

XLV. AT Section 101 is amended by deleting paragraph .41 and footnote 8:

[.41] [Paragraph deleted.]

<sup>fn 8</sup> [Footnote deleted.]

XLVI. AT Section 301 is amended by adding footnote 30 to paragraph .66 to read as follows:

.66 If, after discussing the matter as described in paragraph .65, the practitioner concludes that a material misstatement of fact remains, the action he or she takes will depend on his or her judgment<sup>fn 30</sup> in the particular circumstances. The practitioner should consider steps

such as notifying the responsible party in writing of his or her views concerning the information and consulting his or her legal counsel about further appropriate action in the circumstances.

<sup>fn 30</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLVII.AT Section 601 is amended by adding footnote 8A to paragraph .31 to read as follows:

.31 In an engagement to examine compliance with specified requirements, the practitioner seeks to obtain reasonable assurance that the entity complied, in all material respects, based on the specified criteria. This includes designing the examination to detect both intentional and unintentional material noncompliance. Absolute assurance is not attainable because of factors such as the need for judgment,<sup>fn 8A</sup> the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between personnel of the entity and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the practitioner.

<sup>fn 8A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLVIII. AT Section 701 is amended by adding footnote 17A to paragraph .29 to read as follows:

.29 In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment<sup>fn 17A</sup> regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence (a) failure to obtain reasonable assurance; (b) inadequate planning, performance, or judgment on the part of the practitioner; (c) the absence of due professional care; or (d) a failure to comply with this section.

<sup>fn 17A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-XXXXX; File No. PCAOB-2024-01)

[Date]

**Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on General Responsibilities of the Auditor in Conducting an Audit and Amendments to PCAOB Standards**

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley," or the "Act"), notice is hereby given that on [Date of Form 19b-4 Submission], the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or the "SEC") the proposed rules described in items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

**I. Board's Statement of the Terms of Substance of the Proposed Rules**

On May 13, 2024, the Board adopted *General Responsibilities of the Auditor in Conducting an Audit and Amendments to PCAOB Standards* ("proposed rules"). The text of the proposed rules appears in Exhibit A to the SEC Filing Form 19b-4 and is available on the Board's website at <https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-049-responsibilities-auditor-conducting-audit>, and at the Commission's Public Reference Room.

**II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules**

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Act, for application to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"). The Board's request is set forth in section D.

A. *Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules*

(a) Purpose

The Board adopted a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* ("new standard," "final standard," or "AS 1000"). The new standard replaces a group of standards originally developed by the American Institute of Certified Public Accountants ("AICPA") and adopted on an interim basis by the PCAOB in 2003. That group of standards established the general principles and responsibilities of the auditor when conducting an audit ("foundational standards"). The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. These principles and related responsibilities provide a foundation for the proper performance of the audit.

Through this standard-setting project, the Board has reaffirmed the general principles and responsibilities of the auditor so that the foundation underlying the standards continues to be sound and appropriate for performing high-quality audits.

These principles and responsibilities, enhanced and consolidated into a single auditing standard, together with related amendments, will modernize the auditing standards to better address fundamental aspects of the audit and provide auditors with better direction to protect investors and further the public interest in the preparation of informative, accurate, and independent auditor's reports.

AS 1000 will replace four standards that set forth the general principles and responsibilities of the auditor: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*. AS 1000 combines and updates the general principles and responsibilities of these standards to reflect developments in the auditing environment.

The Board also amended certain other standards that address responsibilities fundamental to the conduct of an audit. These amendments clarify the engagement partner's responsibility to exercise due professional care related to supervision and review of the audit, accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarify the auditor's responsibility to evaluate whether the financial statements are "presented fairly." Finally, the Board adopted additional amendments to conform to these changes.

After carefully considering the comments the Board received, the Board adopted the amendments substantially as proposed, with revisions that reflect the input of commenters.

Since the PCAOB's adoption of the foundational standards in 2003, the auditing environment has evolved, including:

- Changes to auditing requirements through Board-issued standards;
- New or revised independence requirements issued by the Board; and
- Advancements in technology that are increasing the availability of electronic audit tools and use of audit software.

The new standard and related amendments the Board adopted will modernize PCAOB standards to:

- Reflect changes in the auditing environment;
- Eliminate outdated and inconsistent language; and
- Achieve consistency with Board-issued standards.

AS 1000 and the related amendments modernize, clarify, and streamline the general principles and responsibilities of the auditor and provide a more logical presentation, which should enhance the useability of the standards by making them easier to read, understand, and apply.

The Board clarified the auditor's responsibility to evaluate whether the financial statements are "presented fairly." The Board also clarified the engagement partner's due professional care responsibilities by adding specificity to certain audit performance principles set out in the standards. Finally, the accelerated documentation completion date reflects changes in the auditing environment, including advancements in technology that have enabled auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment. The new documentation completion date reduces the window of opportunity for improper alteration of audit documentation and

also enables the Board to potentially begin the inspection process sooner after completion of an audit, which the Board believes can enhance the Board's efforts to improve audit quality and promote investor protection, ultimately enhancing investor confidence.

The new standard and related amendments will apply to all audits conducted under PCAOB standards.

*See* Exhibit 3 for additional discussion of the purpose of this project.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

*B. Board's Statement on Burden on Competition*

Not applicable. The Board's consideration of the economic impacts of the proposed rules is discussed in section D below.

*C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others*

The Board initially released the proposed rules for public comment in PCAOB Release No. 2023-001 (Mar. 28, 2023). The Board received 28 written comment letters that were specifically submitted in response to its initial proposed rules in PCAOB Release No. 2023-001. In addition, the Board received six comment letters relating to its consideration of proposed amendments on quality control, which were released for public comment on November 19, 2022, and that are relevant to the definition of "applicable professional and legal requirements" in these proposed rules. *See* Exhibits 2(a)(B) and 2(a)(C). The Board has carefully considered all comments received. The Board's response to the comments it received, and the changes made to the rules in response to the comments received are discussed below.

**BACKGROUND**



In April 2003, the Board adopted, on an interim basis, the generally accepted auditing standards of the AICPA's Auditing Standards Board ("interim standards") and the related auditing interpretations as they existed then.<sup>1</sup> At that time, the Board stated that it would determine whether the interim standards "should become permanent standards of the Board, should be repealed, or should be modified."<sup>2</sup> Since then, the Board has adopted a number of new auditing standards that supersede or amend portions of the interim standards and related auditing interpretations.<sup>3</sup> However, certain remaining interim standards, including those that address the general principles and responsibilities of the auditor, have continued to be in effect substantially in the form adopted.

Since the adoption of the interim standards, the auditing environment has evolved in many ways, including (i) changes to auditing requirements through Board-issued standards; (ii) new or revised independence requirements issued by the Board;<sup>4</sup> and (iii) advancements in technology that are increasing the availability of electronic audit tools and the use of audit software. While these developments have generally been reflected through amendments to some interim standards and related interpretations in connection with the Board's standard-setting initiatives, the 2022-2026 Strategic Plan reinforced the Board's intent "to modernize and streamline [the Board's] existing

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<sup>1</sup> See *Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). The auditing interpretations were the publications entitled "Auditing Interpretations" issued by the AICPA Auditing Standards Board, as they existed and were effective as of April 2003.

<sup>2</sup> See PCAOB Rel. No. 2003-006.

<sup>3</sup> See, e.g., AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 2101, *Audit Planning*; AS 2810, *Evaluating Audit Results*, and AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

<sup>4</sup> See generally Section 3 of PCAOB rules, *Auditing and Related Professional Practice Standards*, Part 5, *Ethics and Independence*.

standards and to issue new standards where necessary to meet today's needs" as part of the PCAOB's investor protection mission.<sup>5</sup>

In connection with these initiatives,<sup>6</sup> the Board analyzed the interim foundational standards that address the general principles and responsibilities of the auditor in conducting an audit. These foundational standards are:

- AS 1001, *Responsibilities and Functions of the Independent Auditor*;
- AS 1005, *Independence*;
- AS 1010, *Training and Proficiency of the Independent Auditor*; and
- AS 1015, *Due Professional Care in the Performance of Work*.<sup>7</sup>

The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. Through this rulemaking, the Board is reaffirming and modernizing the general principles and responsibilities of the auditor to ensure that the foundation continues to be sound and appropriate for performing high-quality audits.

## **Rulemaking History**

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<sup>5</sup> See PCAOB, *Strategic Plan 2022-2026*, at 10, available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a\\_4/](https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a_4/).

<sup>6</sup> See PCAOB's interim standards project, available at <https://pcaobus.org/oversight/standards/standard-setting-research-projects/interim-standards>.

<sup>7</sup> When adopted by the Board in 2003, this group of interim standards was designated as AU sec. 110, AU sec. 220, AU sec. 210, and AU sec. 230. In 2015, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, and these interim standards were designated as AS 1001, AS 1005, AS 1010, and AS 1015, respectively. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015). The reorganization did not impose additional requirements on auditors or change substantively the requirements of PCAOB standards.

In March 2023, the Board proposed a new, single standard to replace the foundational standards that address the general principles and responsibilities of the auditor in conducting an audit ("proposed standard").<sup>8</sup> The proposal also included key amendments to other PCAOB standards that address matters that are fundamental to the conduct of an audit. These proposed amendments clarified the engagement partner's responsibility to exercise due professional care related to supervision and review of the audit, accelerated the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarified the auditor's responsibility to evaluate whether the financial statements are "presented fairly."

The Board received 28 comment letters on the proposal.<sup>9</sup> Commenters included investor-related groups, firms, firm-related groups, academics, and others. The Board considered all comments in developing the final standard and amendments, and specific comments are discussed in the analysis that follows.

### **Overview of Existing Requirements**

This section discusses key provisions of the existing standards.

Key provisions of AS 1001, *Responsibilities and Functions of the Independent Auditor*, include:

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<sup>8</sup> Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, PCAOB Rel. No. 2023-001 (Mar. 28, 2023) ("proposal" or "proposing release").

<sup>9</sup> The comment letters received on the proposal are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-049-responsibilities-auditor-conducting-audit/comment-letters>).

- The objective of an audit of financial statements is to express an opinion on the fairness of the financial statements in presenting, in all material respects, the financial position, results of operations, and cash flows in accordance with generally accepted accounting principles ("GAAP"). The auditor also disclaims an opinion if circumstances require. (AS 1001.01)
- The responsibilities of the auditor and management are that (i) the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud; and (ii) management is responsible for the financial statements, including adopting accounting policies and establishing and maintaining internal control to initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions in the financial statements. (AS 1001.02-.03)
- The auditor is to possess professional qualifications and exercise professional judgment in determining which auditing procedures are necessary in the circumstances to gain a reasonable basis for the opinion. (AS 1001.04-.05)
- The auditor should be aware of and consider auditing interpretations applicable to the audit and, if the guidance in the interpretations is not followed, be prepared to explain how the auditor complied with the provisions of the auditing standard addressed by the guidance. (AS 1001.11)

Key provisions of AS 1005, *Independence*, require that the auditor:

- Maintain independence in mental attitude and be intellectually honest, impartial, and without bias with respect to the client (i.e., be independent in fact). (AS 1005.01-.03)
- Be free from any obligation to or interest in the client, its management, or its owners, so that the general public maintains confidence in the independence of auditors. (AS 1005.03)
- Not only be independent in fact, but also avoid situations that may lead outsiders to doubt the auditor's independence. (AS 1005.03)

Key provisions of AS 1010, *Training and Proficiency of the Independent Auditor*, require that:

- The audit be performed by persons having adequate technical training, proficiency, and experience as an auditor. (AS 1010.01-.02)
- The training of the auditor be adequate to meet the requirements of the profession, be adequate in technical scope, and include general education. (AS 1010.01-.03)
- New audit professionals obtain professional experience through proper supervision and review of their work by those who are more experienced, with the nature and extent of supervision reflecting variances in practice. (AS 1010.03)
- The engagement partner exercise seasoned judgment in the varying degrees of supervision and review of work performed and judgments exercised by subordinates, and subordinates meet the responsibilities of their work. (AS 1010.03)

- The auditor continue professional training to become aware of developments in business and the profession, and study, understand, and apply new pronouncements on accounting and auditing. (AS 1010.04)

Key provisions of AS 1015, *Due Professional Care in the Performance of Work*, require that:

- The auditor exercise due professional care in the planning and performance of the audit and the preparation of the report, including observance of the auditing standards by professionals within the auditor's organization. (AS 1015.01-.02)
- The auditor possess "the degree of skill commonly possessed" by other auditors and exercise it with "reasonable care and diligence" (i.e., due professional care) in the planning and performance of the audit and the preparation of the report. (AS 1015.01 and .05)
- The engagement team be assigned to tasks and be supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining. (AS 1015.06)
- The engagement partner know, at a minimum, the relevant professional accounting and auditing standards, be knowledgeable of the audit client, and be responsible for the assignment of tasks to, and supervision of, the members of the engagement team. (AS 1015.06)
- The auditor exercise professional skepticism throughout the audit, with a questioning mind and a critical assessment of audit evidence, to diligently gather and objectively evaluate audit evidence, and consider the competency

and sufficiency of the evidence, and not be satisfied with less than persuasive evidence because of a belief that management is honest. (AS 1015.07-.09)

- The auditor obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Reasonable assurance is "a high level of assurance" but is not absolute assurance because of the nature of audit evidence and the characteristics of fraud. (AS 1015.10)

Key provisions of other standards relevant to this rulemaking include:

- AS 1201.04-.05 and AS 2101.03, which describe the engagement partner's responsibilities for supervision and review of audit documentation.
- AS 1215.06, which requires the auditor to document procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.
- AS 1215.15, which requires the auditor to complete the necessary auditing procedures and assemble for retention a complete and final set of audit documentation within 45 days after the report release date.
- AS 2810.30, which requires the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.
- AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles,"* which explains the meaning of "present fairly" as used in the phrase "present fairly ... in conformity with generally

accepted accounting principles," and the basis for the auditor's opinion on whether the financial statements present fairly an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

### **Reasons to Improve Auditing Standards**

The new standard and related amendments are intended to modernize, clarify, and streamline the general principles and responsibilities of the auditor described in the foundational standards. The Board identified several areas discussed below that the Board believes will enhance the useability of the requirements by making them easier to read, understand, and apply.

#### **1. Alignment with Board-issued Standards and Rules**

Since the adoption of the foundational standards, the Board has issued a number of new auditing standards and amendments. Certain of these standards address other principles and responsibilities that are fundamental to the conduct of an audit, including the engagement partner's supervisory and review responsibilities and general requirements for audit documentation. Expressly incorporating these specific principles and responsibilities for conducting an audit in the new standard and related amendments should provide the auditor with more complete direction on matters that are central to the auditor's work.

Certain descriptions of requirements in the foundational standards do not align with the language used in Board-issued standards. For example, some provisions in the foundational standards refer to GAAP;<sup>10</sup> however, in recognition of the SEC's acceptance

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<sup>10</sup> See, e.g., AS 1001.01 and .03.



of filings that include financial statements prepared under accounting frameworks other than U.S. GAAP, such as International Financial Reporting Standards ("IFRS"), Board-issued standards are written as framework neutral and refer instead to the applicable financial reporting framework.<sup>11</sup> As another example, in describing professional skepticism, AS 1015 refers to the competency and sufficiency of the audit evidence rather than using terminology consistent with the Board-issued AS 1105, *Audit Evidence*, which refers to audit evidence as sufficient and appropriate. The Board believes that aligning the descriptions of the general principles and responsibilities in the new standard with language used in Board-issued standards will minimize potential confusion.

The foundational standards were originally written for audits of financial statements, but certain general principles and responsibilities described in the standards (e.g., reasonable assurance, due professional care, and professional skepticism) apply equally to audits of internal control over financial reporting ("ICFR"). None of the foundational standards mention audits of ICFR or refer to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. While AS 2201 refers to the foundational standards for the requirements related to technical training and proficiency as an auditor, independence, and the exercise of due professional care, including professional skepticism,<sup>12</sup> the Board believes it is

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<sup>11</sup> See paragraph .01, footnote 1 of AS 2410, *Related Parties* ("The auditor should look to the requirements of the U.S. Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company ..."); *Auditing Standard No. 18 – Related Parties Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Amendments to PCAOB Auditing Standards*, PCAOB Rel. No. 2014-002 (June 10, 2014), at A4-6 (describing the approach of AS 2410.01, footnote 1 as "framework neutral").

<sup>12</sup> See AS 2201.04.

important to clarify in the new standard that the general principles and responsibilities apply to an audit of ICFR as well as an audit of financial statements.

The application of the general principles and responsibilities should be improved by conforming the presentation of the related requirements to the structure used in Board-issued standards. This includes specifying an introduction and objectives to the new standard. In addition, the responsibilities from the foundational standards should be clarified by expressing the related requirements using terms described in PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* (e.g., using "must" and "should" to describe the degree of responsibility that the standards impose on auditors). Much of the explanatory material from the foundational standards that continues to be relevant has been relocated to the discussion in this release, which should facilitate the auditor's navigation of the relevant requirements and align with the approach taken in Board-issued standards.

## **2. New or Revised Independence Requirements Issued by the PCAOB and the SEC**

Since the adoption of AS 1005 in 2003, the PCAOB has issued independence rules that have imposed certain incremental independence requirements on firms, relative to the SEC rules<sup>13</sup> (e.g., provisions related to tax services for persons in financial reporting oversight roles at issuer audit clients).<sup>14</sup> These incremental independence requirements are not expressly addressed in AS 1005, but nevertheless the auditor is

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<sup>13</sup> See generally PCAOB rules under Section 3. Auditing and Related Professional Practice Standards, Part 5 – Ethics and Independence.

<sup>14</sup> See PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*.

required to comply with them. Further, while AS 1005 includes a general reference to the SEC's requirements for auditor independence, there is no reference to the specific requirements. The Board believes it is helpful to refer explicitly in the new standard to the requirements that govern auditor independence, including independence requirements set out by the federal securities laws and related rules, which include an overarching provision for the auditor to maintain independence from its client in fact and in appearance.<sup>15</sup>

### **3. Advancements in Technology Increasing the Availability of Electronic Audit Tools and Use of Audit Software**

Since the foundational standards were adopted by the PCAOB, advancements in technology have increased the availability of electronic audit tools and use of audit software. Auditors have largely moved away from a paper-based approach to audit documentation in favor of using software that houses electronic workpapers and audit programs. Use of electronic workpapers facilitates more efficient performance and review of audit procedures and enables auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment.

Auditors are also expanding their use of and reliance on electronic audit tools. For example, some firms have made significant investments in internally developed tools for use in the audit. In addition, some "off-the-shelf" applications such as data analysis software have become available to auditors. These advancements have changed the way that many auditors perform and document their audit procedures and retain related audit

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<sup>15</sup> See Section 10A(g) of the Securities Exchange Act of 1934 ("the Exchange Act"), 15 U.S.C. § 78j-1(g);, 17 CFR § 210.2-01 (Regulation S-X Rule 2-01).

documentation. Accordingly, the new standard and amendments reflect an accelerated documentation completion date and related documentation requirements.

#### **4. Outdated and Inconsistent Language**

The foundational standards include outdated and inconsistent language that is not relevant to audits conducted under the standards of the PCAOB. For example, paragraph .03 of AS 1001 provides that the auditor may draft the financial statements in whole or in part based on information from management during performance of the audit. This provision is outdated and should not be included in PCAOB auditing standards because an auditor drafting the financial statements would violate the applicable independence rules.<sup>16</sup> Eliminating outdated language used in the foundational standards should remove inconsistencies between PCAOB auditing standards and the relevant rules of the PCAOB and the SEC. Similarly, in describing the objective of the audit, paragraph .01 of AS 1001 refers to financial position, results of operations, and cash flows. This language could be unnecessarily limiting because the objective of the audit does not change based on the subject matter of the audit (e.g., whether it is an audit of ICFR or the financial statements). The new standard excludes references that are outdated or inconsistent, which the Board believes improves the application of the requirements and provides clearer direction to auditors in executing their responsibilities.

#### **5. Activities of Other Standard Setters**

Since the Board's adoption of the foundational standards, both the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the AICPA have updated their analogous standards:

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<sup>16</sup> See 17 CFR § 210.2-01(c)(4)(i) (Regulation S-X Rule 2-01(c)(4)(i)).

- IAASB Standard – International Standard on Auditing 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* ("ISA 200") (effective 2009); and
- ASB Standard – AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* ("AU-C 200") (effective 2012).

These revisions were part of clarity projects that were designed to make the standards easier to read, understand, and apply.<sup>17</sup> These standards were updated to align the terminology used throughout the standards for consistency and to enhance and update explanatory materials.

## **6. Comments on Reasons for Standard Setting and Proposed Approach**

The proposal sought comment on the appropriateness of the general principles and responsibilities of the auditor and the approach to reorganize and consolidate those responsibilities. Commenters who responded generally agreed that the general principles and responsibilities (i.e., reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment) described in the proposal are appropriate. One commenter suggested that the Board address the relevance and reliability of audit evidence and information in conjunction with the requirements in AS 1105, as part of the general principles and responsibilities. Some commenters

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<sup>17</sup> Descriptions of the clarity projects of the IAASB and ASB are available, respectively, at <https://www.iaasb.org/projects/clarity-iaasb-standards> and <https://us.aicpa.org/interestareas/frc/auditattest/improvingclarityasbstandards>.

addressed the reorganization and consolidation of the four existing foundational standards into one new standard and generally supported the proposed approach.

Commenters were generally supportive of the Board's efforts to modernize and streamline the general principles and responsibilities of the auditor. Several commenters, for example, agreed that the proposed standard would provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand, and apply. Some commenters, including investor-related groups, also expressed support for the proposal's focus on investor protection.

Two commenters suggested consideration of analogous standards of the IAASB and the ASB. One commenter stated that PCAOB auditing standards should not diverge from AICPA auditing standards, to the extent appropriate. Another commenter recommended that the Board consider similar standards of the IAASB and the ASB and assess whether their approach could result in higher quality audits.

The proposal also sought comment on the appropriateness of the general principles and responsibilities of the auditor in light of the availability of electronic audit tools and the use of audit software by both larger and smaller firms. Most commenters did not address this question. One commenter agreed that the proposed general principles and responsibilities of the auditor are appropriate and clear because they are necessary to the audit regardless of electronic tools and audit software. Another commenter recommended considering future possibilities and uses of machine learning and artificial intelligence ("AI") technologies, which in the views of the commenter "are progressing rapidly."

The final standard retains the general principles and responsibilities of the auditor described in the proposal, subject to revisions described below. The final standard also retains the overall approach of consolidating the foundational standards and the general principles and responsibilities of the auditor under one standard. The Board did not add specific requirements for evaluating the relevance and reliability of audit evidence, as suggested by one commenter, because AS 1105 provides the necessary framework for this evaluation. The final standard includes general requirements for conducting an audit, and obtaining sufficient appropriate audit evidence is part of those general requirements.

In addition, in the final standard the Board did not add provisions specific to the current and future use of emerging technologies. Due to the ever-evolving nature of technology, specifying requirements for certain types of technology based on how those tools are used today could quickly make the standard become outdated. Further, the general principles and responsibilities addressed in the standard apply to all audits, irrespective of the technology that may be used in performing audit procedures. The Board continues to address emerging technologies (e.g., machine learning and AI) as part of the staff's ongoing Data and Technology research project.<sup>18</sup> Research from this project may give rise to individual standard-setting projects and may also inform the scope or nature of other projects that are included on the Board's standard-setting agenda.

With respect to comments on analogous standards issued by other standard setters, the Board believes that AS 1000 is based on general principles and responsibilities of the auditor, similar to the bases of analogous IAASB and AICPA

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<sup>18</sup> See the PCAOB's agenda related to standard setting, research, and rulemaking projects, available at <https://pcaobus.org/oversight/standards/standard-setting-research-projects>.

standards. The Board carefully considered the approaches of other standard setters when developing the proposal, and the new standard and amendments being adopted reflect the approach that the Board believes best protects investors and furthers the public interest. As a result, certain differences exist between the Board's new standard and those of other standard setters, including a number of provisions that the Board believes are appropriate and consistent with the Board's statutory mandate to protect the interests of investors and further the public interest.

## **DISCUSSION OF FINAL RULES**

### **A. Overview of Final Rules**

The Board replaced AS 1001, AS 1005, AS 1010, and AS 1015 with one standard, AS 1000, that describes the general principles and responsibilities of an auditor<sup>19</sup> in conducting an audit in accordance with the standards of the PCAOB. Briefly, the new standard:

- Includes introductory language that reaffirms the auditor's fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports;
- Includes objectives for the auditor to conduct and communicate the results of both an audit of a company's financial statements and an audit of a company's ICFR and satisfy and fulfill other general principles and responsibilities described in this standard;

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<sup>19</sup> The term "auditor" includes both a public accounting firm registered with the PCAOB and associated persons thereof, as defined in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*. For example, engagement quality reviewers ("EQRs"), by virtue of their status as associated persons, are within the term "auditor" in AS 1000. *See also* paragraph .03 of AS 1220, *Engagement Quality Review*.



- Retains and clarifies the general principles and responsibilities that are important for an audit, including reasonable assurance, due professional care, professional skepticism, and professional judgment;
- Aligns the engagement partner's supervisory responsibilities under AS 1201 with due professional care;
- Retains the requirement for the auditor to be independent but expresses the obligation more directly by referring to the PCAOB's independence criteria in its rules and standards, and the independence criteria set out in the rules and regulations of the SEC;
- Describes the auditor's obligations to (i) comply with ethics requirements, (ii) obtain and maintain competence, and (iii) prepare audit documentation;
- Expresses the auditor's responsibilities by using the terms set forth in PCAOB Rule 3101 (e.g., must and should) that describe the degree of responsibility that PCAOB standards impose on auditors; and
- Removes language that is outdated, inconsistent, and not relevant to audits conducted under the standards of the PCAOB.

As previously noted, the Board amended other PCAOB auditing standards that address responsibilities fundamental to the conduct of an audit to:

- Clarify the engagement partner's existing responsibilities for supervision and review in AS 1201, AS 1215, and AS 2101 to provide more specificity about the engagement partner's responsibility to exercise due professional care related to supervisory and review activities required to be performed under existing auditor requirements;

- Clarify the requirements for audit documentation in AS 1215 to identify who performed the work, who reviewed the work, and the date of such review;
- Accelerate the period in AS 1215 to assemble a complete and final set of audit documentation for retention from 45 days to 14 days; and
- Update and incorporate the underlying requirements of AS 2815 into AS 2810, and rescind AS 2815, while preserving the meaning of "present fairly" and streamlining the requirements to provide a more logical presentation.

In a separate release, the Board is also adopting a new quality control standard, QC 1000, *A Firm's System of Quality Control*, and a new ethics standard, EI 1000, *Integrity and Objectivity*, together with other amendments to PCAOB standards, rules, and forms.<sup>20</sup> This release includes references to QC 1000 and EI 1000, where appropriate.

## **B. AS 1000**

### **1. Introduction**

*See paragraphs .01 through .02 of the new standard.*

The first paragraph of the proposed standard, under the heading "Introduction," described the fundamental obligation of auditors to protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports. It noted that an audit primarily benefits investors who rely on the audit to provide objective and independent opinions on whether the company's financial statements are presented fairly and, if applicable, on the effectiveness of the company's ICFR. The proposed paragraph further provided that a properly conducted audit and related auditor's report

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<sup>20</sup> See *A Firm's System of Quality Control and Other Amendments to PCAOB Standard, Rules, and Forms*, PCAOB Rel. No. 2024-005 (May 13, 2024).

enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, ICFR. The existing foundational standards do not include an introduction and do not describe the auditor's fundamental responsibility to protect investors.

Investor-related groups strongly supported the proposed standard's emphasis on the auditor's obligation to protect investors. These commenters suggested some clarification in the language describing the auditor's obligation for, and role in, protecting investors, as described in the Supreme Court opinion in *United States v. Arthur Young & Co.*<sup>21</sup> Some pointed to, for example, language stating that the auditor "assumes a *public* responsibility transcending any employment relationship with the client" and that the auditor "owes ultimate allegiance to the corporation's creditors and stockholders, as well as the investing public."<sup>22</sup> One of these commenters stated that without additional clarification, the phrase "fundamental obligation" is a vague concept and open to interpretation. Two commenters recommended including in AS 1000 a footnote from the proposal that cites the *Arthur Young* opinion.

Two commenters, including an investor-related group, recommended that the standard's reference to investors be broadened to include shareholders, debtholders, and other financial statement users who rely on a company's financial statements, consistent with the usage by Financial Accounting Standards Board ("FASB") and the Supreme Court in the *Arthur Young* opinion. One of these commenters recommended including a definition of "financial statement users" in the final standard. Another recommended

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<sup>21</sup> *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984).

<sup>22</sup> *Id.* at 817 (emphasis in original).

adding a footnote to the first sentence of paragraph .01 defining and describing the meaning of "investors."

A number of other commenters, primarily firms, expressed concerns that the introduction language describing the auditor's role was unclear and could be misleading. For example, several commenters noted that the description of the auditor's role in protecting investors could be viewed as creating a new legal obligation owed to investors. In the view of one commenter, the proposed language implied that investor protection is the sole responsibility of the auditor and could give investors false confidence that they can solely rely on an auditor's report as investment advice, when in fact there are many other factors investors should consider. Another commenter asserted that the proposed language could create a misimpression that auditors are permitted and expected to deviate from auditing standards when they believe such a departure would be warranted to further investors' interests. These commenters suggested that the Board clarify the introduction language in the final standard. Some commenters provided alternative language for the Board's consideration. For example, two commenters suggested replacing the phrase "properly conducted" in the last sentence of paragraph .01 with "conducted in accordance with the standards of the PCAOB" to align with language used in the auditor's report. One commenter suggested deleting paragraph .01 entirely.

After considering the comments received, the Board retained the proposed approach to the introduction section, while making certain revisions in light of the comments received.

The Board revised the first sentence of the introduction to state that the auditor has a fundamental obligation to protect investors through the preparation and issuance of

informative, accurate, and independent auditor's reports. The Board also removed a redundant statement from proposed paragraph .01 ("and that obligation governs the auditor's work under the standards of the PCAOB"). This statement is unnecessary because paragraph .02 already clarifies that AS 1000 describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the PCAOB. This includes the fundamental obligation to protect investors as described in paragraph .01.

The fundamental obligation to protect investors is interwoven in the general principles and responsibilities that guide auditors throughout their work. Under current law, the auditor plays a critical role in the financial reporting process. By issuing opinions concerning whether financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, auditors serve a special "public watchdog" function under the existing federal securities laws, requiring "complete fidelity to the public trust."<sup>23</sup> As "gatekeepers," auditors have a public responsibility to serve the public interest.<sup>24</sup> Investors rely on auditors to promote companies' adherence to federal securities law mandates and companies' disclosure of accurate and reliable financial information.<sup>25</sup> "Investor confidence is bolstered by the knowledge that public financial statements have been subjected to the rigors of

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<sup>23</sup> *Arthur Young*, 465 U.S. at 817-18.

<sup>24</sup> *In the Matter of KPMG Peat Marwick LLP*, SEC Rel. No. 34-43862, at 14 & n.54 (Jan. 19, 2001); see John C. Coffee Jr., *Gatekeepers: The Professions and Corporate Governance* 2-3 (2006) (describing "gatekeepers" as "repeat players who provide certification or verification services to investors, vouching for someone else who has a greater incentive than they to deceive").

<sup>25</sup> *In the Matter of the Application of S.W. Hatfield, C.P.A.*, SEC Rel. No. 34-69930, at 33 (July 3, 2013) (reviewing PCAOB disciplinary action).

independent and objective investigation and analysis" by an auditor.<sup>26</sup> This enhanced confidence of investors and other financial statement users in the company's financial statements and ICFR also plays an integral role in maintaining the public trust in the capital markets. The introduction in the final standard underscores the auditor's obligation under the Board's auditing standards and other applicable laws and regulations.

The Board emphasized – in response to commenters who expressed concern that the introductory language, and specifically its use of the term "obligation," could be interpreted to establish a new legal duty – that the introductory language does not alter any existing regulatory or legal requirements or obligations between auditors and investors. It does not establish a novel duty or new form of legal obligation. Rather, it reaffirms the auditor's obligation under the existing legal framework and the important role of the auditing profession in the capital markets.<sup>27</sup>

Paragraph .01 of the final standard has also been revised, as suggested by some commenters, to state that the auditor's responsibility<sup>28</sup> transcends the auditor's relationship with management and the audit committee of the company under audit, providing the foundation for an objective and independent audit. This statement expresses a longstanding principle of public accounting.<sup>29</sup> Paragraph .01 also states that a properly

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<sup>26</sup> *McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005); *see Arthur Young*, 465 U.S. at 819 n.15.

<sup>27</sup> *See* Section 101(c)(6) of Sarbanes-Oxley (authorizing PCAOB to enforce compliance with the "Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the *obligations* and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof ....") (emphasis added).

<sup>28</sup> The terms "obligation" and "responsibility" are used synonymously in this standard.

<sup>29</sup> *See Arthur Young*, 465 U.S. at 817-818 ("By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public.") (emphasis in original); AICPA Professional Standards, Vol. 2, Code of Professional Conduct, ET

conducted audit and the related auditor's report enhance the confidence of investors and other financial statement users in the company's financial statements and, if applicable, ICFR. The Board retained the phrase "properly conducted audit" to align with the description in paragraph .02. The Board removed the sentence that states that "An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company's financial statements are presented fairly and, if applicable, on the effectiveness of the company's internal control over financial reporting" because it is redundant and unnecessary in the context of the surrounding statements. The Board does not believe that the language in paragraph .01 suggests that auditors may deviate from PCAOB auditing standards to protect investors. In fact, the language clearly establishes the fundamental duty of auditors to prepare and issue their reports in accordance with PCAOB standards. Similarly, the Board does not interpret the language of paragraph .01 as suggesting that investors should view auditor's reports as the sole source of investment advice. Collectively, these provisions emphasize that auditors play a critical role in ensuring the accuracy and transparency of a company's financial information, and that this role helps investors make well-informed decisions and supports trust in a company's financial statements.

Finally, a new footnote to paragraph .01 clarifies that references to "investors and other financial statement users" in AS 1000 encompass a broad spectrum of stakeholders.

This group includes not only a company's existing and potential shareholders, but also

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Section 53, Article II – The Public Interest (2002) (".01 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce.").

bondholders, lenders, other creditors, and others who use the company's financial statements.<sup>30</sup>

In addition to the revisions to paragraph .01, the Board relocated certain content, discussed in more detail below, from proposed paragraph .15 into a new note to paragraph .01. The note reminds auditors that their obligation to protect investors provides important context to the auditor's work when applying the requirements of AS 1000 and other PCAOB standards and rules (e.g., when conducting interim reviews in accordance with AS 4105, *Reviews of Interim Financial Information*, or when conducting audits of ICFR in accordance with AS 2201).

Paragraph .02 summarizes the scope and content of AS 1000. The Board did not receive comment on this paragraph and adopted it as proposed.

## **2. Objectives of the Auditor**

*See paragraph .03 of the new standard.*

The proposed standard set forth three objectives of the auditor (a) in an audit of financial statements, to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and to issue an auditor's report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; (b) in an audit of internal control over financial reporting, to obtain reasonable assurance about whether material weaknesses exist as of the date

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<sup>30</sup> See FASB, Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 1, *The Objective of General Purpose Financial Reporting* (Dec. 2021) ("The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity").



specified in management's assessment, and to issue an auditor's report that expresses an opinion on the effectiveness of the company's internal control over financial reporting; and (c) to communicate externally, as required by applicable professional and legal requirements. Other than AS 1001,<sup>31</sup> the existing foundational standards do not include an objective.

The proposal defined the term "applicable professional and legal requirements" by referring to the term's definition in proposed QC 1000.<sup>32</sup> That proposed definition included (i) professional standards, as defined in PCAOB Rule 1001(p)(vi); (ii) rules of the PCAOB that are not professional standards; and (iii) to the extent related to the obligations and responsibilities of accountants or auditors or to the conduct of engagements, rules of the SEC, other provisions of U.S. federal securities law, and other applicable statutory, regulatory, and other legal requirements.

Several commenters expressly supported the proposed objectives of the auditor. Some commenters suggested ways to further clarify these objectives. For example, one commenter suggested that the objectives be reframed as objectives of the "audit" rather than of the "auditor." Another commenter suggested moving the requirements on the determination of critical audit matters ("CAMs") from AS 3101.11, to the objectives of the auditor in AS 1000 in order to highlight the importance of CAMs. One commenter recommended that the objective related to the audit of ICFR refer to the relevant criteria used (e.g., criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission) and clarify that it is integrated with the audit of financial statements.

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<sup>31</sup> See AS 1001.01.

<sup>32</sup> See A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

With respect to the communication objective, one commenter stated that the proposed objective should also refer to communications with the company. Another commenter stated that the term "applicable legal and professional requirements" is overly broad and may inadvertently scope in legal requirements outside of public accountancy laws. An additional commenter suggested that AS 1000 refer instead to "PCAOB rules and standards."

The Board adopted the objectives in the final standard substantially as proposed, with the modifications discussed below.

The purpose of the objectives is to provide additional context for understanding the requirements in the standard. Therefore, the Board added the objective to "satisfy and fulfill the other general principles and responsibilities described in this standard." This provides more explicit linkage to the general principles and responsibilities set forth in the final standard.

The objectives refer, as proposed, to the "objectives of the auditor." Because the standard addresses the general principles and responsibilities of the auditor in conducting an audit, the Board believes that the objectives should be directed at the "auditor" rather than the audit as a whole.

The determination of CAMs is an important part of the auditor's reporting responsibilities and is encompassed under the applicable professional and legal requirements. The auditor's responsibilities for determining and communicating CAMs are described in AS 3101 and align with the stated objectives of that standard.<sup>33</sup> Rather

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<sup>33</sup>*See AS 3101.04 and .11-.17.*

than repeating these requirements, the Board instead added a note to paragraph .17 of the final standard that refers to the potential inclusion of CAMs in the auditor's report.

The suggested references to the relevant criteria used in the audit of ICFR are not suitable for the objective section of AS 1000 and are already covered in other PCAOB standards. The specific requirements relevant to performing an audit of ICFR are addressed in AS 2201, which provides the appropriate context for the framework to be used by the auditor when conducting an ICFR audit and integrating the audit of ICFR with an audit of financial statements.

As was proposed, the final standard includes an objective to communicate externally in accordance with applicable legal and professional requirements. The auditor has a responsibility to make certain communications (e.g., communications about audit results to the audit committee under AS 1301, *Communications with Audit Committees*), in addition to reporting externally on the results of the audit. The reference to these requirements in the objective is not intended to limit or preclude appropriate communications with company personnel. For example, PCAOB auditing standards require the auditor to conduct various inquiries of management and other company personnel (e.g., AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2201), which is part of complying with applicable professional and legal requirements.

For ease of reference, the final standard includes the definition of the term "applicable professional and legal requirements" as:

- Professional standards, as defined in PCAOB Rule 1001(p)(vi);
- Rules of the PCAOB that are not professional standards; and

- To the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system, rules of the SEC, other provisions of U.S. federal securities law, ethics laws and regulations, and other applicable statutory, regulatory, and other legal requirements.

This definition is intended to capture all professional and legal requirements specifically related to engagements under PCAOB standards of issuers and SEC-registered broker-dealers, including relevant accounting, auditing, and attestation standards, PCAOB rules, SEC rules and regulations, other provisions of federal securities law, other relevant laws and regulations (e.g., state law and rules governing accountants), applicable ethics law and rules, and other legal requirements related to the obligations and responsibilities of accountants or auditors in the conduct of the firm's engagements or in relation to the quality control system.<sup>34</sup> It does not encompass requirements that apply to businesses generally, such as tax laws, safety regulations, and employment law.

This definition reflects revisions made in response to comments received on proposed QC 1000.<sup>35</sup> The definition was expanded to explicitly mention ethics laws and

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<sup>34</sup> The requirements related to compliance with applicable professional and legal requirements are meant to make clear that, in engagements subject to PCAOB auditing standards, all applicable professional and legal requirements must be followed. The requirement does not suggest that application of "other applicable statutory, regulatory, and other legal requirements" could supersede rules of the SEC, other provisions of U.S. federal securities law, rules of the PCAOB that are not professional standards, or PCAOB professional standards. On the contrary, requirements relating to "applicable professional and legal requirements" are meant to highlight the importance of adhering to other requirements when those requirements do not conflict with or abridge requirements of federal securities laws, PCAOB rules, or PCAOB standards.

<sup>35</sup> Two commenters supported the definition as proposed. One commenter recommended including the profession's ethical standards explicitly. Two commenters stated the phrase "other applicable statutory, regulatory, and other legal requirements" could be read broadly and extend beyond regulations that directly bear on the conduct of audit engagements. Another commenter suggested amending the definition of "professional standards" in PCAOB Rule 1001(p)(vi) to refer to "quality control standards" rather than "quality control policy and procedures."

regulations.<sup>36</sup> It was also refined to make clear that it encompasses statutory, regulatory, and other legal requirements beyond professional standards and other PCAOB rules "[t]o the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system." This change is designed to limit the breadth of the definition to the relevant circumstances. The phrase "quality control policies and procedures," used in PCAOB Rule 1001(p)(vi), is drawn from Section 110(5) of Sarbanes-Oxley, and therefore no amendment to the PCAOB rule was necessary.

### **3. Professional Qualifications of the Auditor**

#### **i. Independence**

*See paragraphs .04 through .05 of the new standard.*

The Board proposed to carry forward the existing requirement in AS 1005 for the auditor to be independent, and to align the language that describes auditor independence obligations with language used in PCAOB Rule 3520, *Auditor Independence*, and SEC Rule 2-01.<sup>37</sup> Specifically, the Board proposed to require the auditor to be independent of its audit client both in fact and in appearance throughout the audit and professional engagement period.<sup>38</sup> The proposed standard also clarified that the auditor is not independent with respect to an audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed

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<sup>36</sup> These include those arising under state law or the law of other jurisdictions (e.g., obligations regarding client confidentiality).

<sup>37</sup> 17 CFR § 210.2-01 (Regulation S-X Rule 2-01).

<sup>38</sup> See PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term "audit and professional engagement period."

within the engagement. This clarification aligned the standard with language used in SEC Rule 2-01(b)<sup>39</sup> to explain further the meaning of being independent both in fact and in appearance. In addition, the Board proposed to require the auditor to satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the SEC under the federal securities laws.

Several commenters expressed support for including in AS 1000 the existing requirements from AS 1005 and stating more directly the auditor's obligation to comply with the independence requirements of the PCAOB and SEC. Two commenters, including an investor-related group, suggested that the Board replace references to "audit client" with "company under audit." One commenter asserted that using "client" does not recognize that the auditor's public responsibility transcends the employment relationship with the client. Another commenter asserted that the use of "client" mischaracterizes the relationship between auditor and the company or its management, and places the auditor in a "subservient" position. In addition, one commenter suggested adding to the final standard additional language from SEC Rule 2-01(b) to indicate that the PCAOB and SEC will consider "all relevant facts and circumstances" in determining independence. That commenter also suggested limiting the use of the term "independent" in the title of the auditor's report to only those auditors that have complied with the SEC and PCAOB rules.

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<sup>39</sup> Under the general standard in SEC Rule 2-01(b), the SEC "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."

After considering the comments received, the Board adopted the requirements related to independence substantially as proposed with some modifications. The Board agrees with the commenters' observation that language used in the Board's standards can help emphasize that audits are performed primarily for the benefit of investors, not management of the company. Accordingly, the Board replaced references to "audit client" with "company under audit" and added a footnote to clarify that the phrase "company under audit" has the same meaning as "audit client" as defined by PCAOB Rule 3501(a)(iv).

The Board did not add to the final standard additional language from SEC Rule 2-01(b) stating that the PCAOB and SEC will consider "all relevant facts and circumstances" in determining independence. The Board's standards do not address the SEC's processes, and need not repeat in this standard that relevant matters are considered in PCAOB independence determinations.<sup>40</sup> The Board also did not add limitations on the use of the term "independent" in the title of the auditor's report. AS 3101 contains requirements regarding the content of the auditor's report, including the title "Report of Independent Registered Public Accounting Firm." AS 3101 also requires that the auditor's report include a statement that the auditor is required to be independent with respect to the company in accordance with U.S. federal securities laws and the applicable rules and regulations of the SEC and PCAOB. Imposing any limitations on the use of the

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<sup>40</sup> See Note to paragraph (b) of PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting* ("Independence requirements provide that an auditor is not independent of his or her audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement.") (emphasis added).

term "independent" in the title, as suggested by a commenter, is outside of the scope of this standard.

**ii. Ethics**

*See paragraph .06 of the new standard.*

The Board proposed to require the auditor to comply with applicable ethics requirements, including the rules and standards of the PCAOB. Under the proposed standard, ethics requirements included the rules in Section 3, Part 5 of PCAOB rules and proposed EI 1000, *Integrity and Objectivity*, of the QC proposal. The existing foundational standards do not reference the auditor's responsibility to comply with ethics requirements.

A few commenters suggested revisions to the proposed requirement. Two commenters, including an investor-related group, stated that the proposed requirement is weak because it focused on merely complying with rules and standards of the Board. The investor-related group also suggested adding language that discusses subordination of judgment to others, specifically those outside the audit firm (e.g., external specialists). The other commenter recommended requiring that firms create and maintain codes of ethics embracing the principles of proposed EI 1000 and upholding the integrity of capital markets and auditors' fundamental obligations to investors. An additional commenter suggested addressing in the standard broader ethical principles, such as integrity and objectivity, in addition to compliance with rules and standards.

After considering the comments received, the Board retained the requirement to comply with ethics requirements substantially as proposed, with the modifications discussed below. The Board added the word "ethics" before "rules and standards of the



PCAOB" to provide a clearer indication of the rules and standards referenced. Under the final standard, applicable ethics requirements are not limited to the ethics rules and standards of the PCAOB but also include state law and the laws of other jurisdictions that may establish additional ethics provisions with which the auditor is required to comply (e.g., obligations regarding conflicts of interest).

The Board agrees with the underlying point of the comment that auditors should not subordinate their judgment to individuals outside the audit firm (e.g., external specialists) and believe that the new standard will achieve the desired objective of the comment. A subordination or relinquishment of professional judgment would be inconsistent with the requirements of AS 1000.09-.10 related to due professional care, which are discussed below. In addition, EI 1000 addresses the broader ethical principles of integrity and objectivity. Specifically, the overarching requirements in EI 1000 include (i) maintaining integrity, which includes being honest and candid, not knowingly or recklessly misrepresenting facts, and not subordinating judgment; and (ii) maintaining objectivity, which includes being impartial, intellectually honest, and free of conflicts of interest. The intent of the requirement to comply with ethics in AS 1000 is to remind auditors of their responsibilities described in EI 1000 and Section 3, Part 5 of PCAOB rules. Therefore, additional discussion of broader ethical principles and responsibilities is appropriately addressed in EI 1000 and need not be duplicated in AS 1000. The Board expanded the reference to EI 1000 in footnote 6 of paragraph .06 of AS 1000 to clarify that EI 1000 specifically requires auditors to maintain integrity and objectivity. Further clarification on matters related to subordination of professional judgment is unnecessary

in this release. Lastly, the Board considered comments related to firms' adoption of an ethics code as part of the adoption of EI 1000.

**iii. Competence**

*See paragraphs .07 and .08 of the new standard.*

a. Description of competence

The Board proposed to require that the audit be performed by an auditor who has competence to conduct an audit in accordance with applicable professional and legal requirements. Competence, as described in the proposed standard, consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. In the proposing release, the Board explained that the auditor's knowledge and skill relate to adequate technical training and proficiency as an auditor, and the auditor's ability relates to the capabilities to perform, and in the case of supervisory staff, to review assigned tasks. The proposed standard also provided that, in determining the appropriate level of competence, the measure is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time. A note to the proposed requirement stated that competence includes knowledge and expertise in accounting and auditing standards and in SEC rules and regulations relevant to the company being audited and to the related industry or industries in which it operates. The proposed requirement was consistent with the auditor's existing responsibilities under AS 1010 for maintaining "adequate technical training and proficiency" but used updated terminology.

Several commenters sought greater clarity in the proposed requirement, stating that it did not account for the collective competence of the engagement team or that it might imply that all individual members of an engagement team are expected to have the same level of competence. These commenters generally suggested (i) revising the requirement to apply to, for example, "the engagement team, including specialists" or "auditors, collectively" instead of "an auditor" and (ii) clarifying that necessary competence is commensurate with the assigned tasks of the individual auditor. One commenter suggested (i) defining the individuals intended to be covered by the requirement, including subject matter experts and EQRs; (ii) explaining that the competence of individuals varies based on a variety of factors; and (iii) including quantitative factors in the measure of competence. Another commenter noted that the proposed requirement could be interpreted to limit the ability to assign challenging work to junior staff because they may lack significant experience.

Some commenters, mostly firms and professional organizations, also expressed concern with the description of competence in the note to the proposed requirement – which referred to having "expertise" in SEC rules and regulations and the relevant industry of the company being audited – and asked for additional clarification. These commenters asserted that the term "expertise" may impose a higher standard of competence than intended and could imply that the expected level of knowledge is that of a person qualified to engage in the practice of another profession or occupation (e.g., the legal profession). One of these commenters also expressed concern with the implication that a partner without relevant expertise in the industry in which the issuer operates may not be competent to perform an audit of the issuer, even with the assistance of other firm

or engagement team members with relevant industry expertise. Several commenters recommended deleting the reference to "expertise" or using alternative language such as "proficiency" or "sufficient knowledge."

After considering the comments received, the Board adopted the requirement related to competence substantially as proposed, with the modifications discussed below.

First, consistent with the Board's description in the proposal, the Board continues to believe the level of competence needed to conduct the audit is driven by the activities assigned to the individual auditors performing those activities. As the assigned activities in an audit vary from individual to individual, so does the required level of competence to complete those activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. For example, a first-year auditor is not expected to have the same level of competence as a more experienced auditor because the tasks assigned to the seasoned auditor generally require experience gained over time. Further, PCAOB standards and rules use the term "auditor" to mean both a firm registered with the PCAOB and its associated persons.<sup>41</sup> Therefore, the Board believes that defining the individuals covered by the requirement or revising terminology to "auditors" or "engagement team," as suggested by some commenters, is not necessary. The requirements regarding the appropriate assignment of responsibilities to engagement team members and proper supervision are addressed in other PCAOB standards.<sup>42</sup>

Second, the Board agrees that quantitative measures are not wholly irrelevant when measuring competence. Quantitative measures alone may not accurately reflect the

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<sup>41</sup> See PCAOB Rule 1001(a)(xii).

<sup>42</sup> See, e.g., paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, and AS 1201.05.

nature of experience gained over time and therefore competence should not be measured exclusively on a quantitative basis.<sup>43</sup> In consideration of comments, the final requirement clarifies that competence is measured both qualitatively and quantitatively.

Third, the intent of the proposed requirement's note (providing that competence "includes knowledge and expertise" in certain areas) was to provide additional direction to auditors on the meaning of competence in the context of the company being audited. The Board did not intend to impose a higher standard of competence beyond having the knowledge, skill, and ability to enable the auditor to perform the assigned activities in accordance with applicable professional and legal requirements. The Board therefore changed "expertise" to "proficiency" in the final requirement in response to comments. Nevertheless, the Board continues to believe that understanding the company's business and being proficient in the rules and regulations relevant to the company under audit and its related industry is an important part of competence. For example, an engagement partner with significant experience mostly in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee, and have primary responsibility for, an audit of a financial institution.

b. Developing and maintaining competence

The Board also proposed to require that the auditor develop and maintain competence through an appropriate combination of academic education; professional experience in accounting and auditing with proper supervision; and training, including accounting, auditing, independence, ethics, and other relevant continuing professional education. Existing AS 1010 includes a similar requirement.

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The description of competence is consistent with the description in QC 1000.

Investor-related groups advocated for the inclusion of investor-related training that focuses on investors as the primary beneficiaries of the audit and being responsive to investors' needs. These commenters also emphasized the importance of including the auditor's understanding of the business and industry related to the company under audit as part of developing competence. One investor-related group suggested specific training on materiality.

The Board retained the requirement to develop and maintain competence as proposed. The Board agrees with investor-related groups' views on the importance of protecting investors when conducting an audit. In that regard, paragraph .01 of the final standard and the Board's related discussion provide the context of investor protection that is relevant to the auditor's compliance with the requirements for developing and maintaining competence. Further, in considering commenters' suggestion about investor-focused training, the Board believes that the implementation of the final standard will necessarily involve training auditors on the application of the relevant requirements, including conducting an audit with investor protection in mind.

The note to paragraph .07 of the final standard reinforces the need for auditors to have knowledge and proficiency in the requirements relevant to the company being audited and the related industry. Further, the auditor's responsibilities for understanding the company's business and consideration of materiality in planning and performing an audit are specifically addressed in other PCAOB auditing standards,<sup>44</sup> and the Board

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<sup>44</sup> See AS 2110 and AS 2105, *Consideration of Materiality in Planning and Performing an Audit*.

expects that these responsibilities would already be included in training on auditing standards.

#### **4. Due Professional Care, Including Professional Skepticism**

##### **i. Due professional care**

*See paragraphs .09 through .10 of the new standard.*

The Board proposed to require the auditor to exercise due professional care in all matters related to the audit. The proposed standard stated that due professional care (i) concerns what the auditor does and how well the auditor does it, and (ii) means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements. The proposed requirement was based on the existing requirement in AS 1015 to exercise due professional care.

The proposing release explained that exercising due professional care "in all matters related to the audit" would encompass all aspects of planning and performing an audit, including client acceptance and continuance procedures, and would extend to periods after the issuance of the auditor's report, such as completion of audit documentation,<sup>45</sup> reporting on Form AP, *Auditor Reporting of Certain Audit Participants*,<sup>46</sup> and procedures performed in connection with filings under the federal securities statutes.<sup>47</sup> The Board also proposed to retain language from existing standards

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<sup>45</sup> See AS 1215.15 (as proposed to be amended).

<sup>46</sup> See PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

<sup>47</sup> See AS 4101, *Responsibilities Regarding Filings Under Federal Securities Statutes*, which describes the auditor's responsibilities when the auditor's report is included in filings under federal securities statutes.

related to an auditor's use of the work of other auditors, which emphasized that other auditors are responsible for performing their work with due professional care.<sup>48</sup>

Some commenters acknowledged that due professional care is an important principle that should be retained in the final standard. Several commenters expressed support for requiring auditors to exercise due professional care "in all matters related to the audit."

Some commenters, primarily some firms, advocated for retaining certain contextual language from AS 1015.03-.04, including, for example, the description of due professional care in the 1932 legal treatise, *Cooley on Torts*.<sup>49</sup> These commenters expressed concern that without such language there may be a lack of transparency, or confusion among investors and other stakeholders, about the limitations of due professional care.

After considering comments, the Board adopted the requirement to exercise due professional care as proposed. The Board continues to believe that the description of due professional care in the final standard is consistent with the description in AS 1015.03 (and the reference in the current standard to the legal treatise, *Cooley on Torts*), which uses the terms "reasonable care and diligence" and "good faith and integrity but not infallibility" to describe due care. As discussed in the proposal, the Board retained explicit reference to "reasonable care and diligence," which the Board believes is well

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<sup>48</sup> See Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm, PCAOB Rel. No. 2022-002 (June 21, 2022) (amendments approved by the SEC in Rel. No. 34-95488 (Aug. 12, 2022)), which amended AS 1015 to add this provision.

<sup>49</sup> The treatise states, among other things, that "no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment."



understood. The Board also believes that "good faith and integrity" means acting with "integrity." The Board's use of the term "integrity" aligns with its meaning established in EI 1000, which the Board adopted in connection with the Quality Control rulemaking. EI 1000 codifies the concepts of integrity and objectivity, emphasizing that integrity includes being honest and candid, not knowingly or recklessly misrepresenting facts, and not subordinating judgment.<sup>50</sup> The Board believes that the terms used to describe due professional care are clear and should not cause confusion, as suggested by some commenters, because the Board did not change the meaning of due professional care.

The proposed standard specified that, for engagement partners, due professional care also includes (i) appropriately assigning responsibilities to, and supervising, engagement team members; (ii) determining that the audit is properly planned and performed to obtain reasonable assurance; (iii) evaluating that significant findings or issues are appropriately addressed; (iv) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence; and (v) determining that required communications under applicable professional and legal requirements have been made.

The proposed clarifications of the engagement partner's responsibilities leveraged existing requirements for planning and performing an audit and for completing the corresponding audit documentation. For example, AS 1215 describes matters that are considered to be significant findings or issues in an audit and requires the auditor to document the significant findings or issues, including the actions taken to address them.<sup>51</sup>

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<sup>50</sup> See also PCAOB Rel. No. 2024-005.

<sup>51</sup> See AS 1215.12.

As part of the engagement partner's supervisory responsibilities under AS 1201, the proposal stated that the engagement partner would need to evaluate (in a timely manner) the significant findings and issues identified by the engagement team to ensure appropriate action was taken.<sup>52</sup>

Similarly, the proposal stated that significant judgments made by the engagement team, which AS 1220 specifically requires the EQR to review, also warrant the engagement partner's review. Because the engagement partner has primary responsibility for the engagement, they have primary responsibility for the significant judgments made during the engagement, notwithstanding any involvement in or responsibility for those judgments by firm personnel outside of the engagement team, such as members of the firm's national office. Accordingly, the "significant judgments made by the engagement team" include all of the significant judgments made during the engagement.<sup>53</sup> The proposed standard aligned the engagement partner's supervisory and review activities with existing auditor responsibilities.

A few commenters addressed the proposed requirement regarding the engagement partner's responsibilities for exercising due professional care. One commenter recommended separating the partner's responsibilities from the broader requirement to exercise due professional care. Another commenter expressed concern that, as presented, the responsibilities of the engagement partner could be viewed as a substitute for the broader responsibilities applicable to all auditors. This commenter suggested emphasizing

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<sup>52</sup> See AS 1201.05.

<sup>53</sup> See Auditing Standard No.7 – Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Controls Standards, PCAOB Rel. No. 2009-004 (July 28, 2009), at 4 n.7.

in the final standard that for engagement partners, the responsibilities are in addition to those required for all auditors.

Several commenters also suggested clarifications to the proposed requirements. For example, one commenter suggested that the requirements be extended to team members performing supervisory activities. Another commenter pointed to potential inconsistencies with requirements of AS 1201 and AS 2101, noting that AS 1201 does not explicitly require the partner to assign activities to team members that adequately match their levels of competence and allows the partner to seek assistance from appropriate engagement team members in fulfilling responsibilities. One commenter recommended adding a footnote to AS 1220 to the discussion of significant judgments and conclusions.

In response to commenters, the Board relocated the proposed engagement partner's responsibility for due professional care into a separate paragraph in the final standard, with certain clarifications. Specifically, the Board agrees with commenters' views that the engagement partner is not required to directly assign responsibilities to all engagement team members (e.g., audit staff at other accounting firms involved in the audit). Nevertheless, consistent with AS 1015.06, the engagement partner is responsible for the appropriate assignment of tasks to, and supervision of, engagement team members. As such, the final standard states that the engagement partner's responsibility for due professional care includes "being responsible for the appropriate assignment of responsibilities to, and supervision of, engagement team members." This formulation acknowledges that in certain audit engagements, such as large, multi-tiered audits, the engagement partner may not be directly assigning work to engagement team members.

Instead, other engagement team members performing supervisory activities may assist the engagement partner and inform engagement team members of their responsibilities.<sup>54</sup>

The Board believes that relocating the engagement partner's responsibility for due professional care into a separate paragraph helps draw a distinction between the responsibilities applicable to all auditors and those that are incremental for engagement partners. To clarify this further, the Board added "also" to the requirement in paragraph .10 to indicate that the engagement partner responsibilities for due professional care are in addition to those applicable to all auditors. The Board did not expand the applicability of the engagement partner responsibilities described in AS 1000 to other members of the engagement team performing supervisory activities because, as discussed above, the intent of this requirement is to focus the engagement partner on exercising due professional care as the person with the primary responsibility for the engagement and its performance. As suggested by one commenter, the Board added a footnote to the final standard referencing AS 1220 for the discussion of significant judgments and conclusions. The Board adopted the remaining provisions of the requirement as proposed.

**ii. Description of professional skepticism**

*See paragraph .11 of the new standard.*

The proposed standard stated that exercising due professional care includes exercising professional skepticism in conducting an audit, and described professional skepticism as an attitude that includes a questioning mind and a critical assessment of information related to the audit. This requirement is based on the existing auditor responsibility to exercise professional skepticism in AS 1015. The Board emphasized in

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*See AS 1201.05.*

the proposal that application of professional skepticism extends beyond the information used as audit evidence, which is described in AS 1105.02 as the information "that is used by the auditor in arriving at conclusions on which the auditor's opinion is based." For example, by exercising professional skepticism in the preparation of Form AP, the auditor may become aware of inconsistencies in total audit hours reported by another accounting firm participating in the audit based on the level of work assigned to that accounting firm and take corrective action.

An investor-related group supported the proposed description of professional skepticism to include a critical assessment of information related to the audit. In contrast, a number of other commenters, mostly firms, expressed concern about the proposed change in the description of professional skepticism from a critical assessment of "audit evidence" to "information related to the audit," stating that this language is overly broad and its meaning unclear. Some of these commenters noted that, unlike with audit evidence, there is no established framework for auditors to assess information related to the audit and it is unclear what such an assessment would entail. Many of these commenters advocated for retaining the extant description of professional skepticism in AS 1015.07, which includes "a critical assessment of audit evidence."

Some commenters offered additional explanation or suggestions, for example:

- One commenter indicated they were unable to identify information, other than Form AP data, that would be considered "information related to the audit" that is not already part of "audit evidence." This commenter and another recommended specifically incorporating Form AP data into the requirement.

- One commenter indicated the proposed language could risk including information related to the audit that was never presented to the auditor. This commenter suggested retaining reference to "audit evidence" and including a reference to information obtained to comply with rules of the Board.
- Another commenter recommended retaining the reference to "audit evidence" because this concept is supplemented by the requirements in proposed paragraph .11 and by the overarching responsibility to exercise due professional care in relation to all matters related to the audit (including the preparation of Form AP).

Several commenters offered other views related to the description of professional skepticism. For example, one commenter stated that the difference between "critical assessment of information related to the audit" and "objective evaluation of evidence obtained in an audit" in proposed paragraph .11 is unclear. This commenter suggested combining proposed paragraphs .10 and .11 or providing further guidance, including guidance that is aligned with other standard setters. Another commenter questioned the assumption in the proposed standard that all auditors can exercise professional skepticism consistently for the duration of the audit, pointing to a lack of research.

After consideration of comments, the Board revised the description of professional skepticism. The final standard describes professional skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules." While the Board agrees with commenters that information related to the audit that is obtained by the auditor is generally audit evidence, the Board continues to believe that the exercise of

professional skepticism in an audit extends beyond the evaluation of the sufficiency and appropriateness of audit evidence. Professional skepticism is an attitude held by the auditor throughout the audit process. For example, AS 2401, *Consideration of Fraud in a Financial Statement Audit*, provides that professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred.<sup>55</sup> The revised description in AS 1000 retains the extant reference to "critical assessment of audit evidence" but also, as suggested by one commenter, refers to information obtained by the auditor to comply with PCAOB standards and rules, such as information to complete Form AP. The Board believes that the revised description will provide auditors with a clear framework for exercising professional skepticism and aligns with the auditor's obligation to exercise due professional care, which applies to all matters related to the audit.

As suggested by one commenter, the final standard also combines in paragraph .11 the description of professional skepticism (proposed paragraph .10) with the description of what exercising professional skepticism entails (proposed paragraph .11) discussed below. The Board believes this unified paragraph will provide better context for the application of professional skepticism.

**iii. Exercise of professional skepticism**

*See paragraph .11 of the new standard.*

The proposed standard described several factors involved in the exercise of professional skepticism, which were largely consistent with extant requirements. Under the proposed standard, the auditor's exercise of professional skepticism included:

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<sup>55</sup> See AS 2401.13.

- Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and appropriateness (i.e., relevance and reliability) of that evidence;
- Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- Not relying on evidence that is less than persuasive;
- Not assuming that management is honest or dishonest; and
- Consideration of potential bias on the part of management and the auditor.

Some commenters provided views on specific aspects of the factors involved in the auditor's exercise of professional skepticism. The comments and related responses are discussed in more detail below.

*Objectively evaluating evidence.* One commenter suggested requiring the auditor to search for contradictory evidence. Another commenter stated that the proposed description did not sufficiently address professional skepticism in obtaining audit evidence and instead focused only on evaluating the evidence. One commenter stated that the proposed description was unclear and suggested using more direct language, including requiring the auditor to be more neutral in the assessment (e.g., evaluating evidence that both supports assertions and evidence that does not).

The intent of paragraph .11a of AS 1000 is not to alter the responsibilities for obtaining and evaluating evidence addressed in AS 1105, but to remind auditors of their



responsibility to exercise professional skepticism in connection with both obtaining and evaluating audit evidence. As discussed in the proposal, sufficient appropriate audit evidence is necessary to support the auditor's opinion. While primarily obtained from audit procedures performed during the audit, audit evidence may also include information obtained from other sources such as previous audits, and client acceptance or continuance procedures. The exercise of professional skepticism is particularly important in obtaining and evaluating audit evidence when responding to assessed risks of material misstatement, including fraud risks.

Audit evidence consists of both information that supports and corroborates management's assertions and information that contradicts such assertions.<sup>56</sup> The auditor's appropriate application of professional skepticism includes critically assessing this information and should result in procedures that are focused on obtaining evidence that is more relevant and reliable,<sup>57</sup> such as evidence obtained directly by the auditor and evidence obtained from independent, knowledgeable sources. Further, if audit evidence obtained from one source is inconsistent with audit evidence obtained from another, the auditor is required to perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.<sup>58</sup>

Professional skepticism is important in all aspects of the audit, particularly in those areas of the audit that involve significant management judgments or transactions

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<sup>56</sup> See AS 1105.02. A new footnote has been added to AS 1000.11a, referring to AS 1105 for the discussion of management's assertions regarding the financial statements and internal control over financial reporting, and the proposed phrase "regarding the financial statements or internal control over financial reporting" has been deleted from paragraph .11a.

<sup>57</sup> See AS 1105.07-.08.

<sup>58</sup> See AS 1105.29.

outside the normal course of business. It is ultimately the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including when (i) identifying and assessing risks of material misstatement, (ii) performing tests of controls and substantive procedures, and (iii) evaluating audit results. For example, a lack of professional skepticism in the risk assessment process could result in an auditor not identifying or assessing risks appropriately, which could impact the effectiveness of the audit.

*Remaining alert to conditions that may indicate possible misstatement due to fraud.* The Board did not receive significant comments in this area. As part of exercising professional skepticism, the auditor remains alert to conditions that may indicate possible misstatement due to error or fraud. This includes, for example, being alert to information that calls into question the reliability of documents and responses to inquiries the auditor plans to use as audit evidence. Such information could identify conditions that may indicate possible fraud or error in the financial statements. As discussed above, AS 2401 provides further requirements regarding potential fraud risk factors.

*Not relying on evidence that is less than persuasive.* One commenter stated that the proposed phrase "not rely" appears to be more restrictive than the existing phrase "not be satisfied with" in AS 1015.09 because the proposed phrase would preclude the auditor from placing any reliance on anything less than completely persuasive evidence, even in combination with other persuasive evidence.

The proposed phrase "not rely" was intended to convey that, consistent with AS 1015.09, exercising professional skepticism involves seeking evidence that is more persuasive rather than settling on evidence that may be less so. AS 1000 is not intended

to address the sufficiency and appropriateness of evidence. To avoid confusion, the final standard retains the existing terminology from AS 1015 as "not being satisfied with evidence that is less than persuasive." The requirements for obtaining audit evidence, including evaluating its relevance and reliability, are discussed in AS 1105, which provides that the quantity of audit evidence needed is affected by both the risk of material misstatement and the quality of the evidence obtained (i.e., its relevance and reliability). To supplement evidence that is less relevant or obtained from a less reliable source, an auditor would need to gather additional evidence. The appropriate application of professional skepticism focuses the auditor on seeking the best evidence reasonably obtainable.

*Not assuming that management is honest or dishonest.* An investor-related group referenced certain views expressed in the 2000 report by the Public Oversight Board's Panel on Audit Effectiveness.<sup>59</sup> That report recommended that auditing standards require forensic-type fieldwork in which auditors would "modify the otherwise neutral concept of professional skepticism and presume the possibility of dishonesty at various levels of management, including collusion, override of internal control and falsification of documents."<sup>60</sup> The Board believes that establishing a presumption of management's dishonesty would have broader implications beyond the exercise of professional skepticism under this standard.

*Consideration of potential bias on the part of management and the auditor.*

Several commenters expressed concern that the obligations related to consideration of the

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<sup>59</sup> See Public Oversight Board, *The Panel on Audit Effectiveness Report and Recommendations* (Aug. 31, 2000).

<sup>60</sup> *Id.* at 88-89.

auditor's own bias were unclear or could be viewed as a requirement to seek contradictory evidence. Some of these commenters noted that consideration of auditor bias is inherent in the requirements for evaluating audit evidence under AS 1105 and suggested deleting the reference to "and the auditor" from proposed paragraph .11e. One commenter suggested aligning this concept with the approach used by the AICPA in their revised audit evidence standard. Two commenters also questioned the nature and extent of documentation necessary to demonstrate consideration of auditor bias. One investor-related group advocated for requiring the auditor to affirmatively consider the risk of bias, particularly confirmation bias, arising out of the financial relationship between management and the auditor.

The Board continues to believe that it is important to include reference to auditor bias in connection with exercising professional skepticism because certain conditions inherent in the audit environment create incentives and pressures that could impede the appropriate application of professional skepticism and allow unconscious bias to influence decisions. Examples of these incentives and pressures include avoiding significant conflicts with management, providing an unqualified audit opinion prior to the company's filing deadline, achieving high client satisfaction ratings, keeping audit costs low, or cross-selling other services.

As discussed in the proposal, it is important for the auditor, as part of exercising professional skepticism, to consider the impact of management bias and the auditor's own bias that could affect the auditor's judgments. For example, the tendency to seek confirming information can lead the auditor to seek audit evidence that is only consistent with management's explanations, or to favor conclusions that are consistent with the

auditor's initial beliefs or conclusions reached in prior year audits. In exercising professional skepticism, the auditor could mitigate such potential bias by being aware of "confirmation bias," considering alternatives provided by others, and being aware of contradictory information.<sup>61</sup> Auditors and management may also have biases related to electronic information (e.g., a belief that electronic information is either always reliable or inherently prone to error). For example, a tendency to favor output generated from automated systems, even when contradictory information raises questions as to whether such output is reliable, illustrates a form of bias. Exercising professional skepticism, including critically assessing information related to the audit, helps the auditor address the effects of potential bias on professional judgment and decision-making. It is important to clarify, however, that the consideration of potential bias discussed above does not change the auditor's responsibilities for evaluating contradictory evidence, as suggested by some commenters.

Finally, the Board did not add new documentation requirements for demonstrating the auditor's exercise of professional skepticism beyond those addressed in AS 1215. Auditors can demonstrate that their work encompassed the exercise of professional skepticism by documenting the procedures performed and conclusions reached in accordance with AS 1215.

After consideration of the comments, the Board adopted the provisions for exercising professional skepticism substantially as proposed, with the modifications discussed above.

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<sup>61</sup> For a discussion of confirmation bias, *see, e.g.*, Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology* 175 (1998).

## 5. Professional Judgment

*See paragraph .12 of the new standard.*

Auditors exercise professional judgment throughout the audit, and existing standards refer to the use of professional judgment, but do not describe in detail what professional judgment means. The proposed standard provided that the auditor must exercise professional judgment and included a description of professional judgment. As discussed in the proposing release, auditors exercise professional judgment throughout the audit. For example, the auditor exercises professional judgment in:

- Determining the areas to be tested and the nature, timing, and extent of the tests to be performed;
- Interpreting the results of audit testing and evaluating audit evidence;
- Evaluating the reasonableness of accounting estimates in significant accounts and disclosures, based on information that could reasonably be expected to be available through the date of the auditor's report;<sup>62</sup>
- Determining if there are any CAMs in the audit of the financial statements;<sup>63</sup> and
- Determining the nature and extent of documentation to comply with documentation requirements.<sup>64</sup>

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<sup>62</sup> See AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, which discusses the auditor's responsibility to obtain sufficient appropriate evidence to determine whether accounting estimates in significant accounts and disclosures are properly accounted for and disclosed in the financial statements.

<sup>63</sup> See AS 3101 for requirements regarding CAMs.

<sup>64</sup> See AS 1215 for documentation requirements.

As proposed, professional judgment involved applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.

Several commenters, primarily firms, expressed concern that the proposed description of professional judgment could be interpreted as imposing a new strict liability requirement. These commenters suggested removing the phrase "such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements" in the description, noting that a deficiency in an auditor's compliance with applicable professional and legal requirements should not, by default, indicate a failure to exercise appropriate professional judgment. In the view of these commenters, this implication would be contrary to the established interpretation of an auditor's responsibilities, which recognizes that reasonable observers may disagree regarding whether applicable standards were complied with while agreeing that the matter in question was within the purview of the auditors' professional judgment and could result in hindsight challenges of auditors' judgments.

One commenter recommended that the description of professional judgment refer to "sound" judgment, consistent with the description used by the International Ethics Standards Board for Accountants ("IESBA").<sup>65</sup> Another commenter asked for clarification of the concept of "well-reasoned conclusions," noting potential differences

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<sup>65</sup> See IESBA, *Handbook of the International Code of Ethics for Professional Accountants* (2023), Subsection 113 – Professional Competence and Due Care, at 113.1 A1 ("Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.").

with the definition of professional judgment established by other standard setters. Two commenters advocated for the establishment of a judgment framework by the Board. One commenter stated that they heard auditors express the need for more clarity about the degree of documentation necessary to demonstrate their reasoned judgment. Another commenter suggested adding the concept of materiality to the description of an auditor's exercise of judgment, based on the description of judgment in AS 2815.04 with regard to the auditor's opinion on financial statements.

The proposed phrase "such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements" was meant to provide context to the application of professional judgment and was not intended to introduce a strict liability requirement. After considering the comments received, the Board removed this phrase in the final description of professional judgment. The Board continues to believe that it is important to clarify that the use of professional judgment does not allow for an arbitrary exercise of discretion. While conclusions could vary, auditors are required to apply relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances. Therefore, the Board added a note to paragraph .12 to clarify that professional judgment is applied in the context of conducting an audit with due professional care in accordance with applicable professional and legal requirements. The Board believes that this note properly frames the exercise of professional judgment without implying that a deficiency in an auditor's compliance with applicable professional and legal requirements would by default also indicate a failure to exercise appropriate professional judgment.



The Board did not change the description of professional judgment to include "sound judgment" as the Board believes that term is redundant with the phrase "well-reasoned." The phrase "well-reasoned," used in the context of an auditor exercising professional judgment and reaching conclusions, is clear because it refers to judgment made and conclusions reached that are based on logical thinking and an analysis of relevant information.

As discussed earlier, the auditor is required to exercise due professional care in all matters related to the audit. The concept of the auditor's exercise of professional judgment is rooted in conducting the audit with due professional care. Therefore, the Board retained the phrase "well-reasoned" as proposed. Regarding the degree of documentation related to professional judgment, the auditor is expected to comply with documentation requirements of AS 1215, which includes requirements for considering the nature and extent of documentation needed.

The Board believes that creating a "framework" for how auditors should exercise their professional judgment, as suggested by some commenters, would be beyond the scope of this project. The Board further believes it is better for auditors to adhere to overarching principles and standards that mandate the exercise of professional judgment in connection with conducting an audit with due professional care. This approach acknowledges the multifaceted nature of audits and allows auditors to exercise their professional judgment in the unique circumstances of each audit engagement.

## **6. Conducting an Audit**

### **i. Auditor and management responsibilities**

*See paragraph .13 of the new standard.*

The Board proposed to require the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence to (a) obtain reasonable assurance about whether: (1) in an audit of financial statements, the financial statements are free of material misstatement, whether due to error or fraud, or (2) in an audit of ICFR, material weaknesses exist as of the date specified in management's assessment; and (b) provide the auditor with a reasonable basis for forming an opinion. This requirement was retained from AS 1001 and AS 1015 but expanded to cover an audit of ICFR. The Board also proposed to include a note to the requirement that clarified the distinction between the responsibilities of the auditor and those of management, and to expand those responsibilities to include an audit of ICFR. Specifically, the note stated that in an audit of financial statements, the financial statements are management's responsibility and the auditor's responsibility is to express an opinion on the financial statements. In an audit of ICFR, management is responsible for maintaining effective ICFR and for assessing the effectiveness of ICFR, and the auditor's responsibility is to express an opinion on the effectiveness of the company's ICFR.

Several commenters discussed the importance of clearly distinguishing the responsibilities of the auditor from those of management and suggested retaining the corresponding language from AS 1001.02-.03. For example, one commenter observed that some investors may mistakenly believe that the auditor drafts the financial statements. In the view of this commenter, stating that management is "responsible" for the financial statements may be interpreted as a legal responsibility and does not explicitly convey that management prepares the financial statements.

The Board retained the requirement substantially as proposed. In response to commenters, the Board updated the language in the note to clarify that the financial statements, "including their preparation," are the responsibility of management and that management is responsible for "establishing and maintaining" effective ICFR.

**ii. Reasonable assurance**

*See paragraph.14 of the new standard.*

The Board proposed to retain the concept of reasonable assurance from AS 1015. Specifically, the proposed standard stated that reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including in obtaining sufficient appropriate audit evidence.<sup>66</sup> The auditor is able to obtain reasonable, but not absolute, assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of ICFR, material weaknesses are detected.

Commenters generally supported retaining the concept of reasonable assurance but provided views on its proposed description. A number of commenters, primarily firms, recommended that the Board retain certain statements from AS 1015.10-.13 (or similar language) that describe the limitations of an audit. These statements include:

- Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with the standards of the PCAOB may not detect a material weakness in

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<sup>66</sup> See paragraph .03 of AS 1101, *Audit Risk*.

internal control over financial reporting or a material misstatement to the financial statements.<sup>67</sup>

- Even with good faith and integrity, mistakes and errors in judgment can be made. .... [I]n the great majority of cases, the auditor has to rely on evidence that is persuasive rather than convincing.<sup>68</sup>
- Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement.<sup>69</sup>
- [T]he auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the PCAOB.<sup>70</sup>

A few of these commenters also pointed to the characterization of reasonable assurance in the standards of other standard setters (e.g., ISA 200).<sup>71</sup> These commenters

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<sup>67</sup> See AS 1015.10.

<sup>68</sup> See AS 1015.11.

<sup>69</sup> See AS 1015.12.

<sup>70</sup> See AS 1015.13.

<sup>71</sup> Paragraph 13(m) of ISA 200 defines reasonable assurance as "in the context of an audit of financial statements, a high, but not absolute, level of assurance." Paragraph 5 of ISA 200 further describes that reasonable assurance "is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of

generally expressed concern that without such language, the proposal would reduce transparency and contribute to the expectation gap among investors and other stakeholders regarding the nature of reasonable assurance (as compared to absolute assurance). For example, one commenter stated that the elimination of the existing clarifying language could also result in ambiguity as to whether a new level of assurance would be expected, beyond reasonable assurance but less than absolute assurance.

Some commenters offered other clarifications. For example, two commenters suggested retaining certain language from AS 1001.02, which states that the auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected. One of these commenters also acknowledged that identifying limitations on the auditor's responsibilities should not be the main focus of the standard. One commenter recommended that the final standard include guidance on determining whether audit risk is reduced to an appropriately low level, including a requirement to consider changes in technology, the nature and quality of an issuer's financial reporting system, relevant academic and other research, and any other factor that can reduce the risk of material misstatements or fraud.

As discussed further below, the Board retained the description of reasonable assurance as proposed with some modifications. The concept of "reasonable assurance" is not new. Reasonable assurance refers to the auditor's degree of satisfaction that the evidence obtained during the audit supports the assertions of the financial statements. It is

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the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive."

a high level of assurance and is obtained by reducing audit risk to an appropriately low level (i.e., the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated or in an audit of ICFR, when a material weakness exists) through applying due professional care, including obtaining sufficient appropriate audit evidence.<sup>72</sup> AS 1101 discusses audit risk and the relationships among the various components of audit risk in an audit of financial statements. The Board retained a reference to AS 1101 in the final standard and added the description of the term "audit risk." The Board believes that additional guidance on consideration of audit risk, as suggested by one commenter, is outside the scope of this standard. If additional guidance is necessary regarding the auditor's assessment of and response to the risks of material misstatement in an audit, it would be provided in connection with the Board's risk assessment standards.<sup>73</sup>

The Board did not change the meaning of reasonable assurance or the requirement to obtain reasonable assurance. In consideration of comments received, the Board emphasized in the final requirement that reasonable assurance is not absolute assurance. As observed by some commenters, absolute assurance is not attainable because of the nature of audit evidence (e.g., selective testing involving professional judgments<sup>74</sup> regarding the nature, timing, and extent of procedures to be performed; and inherent uncertainty of accounting estimates), and the characteristics of fraud (e.g., falsified company documentation). In many cases, the auditor has to rely on evidence that is

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<sup>72</sup> See AS 1101.03-.04.

<sup>73</sup> See, e.g., AS 1101, AS 2101, AS 2105, AS 2110, and AS 2301.

<sup>74</sup> The discussion above describes requirements for exercising professional judgment.

persuasive rather than convincing. Because the Board did not change the meaning of reasonable assurance, the Board believes that further explanation of the difference between reasonable assurance and absolute assurance is not needed in the final standard.

The Board did not retain additional descriptions of the inherent limitations of an audit from AS 1015.10-.13. The Board believes that these matters are part of the differences between reasonable and absolute assurance discussed above or addressed elsewhere in PCAOB standards. Although a properly planned and performed audit may not detect a material misstatement because of the characteristics of fraud, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.

**iii. Compliance with applicable professional and legal requirements**

*See paragraph.15 of the new standard.*

The Board proposed to require that the auditor comply with applicable professional and legal requirements in conducting the audit. As discussed above, the term "applicable professional and legal requirements" was proposed to have the same meaning as defined in proposed QC 1000. Under existing provisions, auditors are required to comply with PCAOB standards and rules. The proposed requirement emphasized that the overall objective of the auditor is achieved by complying with more than just the standards of the PCAOB. This includes compliance with requirements of Section 10A of the Exchange Act related to illegal acts, related party transactions, and an evaluation of whether there is substantial doubt about the ability of the company to continue as a going

concern.<sup>75</sup> The proposed requirement also stated that, in fulfilling these requirements, the auditor should keep in mind its role in protecting investors.

One commenter on this proposed paragraph stated that the term "applicable professional and legal requirements" appears to exceed the Board's authority, citing Sections 104 and 105 of Sarbanes-Oxley and urged that the Board replace it with "PCAOB rules and standards." Two other commenters noted that applicable professional and legal requirements could be read broadly as a wide range of laws and regulations that do not directly bear on the conduct of audit engagements. Another commenter recommended adding clarifying language in the release to state that although the auditor is expected to comply with applicable legal requirements, the auditor is not expected to have the expertise of a lawyer or to express opinions on matters of law.

The Board disagrees with the commenter's assertions regarding the Board's authority, which extends beyond PCAOB rules and standards. For example, Section 105(c)(4) of Sarbanes-Oxley empowers the Board to sanction a registered firm and its associated persons for violations not only of PCAOB rules and standards but also violations of "the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under [the] Act[.]"

As discussed above, the final standard includes a definition of the term "applicable professional and legal requirements" rather than a reference to the definition in QC 1000. The definition that was proposed in the QC 1000 project has been modified in response to comments received in that rulemaking, to explicitly mention ethics laws

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<sup>75</sup> 15 U.S.C. § 78j-1.



and regulations. The definition was also refined to limit the breadth of the term, by clarifying that it encompasses statutory, regulatory, and other legal requirements beyond professional standards and other PCAOB rules "[t]o the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system." The Board believes that further changes to this term in the final standard are not necessary.

As discussed above, the Board changed "expertise" to "proficiency" in the final description of competence in response to comments. While the Board does not expect auditors to have the expertise of a lawyer, the Board believes that understanding the company's business and being proficient in the rules and regulations relevant to the company under audit and the related industry is important.

Some commenters also stated that the requirement for auditors to "keep in mind their role in protecting investors" when fulfilling the requirement to comply with applicable professional and legal requirements was unclear, including how to apply such a requirement. As discussed above, investor-related groups suggested including the language from the *Arthur Young opinion* to describe the auditor's responsibility. Other commenters suggested that the proposed reference to the auditor's role in protecting investors be deleted from the final requirement or reframed. One commenter pointed to research noting that encouraging auditors to adopt an investor perspective when making judgments may be detrimental to audit quality.<sup>76</sup>

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<sup>76</sup> This commenter cited two research papers: (i) Altiero, Kang, and Peecher (2022) "show that auditors prompted to take an investor perspective are less likely to assess a misstatement as material" and (ii) Dong, Wang, and Chien (2022) "highlight that taking an investor perspective can decrease assessed risk of material misstatement." *See* additional discussion below.

After considering comments and for the reasons discussed above, the Board retained the requirement to comply with applicable professional and legal requirements. The Board removed the reference to "keep in mind their role in protecting investors" from the final standard based on changes made to paragraph .01 of the final standard. As discussed earlier, in connection with certain revisions made to the introductory paragraph of the final standard, the Board added a note to paragraph .01 to remind auditors that their obligation to protect investors is important when complying with all requirements of this and other PCAOB standards and rules.

**iv. Relevant guidance**

*See paragraph.15 of the new standard.*

The Board also proposed a note to paragraph .15 stating that, as part of complying with all applicable professional and legal requirements in conducting the audit, the auditor is required to take into account relevant guidance applicable to the audit. The proposed requirement was an extension of the existing requirement in AS 1001.11 that the auditor be aware of and consider auditing interpretations issued by the AICPA as of 2003, and adopted by the PCAOB and in effect. Under the proposal, relevant guidance included PCAOB auditing interpretations, Board-issued guidance, and releases that accompany the rules and standards of the Board.

Many commenters, mostly firms and firm-related groups, expressed concern that the proposed note is overly broad and unclear. For example, some commenters cited a lack of clarity as to (i) the scope of the Board-issued guidance including whether documents such as concept releases would be covered; (ii) the timeline in which the requirement would apply; (iii) the hierarchy of guidance and what types of guidance

would be considered authoritative; and (iv) how to reconcile potentially conflicting information between proposing and final releases. These commenters generally suggested either deleting the note, codifying the relevant guidance to ensure consistent application, or specifying that relevant guidance includes releases accompanying "final" standards. Another commenter also suggested clarifying the meaning of "take into account," including defining the phrase in PCAOB Rule 3101.

A few commenters, including an investor-related group, recommended including relevant guidance within the standard rather than the accompanying release. Two commenters suggested that the Board consider restructuring guidance in a manner similar to the application and other explanatory material, as presented in the AICPA and IAASB standards. An investor-related group recommended a "codification" approach that would include placing all guidance, interpretations, releases, amendments, and rules in the same location.

After considering comments received, the Board revised the note as follows:

- Replaced the reference to "relevant guidance" with "PCAOB auditing interpretations;" and
- Replaced a footnote describing the scope of the relevant guidance with a footnote describing the scope of PCAOB auditing interpretations.

The note in the final standard provides that, when complying with PCAOB standards, the auditor is required to also take into account PCAOB auditing interpretations applicable to the audit. As mentioned previously, this is an existing requirement that is being carried forward with modifications. In the final standard, PCAOB auditing interpretations refer to the PCAOB publications entitled "Auditing

Interpretations" as currently in effect.<sup>77</sup> These interpretations were originally adopted by the Board in 2003 along with the interim standards. Since that time, certain of these auditing interpretations have been and continue to be revised or rescinded in connection with the other amendments to PCAOB standards. The requirement in the final standard, as it did previously, relates to the interpretations currently in effect.

Apart from the PCAOB auditing interpretations referenced in paragraph .15, the PCAOB also supports the implementation of and compliance with its standards in many other ways, including providing guidance in rulemaking releases that accompany standards, amendments, or rules, or issuing staff guidance.<sup>78</sup> Although there is no requirement to follow these guidance documents, the Board continues to believe that it is important for auditors to pay attention to such guidance, if relevant, when conducting an audit in accordance with PCAOB standards because it may help the auditor understand and comply with complex provisions of those standards or rules. For example, staff guidance can help auditors better understand how the PCAOB intends to implement, inspect against, or enforce existing rules and standards.

The phrase "take into account" in the rule text is not new. It has been used previously in PCAOB standards in reference to information or matters that the auditor should think about or give attention to in performing an audit procedure or reaching a

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<sup>77</sup> PCAOB auditing interpretations do not include independence interpretations. The requirements to comply with independence interpretations are covered by PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.

<sup>78</sup> PCAOB staff prepares guidance to assist in the implementation of PCAOB standards and rules. The typical legend on such guidance states that the document represents the views of PCAOB staff and not necessarily those of the Board, and that the document is not a rule, policy, or statement of the Board. PCAOB staff audit practice alerts are examples of staff guidance that highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits under existing PCAOB standards.

conclusion.<sup>79</sup> Accordingly, the results of the auditor's thinking on the relevant matters should be reflected in the performance and documentation of the respective audit procedure performed or conclusion reached.

Lastly, the Board did not consider the "codification" approach because it is out of scope for this project.

**v. Audit documentation**

*See paragraph.16 of the new standard.*

The Board proposed to require the auditor to prepare audit documentation in accordance with AS 1215. This requirement was intended to emphasize the importance of adequate audit documentation to planning and performing the audit and to the supervision and review of work performed during the audit. Commenters did not express concerns with the documentation requirement, and the Board adopted it as proposed.

**vi. Auditor communications**

*See paragraphs .17 through .20 of the new standard.*

The Board proposed an explicit requirement for the auditor's report to contain (i) an expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed; and (ii) in an audit of internal control over financial reporting, an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed. Under the proposed standard, the auditor would be in a position to express an unqualified opinion only when the auditor has performed the audit in accordance with standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that: (i) in an

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<sup>79</sup> See, e.g., AS 3101.12 and AS 2501.

audit of financial statements, the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; and (ii) in an audit of internal control over financial reporting, the company maintained, in all material respects, effective internal control over financial reporting. The proposal also briefly addressed when circumstances require an auditor to express a qualified opinion, adverse opinion, or disclaimer of opinion and referred to AS 3105 and AS 2201 for a description of those circumstances. The proposed requirements were retained from AS 1001 with modifications to be consistent with provisions of AS 3101 and AS 2201.

One investor-related group requested that the required communications include CAMs, and that paragraph .17a of the proposed standard be revised to refer to CAMs "as a 'must contain' item in the auditor's report." The commenter was concerned with the low numbers of CAMs in auditor's reports and that auditors treat the determination of CAMs as "nearly a 'check the box' exercise." Another commenter suggested edits to proposed paragraphs .17 and .19 to align with existing requirements (e.g., adding the phrase "In an audit of financial statements" to paragraph .17a and moving the phrase "the company's" within paragraph .19).

The Board adopted paragraphs .17-.19 substantially as proposed with some modifications. After considering the comments received, the reference to CAMs in a footnote has been moved to a note to paragraph .17 to emphasize the importance of CAMs. The Board did not make any additional changes to address concerns regarding CAMs. The proposal was not designed to address concerns about the frequency or informative quality of CAMs. Although the Board understands the importance of the

concern raised by commenters, this is outside the scope of this project. The Board also revised paragraph .17a and paragraph .19 to incorporate commenters' suggestions described above. Additionally, the Board changed the phrase "modify the report" to "depart from an unqualified opinion" in paragraph .19 to align with other Board-issued standards that describe reports that include opinions other than an unqualified opinion.<sup>80</sup>

The Board proposed in paragraph .20 to require that the auditor communicate externally in accordance with applicable professional and legal requirements. This is an overarching requirement to communicate externally that is based on existing auditor communication requirements (e.g., AS 1301). The Board did not receive any comments on this requirement and are adopting it with slight modification. The Board changed "as required by" to "in accordance with" applicable professional and legal requirements to align with similar phrases used in other Board-issued standards.

### **Amendments Related to AS 1000**

The amendments the Board adopted are described below.

#### **1. Amendments to AS 2810 and Rescission of AS 2815**

The Board proposed to incorporate into AS 2810 the requirements of AS 2815 regarding the determination of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework for a more logical presentation, and to rescind AS 2815. Currently, AS 2810 requires the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, and AS 2815 describes the meaning of this evaluation. The proposed approach was intended to streamline these

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<sup>80</sup> See, e.g., AS 3105.

requirements into one standard and eliminate redundant or unnecessary language. A number of commenters commented on the proposed amendments to AS 2810. After considering the comments received, the Board adopted amendments to AS 2810 with certain modifications discussed below.

**i. Clarifying the meaning of "present fairly"**

The discussion in the proposing release was designed to clarify the auditor's existing obligation to evaluate the fairness of the financial statements in conformity with the applicable financial reporting framework by stating that "present fairly," under extant PCAOB standards, is a concept that goes beyond mere technical compliance with the requirements of the applicable financial reporting framework.

Some commenters, primarily investor-related groups, supported clarifying the meaning of "present fairly" and provided additional suggestions on amendments to AS 2810. Two investor-related groups suggested that the Board consider going further and require auditors to focus on whether the financial statements are a fair presentation of the company's position rather than narrowly focusing on whether the company is following U.S. GAAP. One investor-related group suggested adding the word "and" immediately before the phrase "in conformity" to make it clear that there is an expectation that the financials are presented fairly, in all material respects *in addition to* conforming with the applicable financial reporting framework. Another group said that auditors should aid in disclosing and providing transparency around the sensitivity and accuracy of climate-related estimates and assumptions.

Other commenters, primarily firms and firm-related groups, viewed the proposed amendments as an expansion of auditors' existing responsibilities. Some commenters



asserted that the statement in the proposal that the auditor's judgments concerning the fair presentation of the financial statements go beyond compliance with the applicable financial reporting framework may create a conflict between the auditor's judgment and management's judgment and introduce potential inconsistency in accounting treatment. Others expressed concern that under the proposal, auditors would expect the company to override the requirements of an applicable financial reporting framework if the financial statements prepared in accordance with the framework did not fairly present the substance of the company's financial results.

Some commenters suggested retaining language from AS 2815.03 which states, "The independent auditor's judgment concerning the 'fairness' of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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." Other commenters suggested explicitly retaining the concept of professional judgment for evaluation of fair presentation.

The Board's proposed clarification of "present fairly" was not intended to change the auditor's existing responsibilities for the evaluation of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework.

First, the amendments to AS 2810 clarify that "presents fairly" involves evaluating whether information in the financial statements is presented and classified appropriately and in a manner that is not misleading, and that this evaluation is made within the applicable financial reporting framework. Contrary to the views of some

commenters, the amendments do not require auditors to expect that the company override or deviate from the requirements of the applicable financial reporting framework. Any override or deviation from the requirements of the applicable financial reporting framework would normally result in a departure from an unqualified opinion under PCAOB standards.<sup>81</sup> Further, the auditor is required to evaluate the risk of omitted, incomplete, or inaccurate disclosures as part of the auditor's risk assessment procedures.<sup>82</sup>

Second, the amendments acknowledge that applicable financial reporting frameworks recognize that additional disclosures may be needed to ensure fair presentation. For example, as noted above, the SEC requires by rule that a company provide further material information as necessary to make any required statements, in the light of the circumstances under which they are made, not misleading.<sup>83</sup> This obligation is also consistent with the accounting standards issued by the FASB<sup>84</sup> and International

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<sup>81</sup> See AS 3105. In addition, under SEC rules, a company's "[f]inancial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided." 17 CFR § 210.4-01(a)(1) (Regulation S-X Rule 4-01(a)(1)). Paragraph (a) of that rule also provides that "the information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

<sup>82</sup> See, e.g., AS 2110.67, which requires the auditor, as part of the auditor's evaluation of fraud risk factors, to include evaluation of how fraud could be perpetrated or concealed by presenting incomplete or inaccurate disclosures or omitting disclosures that are necessary for the financial statements to be presented fairly in conformity with the applicable financial reporting framework.

<sup>83</sup> See 17 CFR § 210.4-01(a) (Regulation S-X Rule 4-01(a)).

<sup>84</sup> See, e.g., FASB Accounting Standards Codification ("FASB ASC") paragraph 105-10-05-1, Generally Accepted Accounting Principles – Overall – Overview and Background ("Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants."); FASB ASC paragraph 235-10-05-3, Presentation – Notes to Financial Statements – Overall - Overview and Background – Importance of Accounting Policies Disclosure ("The accounting policies of an entity are the specific accounting principles and the methods of applying those principles that are judged by the management of the entity to be the most appropriate in the circumstances to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles (GAAP) and that, accordingly, have been adopted for preparing the financial statements.").

Accounting Standards Board ("IASB").<sup>85</sup> Thus, when the auditor evaluates whether company transactions have been recorded and presented in conformity with the applicable financial reporting framework, the auditor may determine that additional company disclosures are needed to better reflect the substance of the transactions. Such evaluation is currently required under both AS 2810.31 and AS 2815.06, and the requirement is retained in the amendments to AS 2810.30A and .31.

In response to commenters, the Board retained, in the first note to AS 2810.30, the language of AS 2815.03, with some modifications. Specifically, the Board revised the reference to "generally accepted accounting principles" to "applicable financial reporting framework." The Board rephrased the sentence to emphasize that the "applicable financial reporting framework provides the basis for the auditor's judgment regarding the presentation of financial position, results of operations, cash flows, and disclosures in financial statements." The Board also agrees with commenters that the auditor's evaluation of fairness of presentation of the financial statements is an exercise of

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<sup>85</sup> See, e.g., IASB International Accounting Standards ("IAS") 1, paragraph 15, Presentation of Financial Statements – Financial Statements – General features – Fair presentation and compliance with IFRSs ("Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation."); IAS 1, paragraphs 19-24, Presentation of Financial Statements – Financial Statements – General features – Fair presentation and compliance with IFRSs (describing financial reporting responsibilities in the "extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Conceptual Framework*"); IAS 8, paragraph 10, Accounting Policies, Changes in Accounting Estimates and Errors ("In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is: (a) relevant to the economic decision-making needs of users; and (b) reliable, in that the financial statements: (i) represent faithfully the financial position, financial performance and cash flows of the entity; (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form; (iii) are neutral, ie free from bias; (iv) are prudent; and (v) are complete in all material respects.").

professional judgment in the context of an applicable financial reporting framework. The first note to AS 2810.30 refers to the auditor's judgment when evaluating the fairness of the overall presentation of financial statements.

The Board also added a new footnote to paragraph .30A, as discussed below, referencing SEC Rule 4-01(a) that describes the company's obligation regarding additional information that may need to be disclosed in the financial statements so that the financial statements are not misleading.

**ii. References to SEC Rule 12b-20**

The proposed amendment to AS 2810.30 included a new footnote 17A that referred to a company's responsibility pursuant to SEC Rule 12b-20 under the Exchange Act, 17 CFR § 240.12b-20 ("SEC Rule 12b-20"). That rule requires the company to disclose "such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading."

Most commenters who addressed the proposed citation to SEC Rule 12b-20 expressed concern with it. While one investor-related group recommended relocating the proposed footnote to the body of the amendments due to its significance, other commenters suggested removing the reference to SEC Rule 12b-20, with some commenters objecting primarily because the rule pertains to companies' disclosures within or beyond the financial statements. Some commenters emphasized that disclosures beyond the financial statements are the responsibility of companies rather than of auditors. Many expressed concerns that referring to the rule might be viewed as expanding the auditor's responsibilities, or would conflict with the auditor's

responsibilities described in AS 3101.08e.<sup>86</sup> One of these commenters suggested citing SEC Rule 4-01(a)(1) instead, because that rule relates specifically to financial statements, upon which the auditor expresses an opinion.

After considering the comments received, the Board deleted proposed footnote 17A with the reference to SEC Rule 12b-20 from the final amendment to AS 2810.30 because that rule reflects a company's responsibilities for information beyond as well as within the financial statements.<sup>87</sup> Instead, the Board retained the existing note to that paragraph requiring that the auditor look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company. The requirements of the SEC for the company under audit are included in SEC Rule 4-01(a), which the Board referenced in a new footnote to paragraph .30A, to remind auditors of the company's obligation regarding additional information that may need to be disclosed in the financial statements so that the financial statements are not misleading.

**iii. Other clarifications to proposed AS 2810.30A**

The Board proposed a new paragraph AS 2810.30A based on the extant requirement from AS 2815.04, using language consistent with other PCAOB standards. Specifically, the Board:

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<sup>86</sup> AS 3101.08e requires that the auditor's report include an opinion that the financial statements present fairly, in all material respects, the financial position of the company, results of operations, and cash flows in conformity with the applicable financial reporting framework, and that the opinion identify the applicable financial reporting framework.

<sup>87</sup> The auditor's responsibility for other information outside of the financial statements is specified in AS 2710, *Other Information in Documents Containing Audited Financial Statements*.

- Combined the concepts in AS 2815.04a – b regarding acceptability and appropriateness of accounting principles and presented them in AS 2810.30Ab;
- Retained the concepts from AS 2815.04c – d regarding informativeness of information presented in the financial statements and presented them as a new AS 2810.30Aa; and
- Retained the concepts from AS 2815.04e regarding transactions presented in the financial statements within a range of acceptable limits as a new AS 2810.30Ac and an amendment to AS 2810.31.

Several commenters expressed concern about not retaining the reference to the "within a range of acceptable limits" from AS 2815 and suggested (i) retaining this phrase in AS 2810.30A or (ii) revising proposed 2810.30A to include a footnote referencing AS 2110 or a note describing the relationship between AS 2810.30A and AS 2110 and adding "in all material respects" to AS 2810.30Ac. Another commenter suggested defining "a reasonable investor" used in AS 2810.30Aa. One commenter encouraged the Board to provide guidance on the use of the term "informative" in AS 2810.30A because it could be widely interpreted and applied in practice.

In addition, several commenters suggested including or clarifying certain terminology or concepts used in the proposed new paragraph, AS 2810.30A. Suggestions included:

- Referencing the importance of exercising professional judgment when evaluating the requirements specified in AS 2810.30A; and

- Clarifying that (i) "financial statements" include all notes to the statements and all related schedules;<sup>88</sup> and (ii) "disclosures" used in AS 2810.30A means "accompanying notes," not other information included in management discussion and analysis ("MD&A") and other disclosures included in the annual report.

After considering the comments received, the Board retained proposed paragraph .30A with modifications discussed below.

The final AS 2810.30A requires an auditor, when evaluating whether the financial statements (including the accompanying notes) present fairly the financial position, results of operations, and cash flows, in all material respects, in conformity with the applicable financial reporting framework, to evaluate whether:

- a. The financial statements are informative of matters that may affect their use, understanding, and interpretation; and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading;
- b. The accounting principles selected and applied by the company's management are appropriate in the circumstances; and
- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements.

The Board added "(including the accompanying notes)" in AS 2810.30A to clarify that financial statements include the accompanying notes, to match the description in AS 2810.31 of financial statements as "financial statements (including the accompanying notes)." Because the Board uses "disclosures" as an interchangeable term with "notes" or

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*See* 17 CFR 210.1-01(b) (Regulation S-X Rule 1-01(b)).

"accompanying notes" throughout PCAOB standards, it is unnecessary to further clarify the terms in AS 2810.30A. The Board also did not add a reference to professional judgment in AS 2810.30A, but as discussed above the Board revised the first note to AS 2810.30 to clarify that the auditor uses professional judgment when evaluating the fairness of financial statements.

The term "informative" is in AS 2815.04c, which refers to AS 2810.31, which in turn provides additional considerations for evaluation of information disclosed in the financial statements (e.g., consideration of the form, arrangement, and the amount of detail given). To clarify this further, the Board retained in the final standard language from AS 2815.04c stating that the information in the financial statements is presented appropriately, in a manner that is "informative of matters that may affect their use, understanding and interpretation" and not misleading. The Board removed the reference to "reasonable investor" from AS 2810.30A because it was limiting and did not consider a broader population of financial statement users (e.g., creditors). The Board also believes that introducing "reasonable investor" in AS 2810.30A may create confusion by implying that an analysis is needed that is distinct from determining if the financial statements are presented fairly in conformity with the applicable financial reporting framework.

Finally, the Board does not believe it is necessary to retain a reference to "within a range of acceptable limits" in AS 2810.30A. The standard is clear that evaluation of fairness is based on auditor judgment and that the concept of materiality is inherent in that judgment, which involves the consideration of qualitative as well as quantitative factors. The combination of these considerations should be clear that not every



transaction or account is evaluated to arrive at the conclusion that the company's financial statements, taken as a whole, are presented fairly, in all material respects.

**iv. Other clarifications to proposed AS 2810.31**

The Board proposed to revise the note to AS 2810.31 by (i) removing the first sentence that describes the requirements from AS 3105 (i.e., inadequate disclosures) and instead adding a reference to AS 3105.24-.27 in paragraph .31, and (ii) adding an extant requirement from AS 2815.06 for the auditor to also evaluate whether the substance of transaction or events differs materially from their form, but changing it from "should consider" to "should evaluate."

Several commenters suggested, in addition to retaining the requirement from AS 2815.06, to also retain a provision from AS 2815.06 that states "generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance." Some commenters suggested not changing the "should consider" requirement from extant AS 2815.06 to "should evaluate" when evaluating a transaction in substance over form. Additionally, some commenters recommended removing or relocating the note in AS 2810.31 to proposed AS 2810.30A for better context.

Two investor-related groups suggested providing guidance on AS 2810.31 by adding the existing concept of what the auditors are required to do (per AS 2815.04c) when the applicable financial reporting framework does not provide guidance (e.g., financial statements and accompanying notes do not disclose the necessary information required), or what considerations should be given by auditors in evaluating fair presentation of financial statements in accordance with proposed AS 2810.30.

After considering the comments received, rather than amending the existing note to AS 2810.31, the Board removed the note in its entirety. The Board believes that a separate requirement to evaluate whether the substance of transactions differs from their form is unnecessary in light of the requirement in new AS 2810.30Aa. As discussed above, AS 2810.30Aa requires auditors to evaluate "whether the financial statements are informative of matters that may affect their use, understanding, and interpretation;" and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading. This evaluation includes determining whether additional disclosures are necessary to reflect, for example, the substance of the company's transactions. The auditor's evaluation of whether company transactions have been recorded and presented in conformity with the applicable financial reporting framework includes the determination of whether additional disclosures are needed in the financial statements.

The Board also believes that AS 2810.31 and the amendments are comprehensive and clear, and thus no additional guidance is warranted. For example, under US GAAP and IFRS, management has a range of conforming choices in selecting classifications and measurements of revenue recognition, segment reporting, and fair value measurement. The auditor is responsible for evaluating whether the disclosures reflect the choices made by management and are not misleading to investors and other financial statement users.

## **2. Amendments Related to Engagement Partner Responsibilities for Supervision**

### **i. Seeking assistance from other engagement team members**

AS 1201 and AS 2101 establish the engagement partner's responsibility for the engagement and its performance, including planning, supervision, and review. The Board proposed to amend the existing requirements in AS 1201 and AS 2101 to clarify that even when the engagement partner seeks assistance from other engagement team members, the engagement partner retains the primary responsibility for the engagement and its performance. One commenter strongly supported these amendments, and the Board adopted them as proposed.

The final notes added to AS 1201 and AS 2101 clarify that while an engagement partner may seek assistance on specific tasks from other engagement team members, they continue to retain the primary responsibility for supervising, reviewing, and ensuring the quality of the work performed in the audit. In other words, the work of other engagement team members does not replace or reduce the engagement partner's responsibility for the engagement and its performance.

**ii. Timing of review**

The Board also proposed a requirement to clarify that the review and evaluation by the engagement partner (and as applicable by other engagement team members performing supervisory activities) of work performed by engagement team members, as described in AS 1201.05c, must be completed prior to the report release date. These amendments did not receive any comment and are being adopted as proposed.

**iii. Workpaper review**

The Board proposed to amend AS 1201 to clarify the extent of the planning, supervisory, review, and documentation activities to be performed by the engagement partner by aligning those activities with existing auditor responsibilities under AS 1015

because the Board believes that the engagement partner's review of audit documentation is an important part of supervision. These amendments were intended to reaffirm the engagement partner's supervisory and review responsibilities in the context of exercising due professional care.<sup>89</sup> Specifically, the Board proposed to add a note stating that notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner is required to review sufficient documentation to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner's attention pursuant to AS 1201.05b, were appropriately addressed; (iii) the conclusions expressed in the auditor's report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. The proposed note also provided that the engagement partner's review includes review of documentation of significant findings or issues<sup>90</sup> and review of documentation that is also subject to review by the EQR, citing the provisions of AS 1220 that specifically require the EQR to review certain documentation.<sup>91</sup>

One commenter stated that the proposed amendments were overly prescriptive and should allow more flexibility regarding the engagement partner's review and sign-off. Another commenter recommended clarifying how due professional care in AS 1201 relates to the engagement partner's responsibilities in AS 1000. This commenter further

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<sup>89</sup> See AS 1000.10 discussed above.

<sup>90</sup> See AS 1215.12.

<sup>91</sup> See AS 1220.09-.10 and .14-.15.

recommended better aligning AS 1201 with proposed AS 1000.09, including the interplay between Note 2 of AS 1201.05, which has specific workpaper review requirements by the engagement partner, while AS 1201.04 also allows the engagement partner to seek assistance from other engagement team members.

After considering the comments received, the Board adopted amendments to AS 1201 substantially as proposed. The Board believes that the amendments clarify the engagement partner's existing obligations for supervision and review. As the engagement team member with primary responsibility for the engagement, the engagement partner must review, at minimum, sufficient documentation of specific audit areas that are deemed important to support the auditor's opinion. Without reviewing sufficient documentation in these areas, the engagement partner would not be able to demonstrate that the engagement partner has the primary responsibility for the audit.

One commenter asserted that the proposed requirement that the "engagement partner's review should include review of documentation ... subject to review by the engagement quality reviewer" could be interpreted to require the engagement partner to review all documentation reviewed by the EQR, beyond what is required in AS 1220.10 or .15. Another commenter expressed concern about the proposed note stating that in multi-tiered audits, other audit partners, not only the engagement partner, should retain the ability to review all documentation subject to EQR review. This commenter suggested not linking engagement partner review requirements to documentation subject to review by EQR.

In response to the commenters, the Board clarified the final requirement by changing the phrase "review of documentation subject to review by the engagement

quality reviewer" to "review of documentation required to be reviewed by the engagement quality reviewer pursuant to the requirements of paragraphs .09-.10 and .14-.15 of AS 1220 ...". This revision further clarifies that the Board expects the engagement partner to review the documentation that the engagement quality reviewer is required to review in order to comply with those provisions of AS 1220, rather than all of the documentation that the engagement quality reviewer may have actually reviewed. The Board believes that the documentation of significant judgments made and conclusions reached by the engagement team that is required to be reviewed by the EQR provides important information to the engagement partner. This is true for all engagements, including multi-location and multi-tiered engagements. The extent of documentation reviewed by the EQR and, under the final amendment, by the engagement partner, will depend on the facts and circumstances of the particular engagement. Further, the requirement for the engagement partner to review documentation required to be reviewed by the EQR does not preclude other engagement team members performing supervisory activities to also review this documentation.

Several commenters further expressed concerns that the proposed amendments create an incorrect perception that the responsibility for all phases of the audit resides with the engagement partner only without any consideration given to the responsibility of the firm or other engagement team members. One of these commenters further suggested including a statement that the engagement partner should tailor the extent of their supervision based on a variety of factors as described in AS 1201.06. AS 1201.05 specifically addresses the responsibilities of the engagement partner relating to

supervision of engagement team members, and the Board does not think it is necessary to change these requirements to address the responsibilities of others.

One commenter stated that the engagement partner's review of documentation to determine that the engagement was performed as planned may be construed as expanding the partner review requirements beyond AS 1215.12c because the review of documentation only relates to "results of auditing procedures that indicate a need for significant modification of planned auditing procedures." The Board does not believe that Note 2 of AS 1201.05 expands the engagement partner's responsibilities. AS 2101.03 states that the engagement partner is responsible for planning the audit and that the engagement partner retains primary responsibility for the engagement and its performance. In addition, the documentation requirements under AS 1215 are not limited to the significant findings and issues described in AS 1215.12 and there are other documentation requirements outside of documenting specific matters.

Another commenter further suggested that the Board define "sufficient documentation" used in proposed Note 2 of AS 1201.05. The Board does not believe this is necessary. What is sufficient will depend on the facts and circumstances of the particular engagement under review. The amount of documentation that the engagement partner would review will vary depending on the associated risk involved in the audit area and the nature of the work performed that the engagement partner reviews. The Board further clarified this point, by changing "sufficient documentation to determine" to "documentation sufficient to determine" in the final amendment. This change is designed to better connect the concept of sufficiency with the matters that the engagement partner will determine.

The Board also proposed other amendments to AS 1201 and AS 2101 to conform to the adoption of AS 1000. These technical and clarifying amendments included replacing references to titles of existing standards with the title of the new standard and updating cross-referenced terminology and paragraph citations. The Board adopted these other amendments as proposed as no comments were received.

### **3. Amendments Related to Documentation**

The Board proposed several amendments to AS 1215 discussed in more detail below. Commenters generally supported the proposed amendments to AS 1215. Some commenters provided specific comments related to (i) documentation completion date and (ii) specific audit documentation and timing for documentation review. These are discussed in more detail below.

#### **i. Documentation completion date**

Audit documentation is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions.<sup>92</sup> Under existing standards, a complete and final set of audit documentation is required to be assembled for retention as of a date not more than 45 days after the report release date, known as the documentation completion date.<sup>93</sup> The Board proposed to accelerate the

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<sup>92</sup> See AS 1215.02.

<sup>93</sup> See AS 1215.15.



documentation completion date by reducing the maximum period from 45 days to 14 days.

Many commenters who addressed the amendment generally supported it or agreed that the proposed acceleration of the documentation completion date would be appropriate or result in increased audit quality. Two commenters further stated that the shorter period of 14 days would not cause significant changes at most firms.

Several commenters raised concerns over the acceleration of the documentation completion date. One commenter stated that the acceleration would likely lead to more audit quality issues due to the increasingly more complex financial accounting, reporting, and auditing landscape requiring more time as well as the current talent crisis. Another commenter stated that 14 days is too short to handle any unforeseen consequences (e.g., technology interruptions). Another commenter questioned whether acceleration of documentation will (i) have any meaningful impact on PCAOB inspection timelines and operating efficiencies and (ii) be workable for smaller firms, who may not have the technology to implement this change.

Two commenters, both investor-related groups, recommended further shortening the documentation completion date to two days because an earlier PCAOB inspection would benefit investors. These two investor-related groups and another commenter questioned why 14 days is a more appropriate timeframe. Focusing on challenges that smaller firms may face in implementing the acceleration, and the diversity across global network firms in documentation archive systems, several commenters recommended a phased implementation approach or extending the implementation over a longer period (e.g., two-year period).

The proposal also sought comment, in light of the proposed 14-day documentation completion date, on whether firms would have difficulty, when filing Form AP within 35 days of the audit report being filed, complying with AS 1215.16. That paragraph of AS 1215 prohibits the deletion or discarding of audit documentation after the documentation completion date but permits the addition of documentation under certain conditions. Two firms stated that they did not foresee significant difficulties in complying with AS 1215.16 with additional costs, while another firm indicated some technological and process challenges. Two commenters recommended making both due dates (i.e., documentation completion date and Form AP due date) the same.

After considering the comments received, the Board adopted the accelerated documentation completion date of 14 days as proposed with modification to the effective date for certain firms discussed below. The 14-day timeline strikes a good balance of meeting the objectives of this amendment (e.g., enhance investor protection by enabling the Board to begin the inspection process sooner after the completion of an audit) while still allowing a two-week period (14 calendar days) to assemble audit documentation for retention (i.e., archive audit documentation). As echoed by some commenters, the Board believes that the accelerated documentation period will not require a significant change for many firms. In the Board's view, the changes to the archiving period (i.e., 14 days) are necessary to focus auditors on assembling a complete set of audit documentation that is high-quality and without documentation errors or omissions in a timely manner. The Board believes that a delay in assembling the audit documentation increases the potential for omissions to occur.

Further, shortening the archiving period also reduces the window of opportunity for improper alteration of audit documentation and increases the quality of documentation because recalling and describing audit procedures long after the work was actually performed can be difficult.

In accordance with AS 1215, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report before the report release date.<sup>94</sup> The presence of complex financial accounting, reporting, or auditing matters should not have a bearing on the archiving period as the effects of such matters on the audit should be addressed before the report release date (i.e., before the 14 days to assemble the audit documentation). Under existing AS 1215.16 auditors are allowed to add documentation after the documentation completion date, if needed.<sup>95</sup> While the Board understands that in practice some firms use a short archiving period, the Board believes that an archiving period of two days, as suggested by investor-related groups, may be too short to handle any unforeseen consequences (e.g., technology interruptions) and could result in inadvertent non-compliance.

The Board also continues to believe that the accelerated documentation completion date of 14 days is still appropriate even when considering the Form AP deadline of 35 days. The Board acknowledged that in most situations, firms currently have 35 days to file Form AP,<sup>96</sup> and a firm must document the computation of total audit

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<sup>94</sup> See AS 1215.15 (as amended).

<sup>95</sup> See AS 1215.16.

<sup>96</sup> Form AP has a filing deadline of 35 days after the date the auditor's report is first included in a document filed with the SEC, or 10 days after the auditor's report is first included in a

hours and include that computation in the files.<sup>97</sup> If the actual hours become available after the documentation completion date but before the Form AP filing, the auditor is required under provisions of AS 1215 to add that information to the audit documentation after the documentation completion date.<sup>98</sup> The instructions to Form AP also provide that firms may use a reasonable method to estimate audit hours when actual hours have not been reported or are otherwise unavailable.<sup>99</sup>

The Board acknowledged that certain firms may have less technologically advanced systems in place and may need more time to implement new processes to comply with the accelerated documentation completion date requirement. Therefore, as discussed in more detail below, the effective dates for this requirement allow a phased-in approach for smaller firms to comply with the 14-day documentation completion date. This approach addresses implementation challenges that some commenters suggested smaller firms may face.

## **ii. Specific audit documentation and timing of review**

The Board also proposed to emphasize that audit documentation must clearly demonstrate who performed the work, who reviewed the work, and the date of such review.<sup>100</sup> In order for an engagement partner to conclude that the audit evidence obtained is sufficient and appropriate to support the opinion expressed in the auditor's

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document filed with the SEC for a registration statement under the Securities Act of 1933. PCAOB Rule 3211(b).

<sup>97</sup> See Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards, PCAOB Rel. No. 2015-008 (Dec. 15, 2015).

<sup>98</sup> See AS 1215.16.

<sup>99</sup> See *Instructions to Form AP, Part IV – Responsibility for the Audit is Not Divided*.

<sup>100</sup> See AS 1215.06.

report,<sup>101</sup> the audit work is required to be reviewed prior to the report release date.

Therefore, the Board also proposed to amend AS 1215.15 to clarify that, before the report release date, the engagement partner and other engagement team members performing supervisory activities have completed their reviews of audit documentation.

One commenter raised a concern that the amendments may result in lower quality documentation and an increase in late filings, providing an example of when a significant issue emerged closer to the issuer's filing deadline, because additional time to complete and review the relevant documentation would be needed. Another commenter suggested further clarifying whether the engagement partner and other supervisors must ensure that all review notes have been sufficiently addressed prior to the report release date.

The Board adopted the amendments to AS 1215 as proposed. The requirement for the engagement partner and other supervisors to review relevant audit documentation prior to the report release date is a clarification of existing requirements in AS 1215 and AS 2101. As discussed earlier, since the auditor's report is dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion,<sup>102</sup> the auditor must have completed all necessary auditing procedures, including documentation to support the work performed that is reviewed by the engagement partner and other reviewers, on or before the auditor's report date, in all cases. The engagement partner and other supervisors should refer to existing requirements in AS 1215.07, in determining the sufficiency of audit documentation. Several factors to consider include nature of the audit procedure, risk of material misstatement associated with the assertion,

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<sup>101</sup> See AS 2810.02.

<sup>102</sup> See paragraph .01 of AS 3110, *Dating of the Independent Auditor's Report*.

and extent of judgment required in performing the work and evaluating the results (i.e., accounting estimates require greater judgment and commensurately more extensive documentation).<sup>103</sup>

Lastly, in relation to proposed amendments in AS 1215.06 and .06A, one commenter agreed with the addition of paragraph .06A but suggested removing the phrase of "who performed the work, the person or persons who reviewed the work, and the date of such review" in AS 1215.06 because the same phrase is already included in AS 1215.06Ab. The Board did not make changes to the final amendments to AS 1215.06 and .06A. The addition of the phrase in paragraph .06 is an intentional clarification, rather than duplication, of what the audit documentation is required to demonstrate. The requirement in paragraph .06, is different, and relates to the sufficiency of documentation needed to meet the experienced auditor threshold.

The Board also proposed other amendments to AS 1215 to conform to AS 1000. These technical and clarifying amendments included replacing references to titles of existing standards with the title of the new standard and updating cross-referenced terminology and paragraph citations. The Board did not receive any comments relating to other amendments to AS 1215 and adopted those as proposed.

#### **4. Other Amendments**

In connection with the adoption of AS 1000, the Board also adopted other amendments to several PCAOB standards to conform with AS 1000, amendments to AS 2810, and rescission of AS 2815. These amendments include superseding the foundational auditing standards.

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<sup>103</sup> See AS 1215.07.

The other changes adopted include replacing references to titles of existing standards with the title of the final standard and updating cross-referenced terminology and paragraph citations.

The proposed amendments that received comments are discussed in more detail below.

**i. Amendments to AS 2710, *Other Information in Documents Containing Audited Financial Statements***

AS 2710.05 refers to differences in the auditor's judgment or opinion. The Board proposed to amend that standard in two ways, by clarifying that the difference of judgment or opinion is "between the auditor and the client," and by adding a footnote clarifying the meaning of "judgment." One commenter suggested replacing "the client" with "management" to be consistent with other PCAOB standards. Although the Board adopted other amendments that refer to the management and audit committee of the company under audit rather than to the auditor's "client," the Board did not make this change throughout the auditing standards because such a sweeping change is outside the scope of this project and may not be warranted in each instance, and thus could create confusion. Because "client" is used in AS 2710 throughout the standard, the Board retained the use of that term in the existing standard and in the amendment, and thus adopted the amendments to AS 2710.05 as proposed.

**ii. Amendments to AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion***

The Board proposed to move certain language in paragraph .01 of AS 3101 to AS 1000. The Board also proposed to move footnote 2 that describes the term "taken as a

whole" to paragraph .02 of AS 3101. Two commenters on the proposed amendments to AS 3101 suggested amending paragraph .11 and paragraph .14, primarily due to the declining number of CAMs disclosed by firms. Other commenters suggested adding language about the meaning of reasonable assurance means and the limitation of the audit in the auditor's report (paragraph .09 and Appendix B). The Board did not make these changes suggested by commenters because they are outside the scope of this project.

One commenter expressed concern that the meaning of "taken as a whole" was changed because a footnote was added to AS 3101.02. As discussed above, the Board did not change the meaning of "taken as a whole" by moving the existing footnote to another paragraph. The Board therefore adopted the amendments as proposed.

### **iii. Amendments to AS 4105, *Reviews of Interim Financial Information***

The Board proposed to replace references to titles of existing standards with the title of the final standard and update cross-referenced terms and paragraph citations in paragraphs .01 and .07. Three commenters noted that the amendments are appropriate. One commenter suggested adding "to the extent those standards are relevant" in AS 4105.01 when referencing AS 1000 because interim reviews are not required to provide reasonable assurance. The Board believes this addition is not necessary because the amendment refers only to compliance with independence and ethics requirements, competence, and exercise of due professional care, which are fundamental to any audit, review, or attestation engagements under the PCAOB standards. All of these concepts are relevant to AS 4105 without exception. The Board adopted the amendments as proposed.

### **iv. Amendments to Attestation Standards**



The Board proposed to replace references to titles of existing standards with the title of the final standard and update cross-referenced terms and paragraph citations. One commenter on these amendments stated that they are appropriate. Another commenter offered suggestions to (i) limit the references to AS 1000 in attestation standards because the general principles and responsibilities in AS 1000 should be specifically tailored to attestation engagements to be operable, (ii) retain paragraph .41 of AT Section 101, *Attest Engagements* a reference to *Cooley on Torts*, which was removed, and (iii) change the reference in footnote 9A of Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, as "review" engagement as opposed to "examination" engagement. The Board noted that the references to AS 1000 have been tailored to the attestation standards. The Board did not retain the reference to the 1932 treatise *Cooley on Torts* because, as the Board explained when it proposed AS 1000, that reference is unnecessary and AS 1000 explains the concept of due professional care in plain language without changing its meaning.<sup>104</sup> The Board revised the footnote of AT No. 2 to refer to a "review" engagement. Otherwise, the Board adopted the amendments as proposed.

## **EFFECTIVE DATE**

In the proposing release, the Board sought comment on the amount of time auditors would need before the proposed standard and related proposed amendments to PCAOB standards would become effective, if adopted by the Board and approved by the SEC. The Board proposed an effective date of June 30 of the year after approval by the SEC.

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<sup>104</sup> See PCAOB Rel. No. 2023-001, at 22.

A number of commenters, mostly firms, suggested that an effective date be based on a fiscal year end date (e.g., audits of fiscal years ending on or after December 15) rather than the proposed effective date of June 30 in the year after SEC approval. These commenters generally pointed to challenges associated with a mid-year implementation (e.g., need to update firm methodologies for foundational standards and for performance standards amended by this project, provide training). Specific dates suggested by commenters included: (i) audits of periods beginning on or after December 15, 2024 (assuming 2023 SEC approval); (ii) 12 months after SEC approval; (iii) 18 months after SEC approval; and (iv) 24 months after SEC approval.

In addition, a firm and a firm-related group suggested that the Board consider the effective dates for other standard-setting projects such as QC 1000 when setting the effective date for AS 1000. In response to commenters, and after considering the effective dates for other Board rulemaking projects, the Board revised the effective date for the new standard and related amendments.

Subject to approval by the SEC, the new standard and related amendments will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2024, except for the 14-day documentation completion date requirement (AS 1215.15). For that requirement, the Board adopted a phased approach to provide smaller firms more time to prepare for implementation. The requirement will take effect as follows:

- For public accounting firms that, during the calendar year ending December 31, 2024, issued audit reports with respect to more than 100 issuers, the 14-day documentation completion requirement will take effect for audits of

financial statements for fiscal years beginning on or after December 15, 2024;  
and

- For all other registered public accounting firms, the 14-day documentation completion requirement will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025.

The Board believes that changing the effective date to fiscal years beginning on or after December 15, 2024 responds to commenters who (i) expressed concerns about having a mid-year implementation and (ii) suggested that an effective date be based on a fiscal year-end date. Given the nature of requirements of the new standard and related amendments, as well as the extent of the differences between the new standard and the foundational standards, the Board believes that the general effective date will provide auditors with reasonable time to implement the new standard and related amendments. Further, extending the effective date for implementation of the 14-day documentation completion date requirement responds to the need articulated by commenters to provide smaller firms more time to prepare for implementation.

*D. Economic Considerations and Application to Audits of Emerging Growth Companies*

The Board is mindful of the economic impacts of its standard setting. This section describes the economic baseline, need, and expected economic impacts of the final standard and related amendments, as well as alternative approaches considered by the Board. Due to data limitations, the economic analysis is generally qualitative in nature.

The Board sought and received comments on the economic analysis in the proposing release.<sup>105</sup> A majority of the commenters expressed views related to the economic analysis, and they generally agreed with the need for the standard. Some commenters suggested that the use of certain proposed language or certain proposed clarifications could result in potential confusion or expansion of auditors' responsibilities or that the proposed removal of certain extant explanatory language could reduce transparency regarding the meaning of the general principles and responsibilities and exacerbate an audit expectation gap. Some commenters suggested that the economic analysis should more carefully consider potential costs or unintended consequences associated with certain key provisions. These comments are addressed below. One commenter asserted that costs that have not been analyzed, quantitatively or qualitatively, include costs to firms from new legal duties and auditor responsibilities. The commenters did not provide data to support their concerns about potential costs and unintended consequences. Their views were based on interpretations that the Board's proposal would make broader changes. However, the Board believes the economic analysis is appropriate and consistent with the limited scope of changes the rulemaking requires. Commenters generally agreed that accelerating the documentation completion date is feasible for firms and beneficial to investors, although some commenters noted potential costs or questioned the expected benefits. One commenter suggested potential unintended consequences associated with clarifying engagement partner responsibilities. Three commenters referenced additional academic research for the Board's consideration. These comments are addressed below.

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<sup>105</sup>*See id.* at 55-57.

The Board considered all of the comments received and have developed an economic analysis below that includes these considerations and evaluates the expected benefits and costs of the final standard and related amendments, discusses potential unintended consequences, and facilitates comparison to alternative actions considered. Specific input is discussed where relevant in the analysis that follows.

**A. Baseline**

The discussion above describes important components of the baseline against which the economic impacts of the standard can be considered, including an overview of existing requirements. Below is the Board's discussion of additional matters that informed its understanding of the baseline for each of the changes.

**1. Modernization of the Foundational Standards**

The discussion above provides an overview of existing requirements of the auditing standards that describe the general principles and responsibilities of the auditor in conducting an audit in accordance with the standards of the PCAOB (i.e., foundational standards). The general principles and responsibilities addressed by the foundational standards are described above and include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment.

The foundational standards are required to be followed in every audit conducted in accordance with PCAOB standards. The general principles and responsibilities in the foundational standards are reflected in firm methodologies, commercially published guidance, and other technical tools. Although there may be circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by how the foundational standards are organized and written, the

Board does not have evidence that auditors are systematically confused about the meaning of the general principles and responsibilities or that the foundational standards are insufficient to support high-quality audits, when applied appropriately.

One commenter suggested there is no evidence that audit personnel are unclear or uncertain about the meaning of the proposed requirements. An investor-related group noted that the proposed standard was consistent with the extant standards.

The views expressed by the commenters align with the Board's belief that the core general principles and responsibilities encompassed by the foundational standards are well-established and sound. While the foundational standards are currently spread across four standards (i.e., AS 1001, AS 1005, AS 1010, AS 1015), contain some extraneous restrictive language, and do not emphasize the investor protection obligation as prominently as desired, applied appropriately, they are sufficient to support high-quality audits.

## **2. Clarification of Engagement Partner Responsibilities**

Under PCAOB standards, engagement partners are responsible for the engagement and its performance, including the proper planning and supervision of the engagement and its compliance with PCAOB standards. While engagement partners are permitted to seek assistance from other team members performing supervisory activities, engagement partners are responsible for proper supervision of the engagement and have primary responsibility for the engagement.

As discussed in the proposal, the staff reviewed firms' available methodology documentation to obtain an understanding of firms' policies and practices for engagement

partner review.<sup>106</sup> A number of larger firms have developed specific guidance, checklists, and other tools to facilitate the engagement partner's review. For example, some firms mandate the use of tools that specify workpapers or topics that engagement partners are required to review directly. These tools require the engagement partner to document their review. Conversely, similar policies of some smaller firms are designed to be applied at a higher level and are not as specific about the required review.<sup>107</sup> The Board did not receive comments that provided additional information addressing the baseline for engagement partner review.

### **3. Accelerating the Documentation Completion Date**

The auditor is required to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. Auditors may need some time after the report release date to assemble the final audit file and complete the audit documentation. The PCAOB standard on audit documentation currently requires completion of documentation within 45 days after the report release date.

When PCAOB inspection staff select issuer audits for inspection, PCAOB notice of inspection and access to firm audit documentation generally do not occur until after the documentation completion date. After an inspection is complete, the Board issues a report

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<sup>106</sup> See *id.* at 36.

<sup>107</sup> The observations in this paragraph are based on the staff's review of the policies of U.S. global network firms ("GNFs") and U.S. non-affiliate firms ("NAFs"). GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.). NAFs are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

on the inspection, and a portion of each report is made available to investors and the public on the PCAOB's website.

As discussed in the proposal, the staff reviewed firms' stated archiving policies and firms' archiving practices to obtain an understanding of firms' policies and practices for completing audit documentation.<sup>108</sup> The Board found a wide range of archiving periods among firms, from the full 45-day period to a much shorter period. In addition, PCAOB staff has observed that certain firms require audit documentation to be archive-ready upon completion of interim audit procedures. The PCAOB established the 45-day period in 2004<sup>109</sup> when firms relied more on paper documentation and needed time to copy, collate, finalize, and file workpapers. PCAOB staff has observed that most firms today have electronic audit tools and audit software that either make those tasks unnecessary or enable the tasks to be performed much faster.

Some U.S. GNFs require engagement teams to archive audit documentation within 10 days after the report release date. Other firms require engagement teams to archive audit documentation within longer periods (ranging from 30 to 45 days after the report release date). Of the firms with policies that allow longer periods, certain of them express expectations to complete documentation within a much shorter period.

All GNFs have established global policies for archiving to be used by their respective non-U.S. affiliate firms. The global policies generally allow for completion of documentation not more than 45 days after the report release date. The global policies of certain GNFs specify a documentation completion date within 14 days after the report

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<sup>108</sup> See PCAOB Rel. No. 2023-001, at 37.

<sup>109</sup> See *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Rel. No. 2004-006 (June 9, 2004), at 5.



release date, or sooner when required by local laws or regulations. In addition to the global policies, certain non-U.S. affiliates of GNFs have local policies requiring documentation completion dates earlier than their respective global policies. Examples observed through the PCAOB's 2022 inspections include non-U.S. affiliates that have local policies specifying completion of documentation by deadlines such as 2 days, 7 days, 10 days, 14 days, and 30 days after the report release date. Additionally, even among certain non-U.S. affiliates that have stated policies of 45 days after the report release date, their documentation systems require completion of documentation within 15 to 40 days (depending on the firm). Generally, non-U.S. affiliates of GNFs use electronic audit documentation systems for documentation and archiving.

The archiving policies of NAFs generally specify a documentation completion date of 45 days after the report release date. PCAOB staff has observed certain NAFs annually inspected by the PCAOB that, in practice, typically archive documentation within 40 days of the report release date. In addition, PCAOB staff has noted that certain other NAFs generally complete their documentation at the end of the full 45-day archiving period. While most NAFs use electronic audit documentation systems, PCAOB staff is aware that some smaller firms still use paper-based workpapers.

The Board did not receive comments specific to the baseline for the documentation completion date, including additional information on firms' current archiving policies and practices.

## **B. Need**

The changes introduced in the final standard are part of the Board's effort to continuously improve and update PCAOB standards. In practice, PCAOB standards are

used by auditors, who are responsible for applying the general principles and responsibilities of the foundational standards. Investors and other stakeholders may also rely on the foundational standards (directly or indirectly) to establish expectations about auditor responsibilities.

**1. Problem to be Addressed**

**i. Modernization of the foundational standards**

The Board identified three potential concerns about the foundational standards:

(i) compliance with the standards; (ii) soundness of the general principles and responsibilities; and (iii) clarity of the standards. The next three subsections explain that the Board does not see a need to make changes to the standards based on compliance with the standards or soundness of the general principles and responsibilities, but does see a need to make changes to modernize and enhance the clarity of the foundational standards.

**a. Compliance with the foundational standards**

In some instances, auditors have not performed audits in compliance with the foundational standards. For example, for the years 2018-2022, the PCAOB issued almost two dozen enforcement orders that described the violation of at least one of the foundational standards. One commenter, an academic, noted research that suggests that audit failures often relate to basic areas of auditor responsibility, such as failure to gather sufficient appropriate audit evidence, failure to exercise due professional care, or insufficient professional skepticism.<sup>110</sup> The commenter added that contributing factors to

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<sup>110</sup> See, e.g., Mark S. Beasley, Joseph V. Carcello, Dana R. Hermanson, and Terry L. Neal, *An Analysis of Alleged Auditor Deficiencies in SEC Fraud Investigations: 1998-2010* (commissioned by Center for Audit Quality) (May 2013).

the noted failures appear to be auditor disincentives to be skeptical<sup>111</sup> or high auditor workloads.<sup>112</sup> For example, research indicates that professional skepticism could be affected by priorities such as engagement budgets rather than investor protection.<sup>113</sup> The commenter also suggested that persistent audit deficiencies, despite PCAOB inspection and enforcement efforts, highlight the importance of auditors' understanding of and compliance with foundational auditing principles.<sup>114</sup> The views expressed by the commenter seem to align with the Board's understanding of auditors' adherence to the foundational standards and the Board's assessment of the need to modernize and clarify those standards, including a reaffirmation of the auditor's obligation to protect investors.

b. Soundness of the general principles and responsibilities

The foundational standards address the general principles and responsibilities of reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. These principles and responsibilities are interconnected. For example, due professional care requires the auditor to exercise professional skepticism, including a questioning mind and a critical assessment of audit evidence. Audit procedures performed with due professional care allow the auditor to

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<sup>111</sup> See, e.g., Joseph F. Brazel, Scott B. Jackson, Tammie J. Schaefer, and Bryan W. Stewart, *The Outcome Effect and Professional Skepticism*, 91 *The Accounting Review* 1577 (2016) and Joseph F. Brazel, Christine Gimbar, Eldar M. Maksymov, and Tammie J. Shaefer, *The Outcome Effect and Professional Skepticism: A Replication and a Failed Attempt at Mitigation*, 31 *Behavioral Research in Accounting* 135 (2019).

<sup>112</sup> See, e.g., Julie S. Persellin, Jaime J. Schmidt, Scott D. Vandervelde, and Michael S. Wilkins, *Auditor Perceptions of Audit Workloads, Audit Quality, and Job Satisfaction*, 33 *Accounting Horizons* 95 (2019).

<sup>113</sup> See, e.g., Brazel et al., *The Outcome Effect and Professional Skepticism* and Brazel et al., *The Outcome Effect and Professional Skepticism: A Replication and a Failed Attempt at Mitigation*.

<sup>114</sup> See, e.g., Ashna L. Prasad and John C. Webster, *What Are the Trends in PCAOB Inspections and the Reported Audit Deficiencies?* 37 *Journal of Accounting, Auditing & Finance* 523 (2022).

obtain reasonable assurance about whether the financial statements are free of material misstatement. Reasonable assurance is achieved, in part, by the exercise of professional judgment, which involves the auditor making decisions based on applying relevant training, knowledge, and experience. There is ample published research that studies alternative versions of these general principles and responsibilities. Below is a summary of several papers that demonstrate an ongoing debate regarding alternatives.

As noted in the proposal,<sup>115</sup> academic research regarding professional skepticism provides a model that identifies two components – skeptical judgment and skeptical action – that are necessary for the effective exercise of professional skepticism.<sup>116</sup> In a synthesis of literature on professional skepticism, researchers conclude that professional skepticism is foundational to the performance of a high-quality audit, and they note that academic research tends to focus on skeptical judgment while PCAOB inspections tend to focus on skeptical action.<sup>117</sup> When accountability to regulators is an incentive based on principles, research suggests that auditors may exhibit more skeptical judgment.<sup>118</sup> When accountability is based on a checklist mentality of following a set of strictly specific requirements, research suggests that auditors may engage in cognitive processing that

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<sup>115</sup> See PCAOB Rel. No. 2023-001, at 39.

<sup>116</sup> See Mark W. Nelson, *A Model and Literature Review of Professional Skepticism in Auditing*, 28 *Auditing: A Journal of Practice & Theory* 1, 5 (2009).

<sup>117</sup> See R. Kathy Hurtt, Helen Brown-Liburd, Christine E. Earley, and Ganesh Krishnamoorthy, *Research on Auditor Professional Skepticism: Literature Synthesis and Opportunities for Future Research*, 32 *Auditing: A Journal of Practice & Theory* 45, 47 (2013). According to the authors, "Skeptical judgment occurs when an auditor recognizes that a potential issue may exist and that more work or effort is necessary. Skeptical action occurs when an auditor changes his/her behavior based on the skeptical judgment. Both skeptical judgment and skeptical action are essential to the audit, with skeptical judgment being a necessary condition for skeptical action."

<sup>118</sup> See Hurtt, et al., *Research on Auditor* 62.

reduces skeptical judgment.<sup>119</sup> On the other hand, a principles-only approach to standards may provide insufficient guidance to support the exercise of judgment.<sup>120</sup> Overall, therefore, there is a spectrum of possible approaches to audit regulation that lies between excessively vague principles and excessively specific requirements. In practice, effective auditing standards may fit into the middle of that spectrum by emphasizing core principles while including some specific requirements to help support skeptical judgment and skeptical action.<sup>121</sup> One commenter, an academic, noted that research on rules- versus principles-based requirements for independence and ethics suggests that a combination of rules and principles is likely to be the most effective approach.<sup>122</sup>

One commenter referenced several academic papers and highlighted pragmatic challenges and costs auditors face when applying the concept of professional skepticism.<sup>123</sup> The commenter reported that past economic research finds violations of

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<sup>119</sup> See M. David Piercey, *Documentation Requirements and Quantified versus Qualitative Audit Risk Assessments*, 30 *Auditing: A Journal of Practice & Theory* 223, 242-43 (2011).

<sup>120</sup> See, e.g., SEC, *Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System* (July 25, 2003).

<sup>121</sup> See, e.g., AS 1210, *Using the Work of an Auditor-Engaged Specialist*.

<sup>122</sup> See, e.g., Terri L. Herron and David L. Gilbertson, *Ethical Principles vs. Ethical Rules: The Moderating Effect of Moral Development on Audit Independence Judgments*, 14 *Business Ethics Quarterly* 499 (2004) and Bryan K. Church, J. Gregory Jenkins, and Jonathan D. Stanley, *Auditor Independence in the United States: Cornerstone of the Profession or Thorn in Our Side?* 32 *Accounting Horizons* 145 (2018).

<sup>123</sup> See, e.g., Brazel et al., *The Outcome Effect*; Ashleigh L. Bakke, Elizabeth N. Cowle, Stephen P. Rowe, and Michael S. Wilkins, *How Do Audit Firms Treat Partners Who Issue Adverse Internal Control Opinions?* Available at SSRN: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4383557](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4383557) (2023); Richard C. Hatfield, Scott B. Jackson, and Scott D. Vandervelde, *The Effects of Prior Auditor Involvement and Client Pressure on Proposed Audit Adjustments*, 23 *Behavioral Research in Accounting* 117 (2011); and Sandra Waller Shelton, *The Effect of Experience on the Use of Irrelevant Evidence in Auditor Judgment*, 74 *The Accounting Review* 217 (1999).

professional skepticism underlying audit deficiencies.<sup>124</sup> The commenter also reported that lack of professional skepticism by auditors regarding frauds of the early 2000s generated academic literature on models of professional skepticism,<sup>125</sup> a scale to measure professional skepticism traits,<sup>126</sup> and interventions designed to help increase professional skepticism.<sup>127</sup> Moreover, the commenter reported that an area of academic psychology research asserts that skeptical behavior is a personality trait that may require a counter-dispositional change in mindset.<sup>128</sup> (The Board noted that this research does not specifically study professional skepticism as a general principle or responsibility in auditing.) In contrast, another commenter reported that academic research highlights the merits of focusing on both obtaining and evaluating information as a pragmatic approach in the exercise of professional skepticism.<sup>129</sup>

These comments suggest that efforts by firms, such as training and on-the-job-coaching, may be needed regarding professional skepticism, but do not suggest that

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<sup>124</sup> See, e.g., Mark S. Beasley, Joseph V. Carcello, and Dana R. Hermanson, *Top 10 Audit Deficiencies*, *Journal of Accountancy* 63 (2001).

<sup>125</sup> See, e.g., Mark W. Nelson, *A Model and Literature Review of Professional Skepticism in Auditing*, 28 *Auditing: A Journal of Practice & Theory* 1 (2009).

<sup>126</sup> See, e.g., R. Kathy Hurtt, *Development of a Scale to Measure Professional Skepticism*, 29 *Auditing: A Journal of Practice & Theory* 149 (2010).

<sup>127</sup> See, e.g., Jessica Maree Cross, Robyn Moroney, and Soon-Yeow Phang, *Is it All in the Mind(Fulness)? An Exploratory Study Assessing the Impact of Mindfulness on Professional Skepticism*, 37 *Accounting Horizons* 25 (2023).

<sup>128</sup> See, e.g., Lewis R. Goldberg, *The Structure of Phenotypic Personality Traits*, 48 *American Psychologist* 26 (1993); Paul E. Bebbington, Orla McBride, Craig Steel, Elizabeth Kuipers, Mirjana Radovanovic, Traolach Brugha, Rachel Jenkins, Howard I. Meltzer, and Daniel Freeman, *The Structure of Paranoia in the General Population*, 202 *The British Journal of Psychiatry* 419 (2013); and Ryan Hamilton, Kathleen D. Vohs, Anne-Laure Sellier, and Tom Meyvis, *Being of Two Minds: Switching Mindsets Exhausts Self-Regulatory Resources*, 115 *Organizational Behavior and Human Decision Processes* 13 (2011).

<sup>129</sup> See, e.g., Jonathan H. Grenier, *Encouraging Professional Skepticism in the Industry Specialization Era*, 142 *Journal of Business Ethics* 241 (2017) and Noel Harding and Ken T. Trotman, *The Effect of Partner Communications of Fraud Likelihood and Skeptical Orientation on Auditors' Professional Skepticism*, 36 *Auditing: A Journal of Practice & Theory* 111 (2017).

professional skepticism as a general principle and responsibility of auditors is flawed. In addition, the views shared by these commenters underscore the need for a well-defined standard that sets forth the requirements of due professional care and professional skepticism, which is discussed further below.

As noted in the proposal, research also offers insights on the appropriate and expected levels of assurance for investors and other users of financial statements.<sup>130</sup> One accounting firm referenced a literature review that notes the audit expectation gap has existed for many years and describes it as a phenomenon in which the expectations of beneficiaries of audited financial statements exceed what auditors can reasonably be expected to accomplish.<sup>131</sup> Early research on the audit expectation gap concludes that 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.<sup>132</sup> Similarly, a more recent multi-country study finds that survey respondents appear to expect much more than reasonable assurance from auditors in order to prevent fraud and company failure.<sup>133</sup>

The Board believes this cross-section of research, either noted in the proposal or by commenters, aligns with the Board's decision to maintain the core general principles and responsibilities of the foundational standards. The synthesis research supports professional skepticism as foundational to the performance of effective audits. Likewise,

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<sup>130</sup> See PCAOB Rel. No. 2023-001, at 39.

<sup>131</sup> See Reiner Quick, *The Audit Expectation Gap: A Review of the Academic Literature*, 94 *Maandblad voor Accountancy en Bedrijfseconomie* 5 (2020).

<sup>132</sup> See, e.g., Marc J. Epstein and Marshall A. Geiger, *Investor Views of Audit Assurance: Recent Evidence of the Expectation Gap*, 177 *Journal of Accountancy* 60, 64 (1994).

<sup>133</sup> See Association of Chartered Certified Accountants, *Closing the Expectation Gap in Audit* (May 2019) ("ACCA Report").

the research on audit assurance supports the principle of reasonable assurance as an appropriate level of assurance based on the underlying benefits and costs of an audit engagement.<sup>134</sup> As explained above, absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. As described above, AS 1000 clarifies the general principles and responsibilities without substantially modifying the general principles and responsibilities. Moreover, the Board does not anticipate that the final standard and related amendments will markedly influence the current audit expectation gap since the Board preserved the core concepts while making marginal adjustments to reaffirm the auditor's obligation to protect investors.

c. Clarity of the foundational standards

As discussed in the proposal, some current features of the foundational standards do not support the most efficient use of the standards.<sup>135</sup> The general principles and responsibilities are currently spread across four standards, which were not developed originally as a cohesive whole. Their current organization continues to reflect their origin as separate requirements that were not drafted to be read together. In addition, the foundational standards contain language that was used in the AICPA's former standards but is outdated and inconsistent for audits conducted today under the standards of the PCAOB. This could undermine users' understanding of the general responsibilities of the auditor for audits conducted in accordance with PCAOB standards. The foundational standards also do not conform to the structure of Board-issued standards, which may hinder an auditor's navigation of the requirements. Finally, the foundational standards do

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<sup>134</sup> See, e.g., Ernest L. Hicks, *Materiality*, 2 Journal of Accounting Research 158 (1964).

<sup>135</sup> See PCAOB Rel. No. 2023-001, at 40.



not reflect developments in the auditing environment since their adoption in 2003, including the PCAOB's adoption of standards and rules, such as standards on audit documentation and engagement supervision, and this lack of consistency or alignment may draw attention away from the general principles and responsibilities.

Overall, these current features of the foundational standards may reduce efficient use of the standards by requiring more time and attention than necessary to read, understand, and apply the standards and may lead to inconsistent application, potential misinterpretation, and ineffective regulatory intervention. Clarity of auditing standards requires effective communication through features such as relevant language, consistency with Board-issued standards and rules, and well-organized presentation, which appear throughout PCAOB and SEC rulemaking initiatives.

Several firms and a firm-related group acknowledged that modernization efforts to streamline and clarify the foundational standards will enhance users' awareness and understanding of the auditor's responsibilities.

(1) Characteristics of modernized auditing standards

Academic research identifies three characteristics of effective disclosure documents that align well with the features of modernized auditing standards: simplicity,<sup>136</sup> salience,<sup>137</sup> and standardization.<sup>138</sup> Simplicity can be achieved with an

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<sup>136</sup> See, e.g., R.E. Nisbett and L. Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* (1980) (finding that individuals have limited cognitive resources to absorb and process information).

<sup>137</sup> See, e.g., Daniel Kahneman, *Thinking, Fast and Slow* (2013) (suggesting that individuals who focus their limited cognitive resources on a subset of information are able to give more weight to the subset when making decisions).

<sup>138</sup> See, e.g., Jeffrey R. Kling, Sendhil Mullainathan, Eldar Shafir, Lee C. Vermeulen, and Marian V. Wrobel, *Comparison Friction: Experimental Evidence from Medicare Drug Plans*, 127 *The Quarterly Journal of Economics* 199 (2012) (finding that standardized information better enables individuals to assess tradeoffs and make coherent, rational decisions).

auditing standard that eliminates language that is outdated and inconsistent. Salience can be achieved with an auditing standard that emphasizes requirements while including explanations in the Board's release rather than the rule text and that incorporates the latest developments in the auditing environment, including the adoption of Board-issued standards and rules. Standardization can be achieved with an auditing standard that is well-organized, with general principles and responsibilities presented in a single standard that is structured similar to other standards.

In addition, the Board is aware of other regulatory initiatives that emphasize clear, well-organized writing as characteristics of effective communication with stakeholders. Two examples of other regulatory initiatives are the SEC Plain English Disclosure rule<sup>139</sup> for issuers' prospectuses, and the Plain Writing Act of 2010<sup>140</sup> for government communications with the public. The purpose of the Plain English Disclosure rule was to make financial and business information available to investors in a form they could read and understand, and the rule includes specific guidance for clear, concise language.<sup>141</sup> The purpose of the Plain Writing Act was to improve the effectiveness and accountability of federal agencies to the public by promoting clear communication that the public can understand and use, and the statute defines plain writing as writing that is clear, concise, and well-organized, and that follows other best practices appropriate to the subject and

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<sup>139</sup> *Plain English Disclosure*, SEC Rel. No. 33-7497 (Oct. 1, 1998).

<sup>140</sup> *Plain Writing Act of 2010*, Public Law 111-274.

<sup>141</sup> The economic effects of easy-to-read disclosure documents are quantified in research that demonstrates a decrease in company valuation caused by a decrease in readability of disclosure documents. *See* Byoung-Hyoun Hwang and Hugh Hokwang Kim, *It Pays to Write Well*, 124 *Journal of Financial Economics* 373 (2017).

the intended audience.<sup>142</sup> While neither the Plain English Disclosure rule nor the Plain Writing Act imposes obligations on the PCAOB, their overall objective to promote effective communication for efficiency of stakeholders' understanding is aligned with the objectives of and approach to the Board's modernization of the foundational standards.

The Board did not receive comments that provided additional information regarding characteristics of modernized auditing standards.

(2) Useability of modernized auditing standards

As summarized above, the Board continues to believe that auditors generally understand their responsibilities under the foundational standards. Nonetheless, there could be certain circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by the current language and organization of the foundational standards. New entrants, for example, may need to spend more time navigating and distilling the extant general principles and responsibilities than they would with more modernized language and organization. These new entrants may include accounting students seeking to enter the auditing profession. They may also include auditors who are experienced in applying other auditing or attestation standards, such as those of the AICPA for entities other than issuers, but who are seeking to perform an audit under PCAOB standards for the first time and who need to confirm their responsibilities under PCAOB rules.

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<sup>142</sup> Using the Plain Writing Act as an exogenous event, research has found that the Plain Writing Act resulted in improved readability of Form 10-Ks that caused the risk of stock price crash to fall. See Shiyun Yin, Thanaset Chevapatrakul, and Kai Yao, *The Causal Effect of Improved Readability of Financial Reporting on Stock Price Crash Risk: Evidence from the Plain Writing Act of 2010*, 216 Economics Letters (2022). Research has also found that while readability of disclosures improved following the Plain English Disclosure rule, improved readability does not appear to influence more experienced market participants, as measured by equity analysts' earnings forecasts. See Samuel B. Bonsall IV, Andrew J. Leone, Brian P. Miller, and Kristina Rennekamp, *A Plain English Measure of Financial Reporting Readability*, 63 Journal of Accounting and Economics 329 (2017).

In addition, the current language and organization of the foundational standards could impede investors' abilities to form accurate expectations about auditor responsibilities under PCAOB standards. Investors form expectations from a number of sources, including potentially the language of the standards themselves, but also from third parties (e.g., media) who may write about PCAOB standards. Standards that are not modernized could contribute to an expectation gap—in this case, a gap between what investors expect from an audit and what auditing standards require.<sup>143</sup> Such a gap could in principle exist in either direction. Investors could be led to expect more than what an audit is required to deliver, and thereby fail to price the risk appropriately. Alternatively, investors could be led to expect less than what an audit is required to deliver, and thereby fail to appreciate the important functions performed by auditors regarding reasonable assurance.

Audit committees may also form inaccurate expectations about the content of PCAOB standards if the standards are not modernized, via mechanisms similar to investors. Given audit committee members' greater familiarity with auditing through their position and responsibilities with the issuer and other relevant professional background, the Board believes this is less likely to occur for audit committees than for investors. However, the negative impact of an audit committee member failing to correctly comprehend the auditor's general responsibilities under PCAOB standards could be more

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<sup>143</sup> Research finds evidence of a persistent gap between investors' expectations of an audit and auditors' performance based on requirements under auditing standards. *See, e.g.,* Klaus Ruhnke and Martin Schmidt, *The Audit Expectation Gap: Existence, Causes, and the Impact of Changes*, 44 *Accounting and Business Research* 572, 592 (2014) (finding that the public has expectations of auditors' responsibilities that do not exist under auditing standards, such as conducting a management audit) and ACCA Report (finding that the persistence of the audit expectation gap reflects, in part, the fact that public expectations of audits can grow in line with what auditors can accomplish).

severe, given the audit committee's role in supervising the audit and the auditor under Sarbanes-Oxley for the benefit of investors.

The Board did not receive comments that provided additional information regarding useability of modernized auditing standards.

**ii. Clarification of engagement partner responsibilities**

One of the responsibilities of engagement partners is to review the work of engagement team members. Any uncertainty under the standards may give engagement partners an incentive, particularly under time pressures, to de-emphasize or omit the review of workpapers. For example, the Board has found instances in which engagement partners did not fulfill their responsibilities for review.<sup>144</sup> However, engagement partner review of workpapers is a critical step to promote audit quality. As noted above, firms have varying policies and tools to facilitate the review required by the engagement partner.

One commenter, an academic, referenced academic studies regarding engagement partner impacts. The commenter reported that one study using data from Taiwan finds evidence that suggests there is variation in the quality of engagement partners and that the market responds to engagement partner quality.<sup>145</sup> In addition, the commenter reported that a group of studies finds evidence that engagement partners can negatively impact audit quality when they do not follow auditing standards, such as by not promoting the

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<sup>144</sup> See, e.g., *In the Matter of Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 (Aug. 16, 2022) and *In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Rel. No. 105-2022-033 (Dec. 6, 2022).

<sup>145</sup> See, e.g., Daniel Aobdia, Chan-Jane Lin, and Reining Petacchi, *Capital Market Consequences of Audit Partner Quality*, 90 *The Accounting Review* 2143 (2015).

need for professional skepticism, ethical behavior, and continuing education.<sup>146</sup> The views shared by the commenter align with the Board's identification of the need to clarify the engagement partner's responsibility to review certain audit documentation.

**iii. Accelerating the documentation completion date**

The discussion above emphasizes the importance of adequate audit documentation and the auditor's responsibilities for documentation under AS 1215, which currently specifies an audit documentation completion date no more than 45 days after the report release date. PCAOB standards require auditors to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. The extant requirements were established in part because documentation that is added well after the completion of an audit is likely to be of lesser quality than documentation produced contemporaneously when audit procedures are performed because reconstructing and recalling activities related to performing audit procedures long after the work was actually performed can be difficult.<sup>147</sup> Separately, significant advancements in electronic audit tools and the use of audit software have occurred over the last two decades, which facilitate contemporaneous documentation and more timely documentation completion. Based on these observations and some firms' policies and practices summarized above, the current documentation completion date that

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<sup>146</sup> See, e.g., Sean A. Dennis and Karla M. Johnstone, *A Field Survey of Contemporary Brainstorming Practices*, 30 *Accounting Horizons* 449 (2016); Harding and Trotman, *The Effect of Partner 111*; Christopher Koch and Steven E. Salterio, *The Effects of Auditor Affinity for Client and Perceived Client Pressure on Auditor Proposed Adjustments*, 92 *The Accounting Review* 117 (2017); and William F. Messier, Jr. and Martin Schmidt, *Offsetting Misstatements: The Effect of Misstatement Distribution, Quantitative Materiality, and Client Pressure on Auditors' Judgments*, 93 *The Accounting Review* 335 (2018).

<sup>147</sup> See PCAOB Rel. No. 2004-006.

is 45 days after the report release date may provide more time than necessary to complete and finalize the audit documentation.

The PCAOB inspection process generally cannot begin until after the documentation completion date. In cases where the PCAOB would like to initiate inspections earlier, the 45-day period imposes an unnecessarily long lag before the PCAOB can provide notice of inspection and obtain access to audit documentation, which may prevent timely identification and resolution of audit deficiencies and delay information on firm performance that is useful to investors for assessing attributes such as audit quality or auditor effort.<sup>148</sup>

As discussed in the Board's proposal, the 45-day period also may pose a greater risk of improper alteration of audit documentation because it provides a lengthy window of opportunity between the release of the audit report and the completion of the audit documentation.<sup>149</sup>

The Board did not receive comments that provided additional information regarding the need to accelerate the documentation completion date.

## **2. How the Changes Address the Need**

### **i. Modernization of the foundational standards**

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<sup>148</sup> See, e.g., Jagan Krishnan, Jayanthi Krishnan, and Hakjoon Song, *PCAOB International Inspections and Audit Quality*, 92 *The Accounting Review* 143 (2017) (finding evidence consistent with improvements in audit quality for foreign firms after PCAOB inspections) and Daniel Aobdia, *The Impact of the PCAOB Individual Engagement Inspection Process—Preliminary Evidence*, 93 *The Accounting Review* 53 (2018) (finding increases in auditor effort subsequent to deficiencies found through PCAOB inspections). The Board notes that the results from these studies do not necessarily mean that PCAOB inspections cause higher audit quality.

<sup>149</sup> For examples of improper alteration of audit documentation within the 45-day archiving period, see, e.g., *In the Matter of Deloitte LLP*, PCAOB Rel. No. 105-2021-014 (Sept. 29, 2021) and *In the Matter of Richard J. Bertuglia, CPA*, SEC Rel. No. 84419 (Oct. 12, 2018).

The changes modernize the foundational standards by reorganizing and consolidating four standards, eliminating language that is no longer relevant, establishing conformity with the structure of Board-issued standards, and harmonizing with PCAOB standards and rules issued after the adoption of interim standards in 2003. These changes are designed to make AS 1000 a more effective and efficiently used standard through a well-organized presentation with relevant language that is more consistent with other PCAOB standards.

**ii. Clarification of engagement partner responsibilities**

The changes clarify engagement partner responsibilities by specifying the engagement partner's due professional care responsibilities, explicitly stating that the engagement partner has primary responsibility for the engagement that is not reduced when assistance is provided by other engagement team members, and explicitly stating that audit documentation must clearly demonstrate the person or persons who reviewed the work and the date of such review. Clarification of the engagement partner's responsibility to review certain audit documentation—including review of documentation of significant findings or issues and review of documentation that is required to be reviewed by the EQR—reaffirms the existing minimum level of responsibilities under due professional care and promotes consistency across audits regarding an engagement partner's oversight of the audit.

**iii. Accelerating the documentation completion date**

The changes accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date. This change enables



PCAOB inspections staff earlier access to audit documentation and reduces the window of opportunity for improper alteration of audit documentation prior to the documentation completion date.

### **C. Economic Impacts**

This section discusses the expected benefits and costs of the changes and potential unintended consequences. The proposal described expected benefits and costs, resulting in comments on each.<sup>150</sup> Two commenters on the proposal noted that the changes will not result in any significant additional costs to auditors or the companies they audit or in any significant benefits to market participants. Some commenters suggested that the economic analysis should more carefully consider potential costs or unintended consequences associated with certain key provisions, as discussed further below. The Board expects the economic impacts of AS 1000, including both benefits and costs, to be relatively modest, especially for those firms that have already incorporated in practice an engagement partner's responsibility for review and an accelerated documentation completion date.

#### **1. Benefits**

##### **i. Modernization of the foundational standards**

To the extent that current features of the existing foundational standards reduce efficient use of the standards, the changes will help enhance useability by making the general principles and responsibilities of the auditor in conducting an audit in accordance with the standards of the PCAOB easier to read, understand, and apply in practice.

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<sup>150</sup> See PCAOB Rel. No. 2023-001, at 45-50.

For users trying to navigate and understand the general principles and responsibilities, efficiency gains may be associated with each of the changes as follows:

- The change to reorganize and consolidate the standards into a single standard will reduce time and attention required to navigate several standards to locate the general principles and ensure relevant requirements are met.
- The changes to eliminate language that is no longer relevant will reduce time and attention required to read, understand, and apply the standard by facilitating a focus on core requirements of the standard.
- The changes to establish conformity with the structure of Board-issued standards and make certain enhancements will help expedite navigation of the requirements and ensure relevant requirements are met by: (i) providing more uniformity among the PCAOB standards with an introduction and objectives that emphasize the auditor's obligations; (ii) updating the articulations of the concepts of due professional care, professional skepticism, professional judgment, and reasonable assurance; (iii) clarifying auditor responsibilities by expressing the requirements using Rule 3101 terms; and (iv) minimizing explanatory material that is instead included in the release discussion.
- The changes to harmonize with PCAOB standards and rules issued after adoption of the interim standards in 2003 will reduce time and attention required to read, understand, and apply the standard by drawing attention to: (i) changes to auditing requirements through Board-issued standards; (ii) clarifying the meaning of present fairly; (iii) an overarching objective for audits of ICFR; and (iv) new rules issued by the Board.

Auditors learning the general principles and responsibilities for the first time may do so more quickly and easily, thereby reducing the cost of training and potentially facilitating the newer auditor's ability to perform PCAOB audits.

While the obligation of auditors would not change, reaffirming the auditor's obligation to protect investors could serve as a reminder. Especially to the extent that auditors do not currently fulfill this obligation, it may prompt auditors to reflect on a sense of obligation to investors and the public that goes beyond their responsibilities to a specific company under audit. At the margins, the emphasis on investor protection could reinforce support for auditors in circumstances where they face decisions that may require them to prioritize the interests of the public over their own interests or the interests of the company under audit. Further, by highlighting the important role auditors play in protecting investors, it could underscore the value of the auditing profession to capital markets.

In addition, a modernized standard may enhance investors' and audit committees' awareness and understanding of the auditor's responsibilities. Investors could be able to more appropriately assess financial statement risk by better understanding the nature and extent of auditor responsibilities. Audit committees' oversight of the auditor could be enhanced, for example, if enhanced clarity of standards facilitates communication between the audit committee and the auditor. Referencing academic research, one commenter on the proposal explained that the role of the audit committee in ensuring the

quality of reported financial results requires improved and expanded dialogue between the audit committee and the auditor.<sup>151</sup>

**ii. Clarification of engagement partner responsibilities**

To the extent that engagement partners currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as required under the existing standards,<sup>152</sup> the clarification of engagement partner responsibilities could improve auditor performance and audit quality by: (i) improving the timeliness of the engagement partner's evaluation of significant findings and judgments; (ii) enhancing the ability of the engagement partner to prevent or detect audit deficiencies; and (iii) facilitating improvements in the quality of the work of other engagement team members. As summarized above, one commenter referenced academic studies that suggest engagement partners can negatively impact audit quality when they do not follow auditing standards.

**iii. Accelerating the documentation completion date**

The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will promote contemporaneous documentation and more timely documentation completion. Documentation that is produced contemporaneously when audit procedures are performed and then completed soon thereafter is likely to provide a more accurate and

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<sup>151</sup> See, e.g., Jeffrey Cohen, Lisa Milici Gaynor, Ganesh Krishnamoorthy, and Arnold M. Wright, *Auditor Communications with the Audit Committee and the Board of Directors: Policy Recommendations and Opportunities for Future Research*, 21 *Accounting Horizons* 165 (2007).

<sup>152</sup> See, e.g., *Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 and *KPMG Assurance and Consulting Services LLP*, PCAOB Rel. No. 105-2022-033.

complete audit file for the engagement. The amendment will also support PCAOB efforts to enhance audit quality via timelier identification and potential resolution of audit deficiencies in cases where inspections are initiated earlier. In such cases, the amendment could facilitate earlier issuance of inspection reports and their availability to investors. In addition, the amendment could enhance auditor performance and audit quality for firms that do not currently implement best practices, but will be more inclined to do so, by proactively focusing on sequencing of work, allocation of resources, and other operating practices.

The benefits associated with an accelerated documentation completion date are likely to be greater for firms that currently make use of the entire 45-day period permitted under current PCAOB standards due to current operating circumstances. These firms would need to make more adjustments to their sequencing of work and allocation of effort to meet the accelerated period. Thus, the concomitant benefits to audit quality would therefore be greater. Based on firms' current archiving policies and practices summarized above, the benefits associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs experience operating efficiencies associated with changes in their sequencing of work, allocation of resources, and other operating practices to comply with the documentation completion date.

The benefits associated with an accelerated documentation completion date will be lower for firms that already either: (i) have a policy that requires that documentation be completed in 14 days or fewer or (ii) have a policy that is closer to or equal to the current 45-day period but in practice complete their documentation shortly after releasing

the audit report. Specifically, the benefits to audit quality will be lower for these firms, but the benefits to investors of earlier PCAOB inspections will still be achieved in cases where inspections are initiated earlier.

Commenters on the proposal generally agreed that accelerating the documentation completion date is feasible for firms and beneficial to investors. One commenter suggested the ability to inspect audits sooner is a benefit that will not significantly increase costs. Another commenter, an academic, suggested there could be market benefits associated with earlier inspections if inspection reports are publicly available earlier and the content of inspection reports is meaningful. The commenter referenced several academic studies that demonstrate improvements in audit quality after PCAOB inspections.<sup>153</sup> The commenter reported that one study finds improvements in internal control audits after PCAOB inspections<sup>154</sup> and that another study finds increases in auditor effort after PCAOB inspections find audit deficiencies.<sup>155</sup> One commenter questioned whether accelerating the documentation completion date would have any meaningful impact on inspection timelines. Based on the acceleration of the documentation completion date by 31 days, the Board noted that the most an inspection report could be accelerated as a result of the accelerated documentation completion date is 31 days.

## **2. Costs**

### **i. Modernization of the foundational standards**

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<sup>153</sup> See, e.g., Krishnan, et al., *PCAOB International Inspections*. The Board notes that the results from these studies do not necessarily mean that PCAOB inspections cause higher audit quality.

<sup>154</sup> See, e.g., Mark L. DeFond and Clive S. Lennox, *Do PCAOB Inspections Improve the Quality of Internal Control Audits?* 55 *Journal of Accounting Research* 591 (2017).

<sup>155</sup> See, e.g., Aobdia, *The Impact of the PCAOB*.

The primary costs of the modernization efforts reflected in the standard will be one-time costs to firms for updating references within firm methodologies and related guidance to reflect the final standard and related amendments. Larger firms that develop their own methodologies will update references directly in those methodologies. Smaller firms generally purchase methodologies from third-party vendors. The implementation costs of the changes may be offset over time because a more logical and easy-to-read-and-navigate standard could enable auditors to save time reading, understanding, and applying the standard. Third parties that refer to PCAOB standards (e.g., in textbooks, training, or review materials) will also need to update those materials.

To the extent that auditors are not taking into account PCAOB auditing interpretations, as used in paragraph .15 and the related note of the standard, those firms will also incur one-time and ongoing costs related to methodology and periodic training for PCAOB auditing interpretations.

To the extent that auditors do not currently fulfill their obligation to protect investors, auditors who face decisions that require them to prioritize the interests of the public over their own interests or the interests of the company under audit may make decisions that benefit the public at a potential cost to the auditor, such as alienating or losing a company under audit. There is likely already a balance struck between fulfilling the auditor's obligation to protect investors and the risk of alienating or losing a company under audit. At the margins, the emphasis on investor protection may move the fulcrum closer to the public interest.

The Board did not receive comments that provided additional information regarding costs of modernization.

**ii. Clarification of engagement partner responsibilities**

To the extent that engagement partners currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as required under the existing standards,<sup>156</sup> those firms may incur one-time costs to update firm methodologies and ongoing costs related to fulfilling their responsibilities. Larger firms that develop their own methodologies will update references directly in those methodologies. Smaller firms generally purchase methodologies from third-party vendors.

While the responsibilities of engagement partners would not change under the new standard, the clarification for engagement partners to perform their duties with due professional care, including their responsibility for performing an appropriate review of the work of other engagement team members, could also impose incremental costs related to fulfilling engagement partner responsibilities to the extent that engagement partners are not currently fulfilling their responsibilities.

One commenter reported that research highlights the importance of and variation in the direction, supervision, and review of audit work.<sup>157</sup> The commenter further noted that direction, supervision, and review are functions that are performed by auditors at different levels of experience, not just engagement partners, and cited research that highlights that the effectiveness of the functions can vary across hierarchical levels.<sup>158</sup>

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<sup>156</sup> See, e.g., *Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 and *KPMG Assurance and Consulting Services LLP*, PCAOB Rel. No. 105-2022-033.

<sup>157</sup> See, e.g., J.S. Rich, I. Solomon, and K.T. Trotman, *The Audit Review Process: A Characterization from the Persuasion Perspective*, 22 *Accounting, Organizations & Society* 481 (1997) and Mark Nelson and Hun-Tong Tan, *Judgment and Decision Making Research in Auditing: A Task, Person, and Interpersonal Interaction Perspective*, 24 *Auditing: A Journal of Practice & Theory* 41 (2005).

<sup>158</sup> See, e.g., Robert J. Ramsay, *Senior/Manager Differences in Audit Workpaper Review Performance*, 32 *Journal of Accounting Research* 127 (1994) and Noel Harding and Ken T. Trotman,



While the Board acknowledged the commenter's points regarding the effectiveness of functions performed by auditors at different levels of experience, the Board's analysis of costs here is limited to costs that are relevant to the economic impacts of the clarification of engagement partner responsibilities.

**iii. Accelerating the documentation completion date**

The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will allow less time to assemble the final set of workpapers after the audit report is released. However, the PCAOB requirement to complete necessary auditing procedures, review those procedures, and collect sufficient appropriate audit evidence prior to the report release date could help mitigate costs to implement the amendment because the only activities that remain are assembling a complete and final set of audit documentation. In addition, the widespread use of electronic audit tools and audit software could help mitigate any costs associated with the amendment.

The costs associated with an accelerated documentation completion date are likely to be greater for firms that currently specify by policy an archiving period that is near or equal to the maximum permitted under current AS 1215.15 and that currently take all or nearly all of the full 45-day period to complete their archiving because of operating circumstances that inhibit faster completion. These firms will have to invest additional resources to enhance sequencing of their work, allocation of resources, and other

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*Hierarchical Differences in Audit Workpaper Review Performance*, 16 Contemporary Accounting Research 671 (1999).

operating practices, or may have to enhance their audit documentation systems, or both, in order to comply with the documentation completion date. Based on firms' current archiving policies and practices summarized above, the costs associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs currently use the entire 45-day period. However, the extended effective date of the 14-day requirement for firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, will allow those firms more time to implement the revised requirement. By contrast, GNFs that already require the completion of documentation within a 14-day period will likely not incur substantial additional costs to comply with the revised requirement.

Electronic audit tools and audit software may facilitate compliance with the requirement by automating, and thereby performing more quickly, certain processes. For firms without electronic systems in place, costs associated with an accelerated documentation completion date may include additional resources, such as in-house personnel or capital investments in audit software, to help assemble a complete and final set of audit documentation in the 14-day time period. PCAOB staff is aware that some small NAFs still use paper-based systems. However, these firms generally perform smaller, less complex audits, such that the firms do not have to mail audit workpapers from multiple locations; therefore, even with a paper-based system, effective sequencing of work, allocation of resources, and other operating practices could enable them to meet the 14-day documentation completion date.

For firms with electronic audit tools and audit software in place, the earlier documentation completion date should not change the functionality or cost of software,

which will facilitate a low-cost transition to the new archiving period. Some firms already have policies that require documentation completion within 14 days of the report release date, and some firms require audit documentation to be archive-ready upon completion of interim procedures. These practices suggest that much of the process involved in assembling a complete and final set of audit documentation, such as assembly, cleanup, and retention, is substantially finished in advance of 45 days. Any firms that currently have a policy or practice of completing audit documentation on or near the 45<sup>th</sup> day may do so merely because the current standard allows 45 days, and thus will not incur costs to meet the accelerated documentation completion date. Alternatively, any firms that currently complete audit documentation on or near the 45<sup>th</sup> day because of operating circumstances may incur costs associated with implementing best practices to effectively sequence work, allocate resources, and incorporate other operating practices to comply with the accelerated documentation completion date. In this case, the Board anticipates that the costs will be offset over time by improvements in operating efficiencies to the extent that operating circumstances are within the firm's control.

An accelerated documentation completion date may also impose costs on multi-firm audits if electronic audit documentation systems are not integrated across firms. GNFs are more likely than NAFs to perform multi-firm audits, but some NAFs do perform multi-firm audits.<sup>159</sup> If electronic systems are not integrated across firms, which is more likely for NAFs, other auditors may need to transmit documentation to the lead auditor to assemble the final set of workpapers. If electronic systems are integrated across firms, the lead auditor may be able to seamlessly archive the work of other auditors.

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<sup>159</sup> See PCAOB Rel. No. 2022-002, at 26-52.

Any costs associated with the requirements may be passed through to investors, or costs may be internalized by firms. While competition in the audit market is characterized by a combination of unique features,<sup>160</sup> issuers that engage firms that pass through any costs may switch firms if the benefits of switching justify the costs of switching.

Some commenters noted potential costs associated with accelerating the documentation completion date. One commenter generally supported accelerating the documentation completion date but noted that firms that use proprietary audit tools and audit software will incur costs related to reprogramming and testing that could be exacerbated for GNFs that are subject to differing jurisdictional requirements. The same commenter also noted that accelerating the documentation completion date may negatively impact smaller firms that do not utilize electronic audit tools to the extent that they are unable to comply with the requirement without considerable investments that may not be economically feasible. Another commenter disagreed with accelerating the date because of human capital factors and a complex auditing landscape. Another commenter reported that academic research investigating the SEC's acceleration of Form 10-K filing deadlines in the 2000s suggests that accelerating the filing deadlines more quickly than 15 days was costly to issuers regarding misstated financial statements.<sup>161</sup>

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<sup>160</sup> See, e.g., Joseph Gerakos and Chad Syverson, *Competition in the Audit Market: Policy Implications*, 53 *Journal of Accounting Research* 725 (2015) (explaining that the audit market exhibits a set of features that distinguish it from other markets for business services, including its role in capital market transparency, mandated demand, and concentrated supply).

<sup>161</sup> See, e.g., Lisa Bryant-Kutcher, Emma Yan Peng, and David P. Weber, *Regulating the Timing of Disclosure: Insights from the Acceleration of 10-K Filing Deadlines*, 32 *Journal of Accounting and Public Policy* 475 (2013); Colleen M. Boland, Scott N. Bronson, and Chris E. Hogan, *Accelerated Filing Deadlines, Internal Controls, and Financial Statement Quality: The Case of Originating Misstatements*, 29 *Accounting Horizons* 551 (2015); and Khaled Alsabah, *The 15-Day Debate and the Value of Early Release of Information: Evidence from 10-K Filings*, 42 *Journal of Accounting and Public Policy* 1 (2023).

The commenter acknowledged the analogy may not align with the documentation completion date but suggested that it is likely that firms currently requiring more than 29 days to complete audit documentation will likely incur non-trivial compliance costs.

The Board acknowledged that firms that use proprietary audit tools and audit software will incur costs related to reprogramming and testing. While the Board also acknowledged that some smaller firms may incur costs related to investments and some firms may incur costs related to human capital or a complex auditing landscape, the Board believes that most firms will incur incremental costs because they already use electronic audit documentation systems. Likewise, the Board believes the contrast between the SEC's acceleration of Form 10-K reporting deadlines and the Board's acceleration of the documentation completion date is too stark to be a useful comparison because the auditing standards require that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date. Based on the broad support by commenters for accelerating the documentation completion date and the existing requirement that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date, the Board continues to believe that accelerating the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will provide better protection for investors.

One commenter suggested that keeping the 35-day filing requirement for Form AP in light of accelerating the documentation completion date could create technological

and process challenges for firms. Another commenter suggested that firms could incur incremental costs such as process changes and administrative costs. In contrast, some commenters said they would not have difficulty filing Form AP within 35 days of the audit report being filed with the SEC. Two commenters suggested the time to file Form AP should be consistent with the documentation completion date. The Board adopted the 14-day deadline for archiving audit documentation. The Board noted that firms, under AS 1215, can add information to the audit documentation after the documentation completion date, if necessary, to record their compliance with Form AP requirements. Consequently, the Board does not perceive any conflict or a necessity to modify either the 35-day Form AP filing requirement or the proposed 14-day deadline for archiving audit documentation.

### **3. Potential Unintended Consequences**

In addition to the benefits and costs discussed above, the final standard and related amendments could have unintended economic consequences. The proposal described potential unintended consequences, which commenters addressed in their letters.<sup>162</sup> This section discusses the potential unintended consequences the Board considered as well as its consideration of such consequences in adopting the final standard and related amendments. The discussion also addresses, where applicable, any mitigating or countervailing factors, including revisions to the proposed standard and related amendments reflected in the final standard and related amendments the Board adopted.

#### **i. Modernization of the foundational standards**

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<sup>162</sup> See PCAOB Rel. No. 2023-001, at 50-51.

The changes to modernize the foundational standards are not intended to impose new requirements on auditors or substantially change the requirements of PCAOB standards.

Commenters noted potential unintended consequences related to the removal of explanatory language or the use of certain language in the proposed rule text or release discussion. Several commenters suggested that removing explanatory language on limitations of an audit may exacerbate the audit expectation gap and cause potential confusion among auditors. Commenters also suggested that the use of certain proposed language or certain proposed clarifications could result in potential confusion or unintended expansion of auditors' responsibilities. For example, one commenter suggested that requiring auditors to "keep in mind their role in protecting investors" could encourage auditors to adopt an investor perspective when making judgments, which research highlights may be detrimental to audit quality.<sup>163</sup>

These potential unintended consequences will be mitigated by changes to language in the adopted rule text or release discussion. Throughout the rulemaking process, the Board emphasized that eliminating restrictive provisions does not alter the core principles and responsibilities that are transitioned from the current standards to AS 1000. The Board removed the reference to "keep in mind their role in protecting investors" from the final standard based on changes made to paragraph .01 of the final standard. While the Board emphasized the investor protection obligation, the Board

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<sup>163</sup> See, e.g., Elizabeth C. Altiero, Yoon Ju Kang, and Mark E. Peecher, *Motivated Perspective Taking: Why Prompting Auditors to Take an Investor's Perspective Makes Them Treat Identified Audit Differences as Less Material*, 39 *Contemporary Accounting Research* 339 (2022) and Lei Dong, Lei Wang, and Wen-Wen Chien, *The Joint Effect of Supervisor Influence and Investor Perspective: Unintended Consequences on Assessing Accounting Estimates*, 37 *Managerial Auditing Journal* 151 (2022).

clarified that the emphasis does not create any new legal requirements. The Board does not believe that highlighting the auditor's existing obligation to protect investors will widen any expectation gap or decrease audit quality. Instead, the Board's goal was to heighten auditors' awareness and reinforce their existing obligation.

**ii. Clarification of engagement partner responsibilities**

An unintended consequence of the amendment to clarify engagement partner responsibilities would occur if, contrary to the Board's expectation, some firms whose engagement partners currently do more than will be required to meet the minimum requirement for engagement partner review, do less in the future to merely meet the minimum requirement.<sup>164</sup>

This potential unintended consequence will be mitigated by the extent to which engagement partners are aware that the engagement's performance is primarily their responsibility. Furthermore, in contrast to a highly specific minimum threshold, the Board noted that engagement partners under AS 1000 are bound to broad due professional care responsibilities that are less likely to incentivize engagement partners to merely meet a precise set of criteria without exceeding those criteria. In addition, economic reasons that generate enhanced performance in the first place, such as partner compensation, inspections, and litigation threat, help to mitigate this potential unintended consequence.

One commenter suggested that the amendment to clarify engagement partner responsibilities is reasonable and clear but could present unintended consequences by

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<sup>164</sup> See, e.g., Aobdia, *The Impact of the PCAOB* (finding that auditor effort declines subsequent to PCAOB inspections of engagements that do not receive a Part I finding).



limiting firms' abilities to attract and retain talent, which could potentially result in lower audit quality if people leave the profession. The Board anticipates that the amendments related to engagement partner responsibilities will be unlikely to significantly affect firms' abilities to attract or retain talent, or to disincentivize individuals from being willing to serve as engagement partners because AS 1000 clarifies existing engagement partner responsibilities. As outlined in the rest of the economic analysis, the Board acknowledges that some marginal economic impacts could follow from these amendments, but does not agree with the commenter that those effects will be dramatic.

**iii. Accelerating the documentation completion date**

Unintended consequences of accelerating the documentation completion date would occur if, contrary to the Board's expectation, (i) auditor time prior to the report release date that was previously spent focusing on audit procedures is now spent on assembling final workpapers or (ii) the archiving period results in higher costs that cause firms with paper-based documentation systems to exit the audit market or to not enter the audit market.

These potential unintended consequences will be mitigated by the current requirement that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date.<sup>165</sup> Furthermore, if firms proactively sequence work, allocate resources, and incorporate other operating efficiencies, they should not experience substantial disruptions and should be able to handle the accelerated archiving deadline without major problems.

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<sup>165</sup> See AS 1215.15.

One commenter acknowledged that accelerating the documentation completion date may enhance audit quality overall but suggested that it could have an initial negative impact on audit quality as a result of accelerating the archiving process into the period when many SEC practice audit professionals need to start working on other issuer audit engagements. Another commenter also acknowledged that accelerating the documentation completion date may enhance audit quality and said it may allow PCAOB inspections to begin sooner after completion of an audit, but issuers may have various filing deadlines or require extensions that will necessitate the full attention of professionals on those engagements. One commenter acknowledged that the acceleration is beneficial and appropriate, but suggested that beginning the inspection process earlier could be detrimental to audit quality because earlier inspections could cause auditors to reallocate their time to the inspection process and away from audits of financial statements. Consistent with the acknowledgements by these commenters, the Board continues to believe that accelerating the documentation completion date will be facilitated by the widespread use of electronic audit tools and audit software by most firms, which could mitigate potential operating disruptions that firms experience as they adjust to the accelerated date.

One commenter stressed the importance of the quality of audit documentation and noted that technology interruptions or cybersecurity matters could impact the ability of a firm to meet the accelerated deadline. However, the possibility of technology interruptions or cybersecurity matters could impact a firm's ability to meet any deadline. Another commenter reported that academic studies find there can be unintended consequences of additional regulation, including new costs associated with extensive

audit documentation, auditors taking a "box-ticking" approach to extensive documentation requirements, and reduced auditor retention.<sup>166</sup> However, accelerating the documentation completion date does not add any new documentation requirements.

#### **D. Alternatives Considered**

During the formulation of the proposal and adoption of the final standard and related amendments, the Board considered a number of alternative approaches to the final standard and related amendments the Board adopted, including those suggested by commenters.

##### **1. Modernization of the Foundational Standards**

The Board considered whether to update the foundational standards and keep them as individual standards, but the Board believes that combining the general principles and responsibilities into one standard is more logical and easier to navigate. This approach is also consistent with the approaches of other standard setters. For example, both the IAASB and the ASB address general responsibilities of the auditor in one standard (see IAASB's ISA 200 and ASB's AU-C 200).

The Board also considered whether to incorporate the requirements of AS 2815 into AS 1000, but believes that it is more logical to incorporate the requirements of AS 2815 into AS 2810 because both standards address requirements for concluding audit procedures. This approach also eliminates unnecessary cross-references between the two standards and makes the auditor's responsibilities easier to locate. AS 1000 includes a

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<sup>166</sup> See, e.g., Colleen M. Boland, Brian E. Daugherty, and Denise Dickins, *Evidence of the Relationship between PCAOB Inspection Outcomes and the Use of Structured Audit Technologies*, 38 *Auditing: A Journal of Practice & Theory* 57 (2019) and Marion Brivot, Mélanie Roussy, and Maryse Mayer, *Conventions of Audit Quality: The Perspective of Public and Private Company Audit Partners*, 37 *Auditing: A Journal of Practice & Theory* 51 (2018).

reference to AS 2810 for the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

## **2. Clarification of Engagement Partner Responsibilities**

With respect to engagement partner responsibilities, the Board considered retaining the language of AS 1010 that describes the use of judgment in the context of the partner's responsibilities for supervision. However, the Board believes that leveraging the requirements of AS 1201, a more recent standard, avoids potential confusion and aligns the engagement partner's responsibilities with Board-issued standards. Other alternatives to the amendments related to engagement partner responsibilities, including comments received, were considered as discussed above.

## **3. Accelerating the Documentation Completion Date**

For the documentation completion date, the Board considered a length of time between the current 45-day period and the 14-day period, such as 21 days or 30 days. The Board believes that a shorter period of time may provide better protection for investors than a longer period: it could permit acceleration of PCAOB inspections and provide the strongest incentives for firms to implement operating efficiencies that may ultimately improve audit quality. Thus, in principle, a shorter documentation completion date could achieve more benefits than a longer period. The Board's assessment of existing firm practice as described above led it to believe that 14 days is feasible for firms and that a longer period could therefore be unnecessary and would erode the benefits that would otherwise be achieved.

Investor-related groups suggested the documentation completion date should be reduced to two days for all firms. The Board continues to believe 14 days is feasible for all firms while not being too restrictive for firms that may require more time. Another commenter asserted that the economic analysis did not adequately consider alternatives other than 14 days and that the analysis did not offer any alternatives to begin inspections earlier other than accelerating the documentation completion date. As noted above, the Board considered a length of time between the current 45-day period and the 14-day period. Moreover, the need to accelerate the documentation completion date is based on other considerations in addition to cases where the PCAOB would like to initiate inspections earlier. Another commenter asserted that firms' operating efficiencies are not the purview of the PCAOB. However, the need for the amendment is not based on operating efficiencies but may result in operating efficiencies that improve audit quality.

The Board also considered whether to specify different documentation completion dates for different classes of firms, based on specific firm characteristics that may make compliance with an accelerated documentation completion date especially challenging because of some practical obstacle or because of expenses that are common to that class of firms. For example, the Board considered specifying a longer documentation completion date for NAFs than for GNFs. However, as noted above, the Board believes that the 14-day period is a feasible period for all firms; the Board is not aware of any practical obstacle or expenses that will make compliance with a 14-day period especially challenging for all firms within a particular class. In contrast, a uniform and consistent archiving period for all firms would facilitate implementation and compliance, especially for audits that involve multiple firms that could be subject to different archiving periods.

Finally, having a unified archiving date will enable earlier PCAOB inspections across all registered firms.<sup>167</sup>

## **SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES**

Pursuant to Section 104 of the Jumpstart Our Business Startups ("JOBS") Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies ("EGCs"), as defined in Section 3(a)(80) of the Exchange Act, unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."<sup>168</sup> As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.<sup>169</sup>

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.<sup>170</sup> As of the November 15, 2022 measurement date, there

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<sup>167</sup> While the Board has not specified different documentation completion dates for different classes of firms, the extended effective date of the 14-day requirement for firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, will allow those firms more time to implement the revised requirement.

<sup>168</sup> See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The new standard does not fall within either of these two categories.

<sup>169</sup> The Board provided this analysis of the impact on EGCs to assist the SEC in making the determination required under Section 104 to the extent that the requirements apply to "the audit of any emerging growth company" within the meaning of Section 104 of the JOBS Act.

<sup>170</sup> See PCAOB, *Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2022* (Feb. 20, 2024) ("EGC White Paper"), available at <https://assets.pcaobus.org/pcaob->

were 3,031 companies<sup>171</sup> that self-identified as EGCs and filed audited financial statements with the SEC between May 16, 2021, and November 15, 2022, that included an audit report signed by a firm.<sup>172</sup>

As discussed in the proposal, the economic impacts of the standard and related amendments are generally applicable to audits of EGCs.<sup>173</sup> The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days could impact the audits of EGCs more than the audits of non-EGCs to the extent that EGCs are more likely than non-EGCs to be audited by NAFs.<sup>174</sup> As discussed above, NAFs are expected to require more changes than GNFs in their sequencing of work, allocation of resources, and other operating practices to comply with the accelerated documentation completion date. Therefore, all else equal, both the benefits and costs of the amendments, including the amendment to accelerate the documentation completion date, may be higher for EGC audits than for non-EGC audits.

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[dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2022.pdf?sfvrsn=a8294f3\\_2](https://www.pcaob.com/dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2022.pdf?sfvrsn=a8294f3_2).

<sup>171</sup> The EGC White Paper uses a lagging 18-month window to identify companies as EGCs. Please refer to the "Current Methodology" section in the EGC White Paper for details. Using an 18-month window enables staff to analyze the characteristics of a fuller population in the EGC White Paper but may tend to result in a larger number of EGCs being included for purposes of the present EGC analysis than would alternative methodologies. For example, an estimate using a lagging 12-month window would exclude some EGCs that are delinquent in making periodic filings. An estimate as of the measurement date would exclude EGCs that have terminated their registration or that have exceeded the eligibility or time limits.

<sup>172</sup> See EGC White Paper 17. Based on staff analysis as of the Nov. 15, 2022 measurement date, 86 percent of the 263 firms that issued audit reports for EGCs performed audits for both EGC and non-EGC issuers while 14 percent performed issuer audits only for EGCs.

<sup>173</sup> See PCAOB Rel. No. 2023-001, at 52-54.

<sup>174</sup> PCAOB staff analysis indicates that, compared to exchange-listed non-EGCs, exchange-listed EGCs are approximately 2.6 times as likely to be audited by an NAF (source: EGC White Paper and Standard & Poor's).

While both the benefits and costs of the amendment to accelerate the documentation completion date may be higher for EGC audits, the costs may be mitigated based on certain characteristics of EGCs. For example, to the extent that EGCs are smaller than non-EGCs, EGC audits may be less complex, which potentially facilitates expeditious assembly of the final workpapers.<sup>175</sup> In addition, to the extent that EGCs are audited by firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, the extended effective date of the amendment to accelerate the documentation completion date will allow those firms more time to implement the accelerated documentation completion date.<sup>176</sup> Moreover, as EGCs are not large accelerated filers ("LAFs"), the SEC Form 10-K filing deadline for EGCs is either 75 days after the fiscal year end for accelerated filers or 90 days for non-accelerated filers. This provides firms with an additional 15 days for accelerated filers or 30 days for non-accelerated filers, as compared to the time period for LAFs, to assemble the required final workpapers during a period that may be proportionately less busy.

The amendment to accelerate the documentation completion date could improve efficiency and capital formation for EGCs to the extent that the amendment reduces uncertainty about the reliability of an EGC's financial statements via enhanced audit quality. Investors who are uncertain about the reliability of an EGC's financial statements may require a larger risk premium that reduces the efficient allocation of capital or increases the cost of capital. Thus, any reduction of uncertainty via enhanced audit

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<sup>175</sup> See EGC White Paper, Figure 9 and Figure 12 (indicating that exchange-listed EGCs have lower market capitalization and revenue than exchange-listed non-EGCs).

<sup>176</sup> See EGC White Paper 22. Based on staff analysis as of the Nov. 15, 2022 measurement date, U.S. firms audited 2,548 EGCs, of which 817 were audited by firms that issued audit reports for 100 or fewer issuer audit clients.



quality, including from firms' implementation of operating efficiencies, could improve the efficiency of capital allocation, lower the cost of capital, and enhance capital formation for those EGCs.

The amendment to accelerate the documentation completion date could also impact competition in an EGC product market if any indirect costs to audited companies disproportionately affect EGCs relative to their competitors. For example, if EGCs are forced to raise prices in order to remain viable but their non-EGC competitors are not forced to raise prices, this may divert market share toward their non-EGC competitors. This could increase competition in markets where EGCs have a dominant market share and decrease competition in markets where EGCs have a less than dominant market share. However, the incentives for firms to pass costs onto EGCs may also be limited by competition for audits.

The proposal sought comments on the applicability of the proposed requirements to audits of EGCs. Several commenters agreed that the requirements of AS 1000 should apply to the audits of EGCs. One commenter suggested that the audits of EGCs should be subject to stricter requirements because non-accelerated filers have a higher incidence of restatements and because small capitalization issuers have a higher proportion of equity owned by individual investors but less coverage by sell-side analysts.<sup>177</sup> However, the Board continues to believe the same standard and related amendments should apply to audits of EGCs and non-EGCs to avoid the potential for confusion that could accompany

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<sup>177</sup> See, e.g., Audit Analytics, *2021 Financial Restatements: A Twenty-One Year Review* (May 2022) and Garnet Roach, *Only Small Caps See Minority of Shares Held by Institutions, Research Shows*, IR Magazine (Jan. 18, 2022).

differences within firms' policies and procedures with respect to audits of EGCs and non-EGCs.

Accordingly, and for the reasons explained above, the Board has requested that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the standard and related amendments to audits of EGCs.

### **III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents, the Commission will:

- (A) By order approve or disapprove such proposed rules; or
- (B) Institute proceedings to determine whether the proposed rules should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's internet comment form (<https://www.sec.gov/rules/pcaob>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include PCAOB-2024-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to PCAOB-2024-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<https://www.sec.gov/rules/pcaob>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to

PCAOB-2024-01 and should be submitted on or before [INSERT DATE 21 DAYS  
AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

By the Commission.

Vanessa A. Countryman

Secretary



**Proposed Auditing Standard – General  
Responsibilities of the Auditor in Conducting  
an Audit  
and  
Proposed Amendments to PCAOB Standards**

PCAOB Release No. 2023-001  
March 28, 2023

PCAOB Rulemaking  
Docket Matter No. 049

**Summary:** The Public Company Accounting Oversight Board (“PCAOB” or the “Board”) is proposing a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, that, together with other amendments, would reorganize and consolidate a group of interim standards adopted by the Board in April 2003. The proposed new auditing standard addresses the general responsibilities of the auditor, such as due professional care and professional skepticism, when conducting an audit in accordance with the standards of the PCAOB.

**Public**

**Comment:** Interested persons may submit written comments to the Board. Comments should be sent by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board’s website at [pcaobus.org](http://pcaobus.org). Comments also may be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 049 in the subject or reference line and should be received by the Board no later than May 30, 2023.

**Board**

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## I. EXECUTIVE SUMMARY

We are proposing a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (“proposed standard” or “proposed AS 1000”). Proposed AS 1000 would replace a group of standards originally developed by the American Institute of Certified Public Accountants (“AICPA”) and adopted on an interim basis by the PCAOB in 2003. That group of standards establishes the general principles and responsibilities of the auditor when conducting an audit (“foundational standards”). The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. These principles and related responsibilities provide a foundation for the proper performance of the audit.

Through this standard-setting project, we are reaffirming the general principles and responsibilities to ensure that the foundation continues to be solid and appropriate for maintaining high-quality audits. These principles and responsibilities, together with modernized auditing standards, should equip the auditor with better tools to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

Currently, the general principles and responsibilities are addressed across four standards: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*. The proposal would combine the general principles and responsibilities from these standards into one standard (proposed AS 1000), while also making updates to reflect developments in the auditing environment.

We are also proposing to amend certain other standards that address responsibilities fundamental to the conduct of an audit. These amendments would clarify the engagement partner’s responsibility to exercise due professional care related to supervision and review of the audit, accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarify the auditor’s responsibility to evaluate whether the financial statements are “presented fairly.” Finally, we are proposing additional amendments to conform to these changes.

### **Why Is the Board Proposing These Changes?**

Since the PCAOB’s adoption of the foundational standards in 2003, the auditing environment has evolved, including:

- Changes to auditing requirements through Board-issued standards;
- New or revised independence requirements issued by the Board; and



- Advancements in technology affecting the availability of electronic audit tools and use of audit software.

### **How Would this Proposal Modernize PCAOB Standards?**

The proposed standard and related amendments would modernize PCAOB standards as follows:

- Reflect changes in the auditing environment;
- Eliminate outdated and inconsistent language; and
- Achieve consistency with Board-issued standards.

The proposed standard and related amendments are designed to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand, and apply. We propose to clarify the auditor’s responsibility to evaluate whether the financial statements are “presented fairly.” We also propose to clarify the engagement partner’s due professional care responsibilities by adding specificity to certain audit performance principles set out in the standards. Finally, an accelerated documentation completion date reflects changes in the auditing environment including that advancements in technology have enabled auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment. It would also enable the Board to potentially begin the inspection process sooner after completion of an audit, which we believe could enhance the Board’s efforts to improve audit quality and promote investor protection, ultimately enhancing investor confidence.

### **Requesting Public Comment on Our Proposal**

In this release, we are seeking comment on all aspects of the proposed standard and related amendments, including the appropriateness of the general principles and responsibilities, and on proposed conforming amendments to other PCAOB auditing standards. We have included detailed questions soliciting your feedback on specific aspects of the Board’s proposal. You are encouraged to comment on any or all topics, respond to any or all questions, provide feedback in areas not covered by specific questions, and provide any evidence, including data or your practical experiences, that informs your views.

Instructions on how to comment, including by e-mail or postal mail, can be found on the cover sheet of this release. Comments submitted can be found at the docket page of PCAOB Rulemaking Docket Matter No. 049.

## II. BACKGROUND

In April 2003, the Board adopted, on an interim basis, the generally accepted auditing standards of the AICPA's Auditing Standards Board as they existed then ("interim standards").<sup>1</sup> At that time, the Board stated that it would determine whether the interim standards "should become permanent standards of the Board, should be repealed, or should be modified."<sup>2</sup> Since then, the Board has adopted a number of new auditing standards<sup>3</sup> and proposed additional standards<sup>4</sup> to supersede or amend portions of the interim standards. However, certain remaining interim standards, including those that address the general principles and responsibilities of the auditor, continue to be in effect substantially in the form adopted.

Since the adoption of the interim standards, the auditing environment has evolved in many ways, including: (i) changes to auditing requirements through Board-issued standards; (ii) new or revised independence requirements issued by the Board;<sup>5</sup> and (iii) advancements in technology affecting the availability of electronic audit tools and the use of audit software. While these developments have generally been reflected through amendments to some interim standards in connection with the Board's standard-setting initiatives, opportunities remain to consider broader changes to modernize and better align interim standards with Board-issued standards and to reflect changes in the auditing environment.

In our 2022-2026 Strategic Plan, we expressed our re-energized focus on the PCAOB's investor protection mission and stated our intent "to modernize and streamline our existing standards and to issue new standards where necessary to meet today's needs."<sup>6</sup> Commenters on the draft of the strategic plan that we issued for public comment in August 2022 generally

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<sup>1</sup> See *Establishment of Interim Professional Auditing Standards*, PCAOB Release No. 2003-006 (Apr. 18, 2003).

<sup>2</sup> *Id.*

<sup>3</sup> See, e.g., AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 2101, *Audit Planning*; and AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

<sup>4</sup> See, e.g., *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Release No. 2022-006 (Nov. 18, 2022), and *Proposed Auditing Standard – The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*, PCAOB Release No. 2022-009 (Dec. 20, 2022).

<sup>5</sup> See generally, e.g., PCAOB rules under Section 3. Auditing and Related Professional Practice Standards, Part 5 – Ethics and Independence.

<sup>6</sup> See PCAOB, Strategic Plan 2022-2026, at 10, available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a\\_4/](https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a_4/)

supported this initiative.<sup>7</sup> One commenter noted that “[m]odernization is necessary to make sure that these standards remain fit for purpose and reflect both significant changes in how audits are performed and developments in the capital markets in which companies operate.”<sup>8</sup> Another commenter noted that “investors have asked the PCAOB to increase stability and predictability by developing more permanent standards (*i.e.*, depending less on interim standards).”<sup>9</sup> The need to update the interim standards has been cited in other letters received by the PCAOB and the Securities and Exchange Commission (“SEC”).<sup>10</sup>

In connection with our standard-setting initiatives,<sup>11</sup> we are evaluating which of the interim standards are necessary to retain and, of those, which should be retained with minimal updates and which warrant more significant changes. In this regard, today we are proposing a new, single standard to replace the interim standards that address the general principles and responsibilities of the auditor in conducting an audit. These foundational standards are:<sup>12</sup>

- AS 1001, *Responsibilities and Functions of the Independent Auditor*;
- AS 1005, *Independence*;
- AS 1010, *Training and Proficiency of the Independent Auditor*; and

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<sup>7</sup> See PCAOB, *Request for Public Comment – Draft 2022-2026 PCAOB Strategic Plan*, PCAOB Release No. 2022-003 (Aug. 16, 2022). Comments on the draft strategic plan are available at <https://pcaobus.org/about/strategic-plan-budget/comments-on-pcaob-draft-strategic-plan-2022-2026>.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> See *Letter from former members of PCAOB Investor Advisory Group* (Apr. 19, 2021), available at <https://consumerfed.org/wp-content/uploads/2021/04/PCAOB-IAG-Letter.pdf>. See also *Letter from Alliance of Concerned Investors* (Feb. 14, 2022), available at [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/advisory/documents/comments/3\\_aoci.pdf?sfvrsn=f47eefbb\\_4](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/advisory/documents/comments/3_aoci.pdf?sfvrsn=f47eefbb_4) and *Letter from Mary M. Bersot, et al.* (Feb. 28, 2022), available at [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/advisory/documents/comments/16\\_bersot.pdf?sfvrsn=83d93742\\_4](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/advisory/documents/comments/16_bersot.pdf?sfvrsn=83d93742_4).

<sup>11</sup> See PCAOB’s interim standards project, available at <https://pcaobus.org/oversight/standards/standard-setting-research-projects/interim-standards>.

<sup>12</sup> When adopted by the Board in 2003, this group of interim standards was designated as AU sec. 110, AU sec. 220, AU sec. 210, and AU sec. 230. In 2015, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, and these interim standards were designated as AS 1001, AS 1005, AS 1010, and AS 1015, respectively. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization did not impose additional requirements on auditors or change substantively the requirements of PCAOB standards.

- AS 1015, *Due Professional Care in the Performance of Work*.

The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. We believe that these principles and responsibilities are generally understood by auditors and investors and lay the appropriate groundwork for audit procedures performed under PCAOB standards.

Our analysis also considered whether other matters that are fundamental to the conduct of an audit merit inclusion in the proposed standard or amendments to other PCAOB standards.

- First, our auditing standards describe many of the engagement partner's responsibilities as general responsibilities and permit the engagement partner to seek assistance from others. More specificity about the engagement partner's responsibility to exercise due professional care could benefit auditors and investors. Such responsibilities relate to important aspects of the audit, including the supervision and review of audit documentation in AS 1201, AS 1215, and AS 2101.
- Second, the requirements in AS 1215 for documenting and reviewing the performance of audit procedures, including the requirement to complete audit documentation within 45 days of releasing the auditor's report, were adopted by the PCAOB almost 20 years ago, before the widespread use of electronic documentation.
- Third, AS 2810, *Evaluating Audit Results*, requires that the auditor evaluate whether the financial statements are "presented fairly," but important concepts related to that evaluation are discussed in a different standard, AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."*

The remainder of this section provides an overview of existing requirements included in the foundational standards and other relevant standards, and discusses our reasons for modernizing, streamlining, and amending these auditing standards.

## A. Overview of Existing Requirements

This section discusses key provisions of the existing standards.

Key provisions of AS 1001, *Responsibilities and Functions of the Independent Auditor*, include:

- The objective of an audit of financial statements is to express an opinion on the fairness of the financial statements in presenting, in all material respects, the financial position, results of operations, and cash flows in accordance with generally

accepted accounting principles. The auditor also disclaims an opinion if circumstances require. (AS 1001.01)

- The responsibilities of the auditor and management are that: (i) the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud; and (ii) management is responsible for the financial statements, including adopting accounting policies and establishing and maintaining internal control to initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions in the financial statements. (AS 1001.02-.03)
- The auditor is to possess professional qualifications and exercise professional judgment in determining which auditing procedures are necessary in the circumstances to gain a reasonable basis for the opinion. (AS 1001.04-.05)
- The auditor should be aware of and consider auditing interpretations applicable to the audit and, if the guidance in the interpretations is not followed, be prepared to explain how the auditor complied with the provisions of the auditing standard addressed by the guidance. (AS 1001.11)

Key provisions of AS 1005, *Independence*, require that the auditor:

- Maintain independence in mental attitude and be intellectually honest, impartial, and without bias with respect to the client (i.e., be independent in fact). (AS 1005.01-.03)
- Be free from any obligation to or interest in the client, its management, or its owners, so that the general public maintains confidence in the independence of auditors. (AS 1005.03)
- Not only be independent in fact, but also avoid situations that may lead outsiders to doubt the auditor's independence. (AS 1005.03)

Key provisions of AS 1010, *Training and Proficiency of the Independent Auditor*, require that:

- The audit be performed by persons having adequate technical training, proficiency, and experience as an auditor. (AS 1010.01-.02)
- The training of the auditor be adequate to meet the requirements of the profession, be adequate in technical scope, and include general education. (AS 1010.01-.03)

- New audit professionals obtain professional experience through proper supervision and review of their work by those who are more experienced, with the nature and extent of supervision reflecting variances in practice. (AS 1010.03)
- The engagement partner exercise seasoned judgment in the varying degrees of supervision and review of work performed and judgments exercised by subordinates, and subordinates meet the responsibilities of their work. (AS 1010.03)
- The auditor continue professional training to become aware of developments in business and the profession, and study, understand, and apply new pronouncements on accounting and auditing. (AS 1010.04)

Key provisions of AS 1015, *Due Professional Care in the Performance of Work*, require that:

- The auditor exercise due professional care in the planning and performance of the audit and the preparation of the report, including observance of the auditing standards by professionals within the auditor's organization. (AS 1015.01-.02)
- The auditor possess "the degree of skill commonly possessed" by other auditors and exercise it with "reasonable care and diligence" (i.e., due professional care) in the planning and performance of the audit and the preparation of the report. (AS 1015.01, .05)
- The engagement team be assigned to tasks and be supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining. (AS 1015.06)
- The engagement partner know, at a minimum, the relevant professional accounting and auditing standards and be knowledgeable of the audit client and be responsible for the assignment of tasks to, and supervision of, the members of the engagement team. (AS 1015.06)
- The auditor exercise professional skepticism throughout the audit, with a questioning mind and a critical assessment of audit evidence, to diligently gather and objectively evaluate audit evidence and consider the competency and sufficiency of the evidence, and not be satisfied with less than persuasive evidence because of a belief that management is honest. (AS 1015.07-.09)
- The auditor obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Reasonable assurance is "a high level of assurance" but is not absolute assurance because of the nature of audit evidence and the characteristics of fraud. (AS 1015.10)

Key provisions of other standards relevant to this rulemaking include:

- AS 1201.04-.05 and AS 2101.03, which describe the engagement partner’s responsibilities for supervision and review of audit documentation;
- AS 1215.06, which requires the auditor to document procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions;
- AS 1215.15, which requires the auditor to complete the necessary auditing procedures and assemble for retention a complete and final set of audit documentation within 45 days after the report release date; and
- AS 2815, which explains the meaning of “present fairly” as used in the phrase “present fairly ... in conformity with generally accepted accounting principles,” and the basis for the auditor’s opinion on whether the financial statements present fairly an entity’s financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

## B. Reasons to Improve Auditing Standards

The foundational standards continue to be in effect substantially in the form adopted by the Board in 2003. In our view, the general principles and responsibilities addressed by these standards remain central to the practice of auditing. The standards could be updated to streamline and clarify the general principles and responsibilities, which would enhance the useability of the standards by making them easier to read, understand, and apply. As described above, there are opportunities to consider broader changes to better align the general principles and responsibilities of the foundational standards with those of Board-issued standards and to reflect changes in the auditing environment, which has evolved since the Board adopted the interim standards.

### 1. Alignment with Board-issued standards and rules

Since the adoption of the foundational standards, the Board has issued a number of new auditing standards and amendments. Certain of these standards address other principles and responsibilities that are fundamental to the conduct of an audit, including the engagement partner’s supervisory and review responsibilities and general requirements for audit documentation. Expressly incorporating these specific principles and responsibilities for conducting an audit in the proposed standard and related amendments would provide the auditor with more complete direction on matters that are central to the auditor’s work.

Certain descriptions in the foundational standards could be updated to align with the language used in Board-issued standards. For example, the foundational standards<sup>13</sup> refer to generally accepted accounting principles (“GAAP”); however, in recognition of the SEC’s acceptance of filings that include financial statements prepared under accounting frameworks other than U.S. GAAP, such as International Financial Reporting Standards (“IFRS”), Board-issued standards (e.g., AS 3101) are written as framework neutral and refer instead to the applicable financial reporting framework.<sup>14</sup> As another example, in describing professional skepticism, AS 1015 refers to the competency and sufficiency of the audit evidence. This formulation could be updated to align with the Board-issued AS 1105, *Audit Evidence*, which refers to audit evidence as sufficient and appropriate.

The foundational standards were originally written for audits of financial statements, but certain general principles and responsibilities described in the standards (e.g., reasonable assurance, due professional care, and professional skepticism) apply equally to audits of internal control over financial reporting (“ICFR”). None of the foundational standards mention audits of ICFR or refer to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements*. While AS 2201 refers to the foundational standards for the requirements related to technical training and proficiency as an auditor, independence, and the exercise of due professional care, including professional skepticism, we believe it would be helpful to clarify that the general principles and responsibilities apply to an audit of ICFR as well as an audit of financial statements.

The general principles and responsibilities of the foundational standards could also be streamlined by conforming to the structure used in Board-issued standards. This includes adding an introduction and objectives to the proposed standard. In addition, the responsibilities could be clarified by expressing the requirements using PCAOB Rule 3101 terms (e.g., using “must” and “should” to describe the degree of responsibility that the standards impose on auditors). Any explanatory material that continues to be relevant could be relocated to the release discussion, which would facilitate the auditor’s navigation of the new or revised requirements and align with the approach taken in Board-issued standards.

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<sup>13</sup> See, e.g., AS 1001. See also AS 2815.

<sup>14</sup> See paragraph .01, footnote 1 of AS 2410, *Related Parties* (“The auditor should look to the requirements of the U.S. Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company ...”); *Auditing Standard No. 18 – Related Parties Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2014-002 (June 10, 2014), at A4-6 (describing the approach of AS 2410.01, footnote 1 as “framework neutral”).



## **2. New or revised independence requirements issued by the PCAOB and the SEC**

Since the adoption of AS 1005 in 2003, the PCAOB has issued independence rules that have imposed certain incremental independence requirements on registered public accounting firms, relative to SEC rules<sup>15</sup> (e.g., independence impairments related to tax services for persons in financial reporting oversight roles at issuer audit clients).<sup>16</sup> These incremental independence requirements are not expressly addressed in existing AS 1005, but nevertheless the auditor is required to comply with them. Further, while existing AS 1005 includes a general reference to the SEC's requirements for auditor independence,<sup>17</sup> there is no reference to the specific requirements. We believe that it would be helpful to refer explicitly to the requirements that govern auditor independence, including independence requirements set out by the SEC, which include an overarching provision for the auditor to maintain independence from its client in fact and in appearance.

## **3. Advancements in technology affecting the availability of electronic audit tools and use of audit software**

Since the foundational standards were adopted by the PCAOB, there have been advancements in technology affecting the availability of electronic audit tools and use of audit software. Auditors have largely moved away from a paper-based approach to audit documentation in favor of using software that houses electronic workpapers and audit programs. Use of electronic workpapers facilitates more efficient performance and review of audit procedures and enables auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment.

Auditors are also expanding their use of and reliance on electronic audit tools. For example, some firms have made significant investments in internally developed tools for use in the audit. In addition, some "off-the-shelf" applications such as data analysis software have become available to auditors. These advancements have changed the way that many auditors perform and document their audit procedures and retain related audit documentation.

## **4. Outdated and inconsistent language**

The foundational standards include outdated and inconsistent language that is not relevant to audits conducted under the standards of the PCAOB. For example, paragraph .03 of AS 1001 provides that the auditor may draft the financial statements in whole or in part based

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<sup>15</sup> See generally, e.g., PCAOB rules under Section 3. Auditing and Related Professional Practice Standards, Part 5 – Ethics and Independence.

<sup>16</sup> See PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*.

<sup>17</sup> See Section 10A(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1(g); Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01.

on information from management during performance of the audit. This provision is outdated and should not be included in PCAOB auditing standards because an auditor drafting the financial statements would violate the applicable independence rules.<sup>18</sup> Eliminating outdated language from the auditing standards would remove inconsistencies between the auditing standards and rules of the PCAOB and the SEC and provide clearer direction to auditors in executing their responsibilities. Similarly, in describing the objective of the audit, paragraph .01 of AS 1001 refers to financial position, results of operations, and cash flows. This language could be unnecessarily limiting because the objective of the audit does not change based on the subject matter of the audit (e.g., whether it is an audit of ICFR or the financial statements).

## 5. Activities of other standard setters

Since the Board's adoption of the foundational standards, both the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the AICPA have updated their analogous standards:

- IAASB Standard – International Standards on Auditing 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* ("ISA 200") (effective 2008); and
- ASB Standard – AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* ("AU-C 200") (effective 2012).

These revisions were part of clarity projects that were designed to make the standards easier to read, understand, and apply.<sup>19</sup> These standards were updated to align the terminology used throughout the standards for consistency and to enhance and update explanatory materials. A comparison of proposed AS 1000 to the analogous standards of other standard setters is available on the Board's website in Docket 049.

## III. DISCUSSION OF PROPOSAL

### A. Overview of Proposal

We are proposing to replace AS 1001, AS 1005, AS 1010, and AS 1015 with one standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, that would

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<sup>18</sup> See Regulation S-X Rule 2-01(c)(4)(i), 17 C.F.R. § 210.2-01(c)(4)(i).

<sup>19</sup> Descriptions of the clarity projects of the IAASB and ASB are available, respectively, at <https://www.iaasb.org/projects/clarity-iaasb-standards> and <https://us.aicpa.org/interestareas/frc/auditattest/improvingclarityasbstandards>.

describe the general responsibilities of an auditor<sup>20</sup> in conducting an audit in accordance with the standards of the PCAOB. Briefly, the proposed standard would:

- Include objectives for the auditor in conducting and communicating the results of both an audit of a company's financial statements and an audit of the company's internal control over financial reporting;
- Retain and clarify the general principles and responsibilities that are important for an audit, including reasonable assurance, due professional care, professional skepticism, and professional judgment;
- Align the engagement partner's supervisory responsibilities under AS 1201 with due professional care;
- Retain the requirement for the auditor to be independent but express the obligation more directly by referring to the PCAOB's independence rules and standards, and the SEC's independence criteria;
- Describe the auditor's obligations to (i) comply with ethics requirements, (ii) obtain and maintain competence, and (iii) prepare audit documentation;
- Express the auditor's responsibilities by using the terms set forth in PCAOB Rule 3101 (e.g., must and should) that describe the degree of responsibility that PCAOB standards impose on auditors; and
- Remove language that is outdated, inconsistent, and not relevant to audits conducted under the standards of the PCAOB.

As previously noted, we are proposing changes to other PCAOB standards that address responsibilities fundamental to the conduct of an audit to:

- Clarify the engagement partner's existing responsibilities for supervision and review in AS 1201, AS 1215, and AS 2101 to provide more specificity about the engagement partner's responsibility to exercise due professional care related to supervisory and review activities required to be performed under existing auditor requirements;
- Clarify the requirements for audit documentation in AS 1215 to identify who performed the work, who reviewed the work, and the date of such review;

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<sup>20</sup> The term "auditor" includes both a public accounting firm registered with the PCAOB and associated persons thereof, as defined in Rule 1001, *Definitions of Terms Employed in Rules*. For example, engagement quality reviewers, by virtue of their status as associated persons, are within the term "auditor" in proposed AS 1000. See also paragraph .03 of AS 1220, *Engagement Quality Review*.

- Accelerate the period in AS 1215 to assemble a complete and final set of audit documentation for retention from 45 days to 14 days; and
- Update and incorporate the underlying requirements of AS 2815 into AS 2810, and rescind AS 2815, to clarify the meaning of “presents fairly” and streamline the requirements to provide a more logical presentation.

## B. Proposed AS 1000

### 1. Introduction and objective

*See paragraphs .01 through .03 of the proposed standard in Appendix 1.*

Auditors have a fundamental obligation to the public by serving as the protector of the public interest in the integrity of financial statements. The Supreme Court described this responsibility as a “public watchdog” function that “demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.”<sup>21</sup> We believe it is important to explicitly remind auditors of their obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports.

As noted in the proposed standard, an audit primarily benefits investors who rely on the audit to provide objective and independent opinions on whether a company's financial statements are presented fairly and on, if applicable, the effectiveness of the company's internal control over financial reporting. A properly conducted audit and related auditor's report enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, ICFR.

The proposed standard addresses the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the PCAOB. An audit conducted in accordance with these standards provides the basis for the auditor to express an opinion in the auditor's report on which investors and other financial statement users can rely on when making investment decisions.

The proposed standard sets out the objectives of the auditor, states requirements for the auditor's professional qualifications and the auditor's general responsibilities applicable in

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<sup>21</sup> See *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (also noting that an “independent certified public accountant ... [b]y certifying the public reports that collectively depict a corporation's financial status, ... assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to [the] investing public”) (emphasis in original).

all audits, and describes the auditing principles relevant to conducting an audit. The requirements of the proposed standard would apply to an audit of financial statements and an audit of internal control over financial reporting. We are proposing that the standard cover both types of audits because the general principles are the same, and the general objectives of the auditor are similar.

Many of the general principles and responsibilities described in proposed AS 1000 also apply to interim review and attestation engagements. Therefore, we are proposing amendments, consistent with proposed AS 1000, to certain provisions in those standards to make similar improvements.<sup>22</sup>

Under the proposed standard, the objectives of the auditor are: (i) in an audit of financial statements, obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and issue an auditor's report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; (ii) in an audit of internal control over financial reporting, obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment, and issue an auditor's report that expresses an opinion on the effectiveness of the company's internal control over financial reporting; and (iii) communicate externally in accordance with applicable professional and legal requirements.

The term "applicable professional and legal requirements," as defined in the recently proposed quality control standard ("proposed QC 1000"),<sup>23</sup> includes: (i) professional standards, as defined in PCAOB Rule 1001(p)(vi); (ii) rules of the PCAOB that are not professional standards; and (iii) to the extent related to the obligations and responsibilities of accountants or auditors or to the conduct of engagements, rules of the SEC, other provisions of U.S. federal securities law, and other applicable statutory, regulatory, and other legal requirements. This definition is intended to capture all professional and legal requirements specifically related to audits of issuers and SEC-registered broker and dealers performed under PCAOB standards, including the relevant accounting and auditing standards, PCAOB and SEC rules, other federal securities laws (e.g., Section 10A of the Securities Exchange Act of 1934), other relevant laws and regulations (e.g., state law and rules governing accountants), and other legal requirements related to the obligations and responsibilities of auditors or to the conduct of the audit.

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<sup>22</sup> See Appendix 4 of this release for these other proposed amendments.

<sup>23</sup> See PCAOB Release No. 2022-006. Proposed QC 1000 includes some definitions and amendments that are also included in proposed AS 1000. If, prior to the conclusion of this rulemaking, the Board has adopted definitions and amendments in proposed QC 1000 that affect this rulemaking, the Board may make conforming changes to proposed AS 1000.

Other than AS 1001,<sup>24</sup> the foundational standards do not include an objective. Adding overarching objectives of the auditor in the proposed standard would emphasize the purpose of the procedures set forth in a standard. The inclusion of the objectives would also be consistent with other Board-issued standards.

## 2. Professional qualifications of the auditor

### i. Independence and Ethics

*See paragraphs .04 through .06 of the proposed standard in Appendix 1.*

The proposed standard would carry forward the existing requirement in AS 1005 for the auditor to be independent. We are also proposing to directly align language that describes auditor independence obligations with language used in PCAOB Rule 3520, *Auditor Independence*, and Regulation S-X Rule 2-01, *Qualifications of Accountants* (“Rule 2-01”).<sup>25</sup> Under the proposed standard, the auditor would be required to be independent of its audit client both in fact and in appearance throughout the audit and professional engagement period.<sup>26</sup>

An auditor’s independence is a basic tenet of auditing. Auditors are required to be both independent in fact – that is, objective and unbiased in attitude – and independent in appearance to others. If investors do not perceive that the auditor is independent from the audit client, they will likely derive less confidence from the auditor’s report and the audited financial statements.<sup>27</sup>

The proposed standard clarifies that the auditor is not independent with respect to an audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed within the engagement. This clarification aligns

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<sup>24</sup> See AS 1001.01.

<sup>25</sup> Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01.

<sup>26</sup> See PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term “audit and professional engagement period.”

<sup>27</sup> See *United States v. Arthur Young & Co.*, 465 U.S. 805, 819 n.15 (1984) (“It is therefore not enough that financial statements *be* accurate; the public must also *perceive* them as being accurate. Public faith in the reliability of a corporation’s financial statements depends upon the public perception of the outside auditor as an independent professional.”).

the standard with language used in SEC Rule 2-01(b)<sup>28</sup> to explain further the meaning of being independent both in fact and in appearance.

Since the adoption of AS 1005 by the Board in 2003, the PCAOB has added incremental independence obligations for registered public accounting firms, such as prohibitions on tax services for persons in financial reporting oversight roles at issuer audit clients and communications with audit committees concerning independence.<sup>29</sup> These additional independence requirements are not expressly addressed in existing AS 1005, but nevertheless the auditor is required to comply with them. We believe that it would be helpful to specify in the proposed standard the requirements that govern auditor independence. Therefore, the proposed standard would require the auditor to satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the SEC.

The PCAOB's interim independence standards cover many of the same topics as the rules of the SEC. Recognizing the overlap, the Board requires firms to comply with the more restrictive of the Board's independence standards or the SEC's rules.<sup>30</sup> As a reminder of these obligations, the proposed standard refers to PCAOB Rule 3500T for this requirement.

The proposed standard would also require the auditor to comply with applicable ethics requirements, including the rules and standards of the PCAOB.<sup>31</sup> These requirements include the rules in Section 3, Part 5 of PCAOB rules and proposed EI 1000, *Integrity and Objectivity*, of PCAOB Release No. 2022-006.

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<sup>28</sup> Under the general standard in Rule 2-01(b), the SEC "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."

<sup>29</sup> See PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*, and PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*.

<sup>30</sup> See PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.

<sup>31</sup> In conducting an audit in accordance with PCAOB standards, paragraph .15 of the proposed standard would also require the auditor to comply with all applicable professional and legal requirements, which would include other applicable requirements regarding accountant ethics and independence, such as those arising under state law or the law of other jurisdictions (e.g., obligations regarding client confidentiality).

## ii. Competence

*See paragraphs .07 and .08 of the proposed standard in Appendix 1.*

AS 1010 uses the term “adequate technical training and proficiency” to describe the requirements for proper education, ongoing training, and experience in auditing.<sup>32</sup> We are proposing to replace the term “adequate technical training and proficiency” with the term “competence.” This approach would align the proposed standard with the terminology of proposed QC 1000. The proposed standard would require that the audit be performed by an auditor who has the competence to conduct an audit in accordance with the applicable professional and legal requirements<sup>33</sup> and the firm’s policies and procedures.

Competence, as described in the proposed standard, consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm’s policies and procedures. The auditor’s knowledge and skill relate to adequate technical training and proficiency as an auditor. The auditor’s ability relates to the capabilities to perform, and in the case of supervisory staff, to review assigned tasks, which include sufficient time and resources to comply with applicable professional and legal requirements.

The level of competence needed would be driven by the activities that an auditor is assigned, so that such activities are performed in accordance with the applicable professional and legal requirements and the firm’s policies and procedures. The proposed standard provides that, in determining the appropriate level of competence, the measure is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time. For example, an engagement partner with significant experience in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee the audit of a financial institution.

The proposed standard would require the auditor to develop and maintain competence through an appropriate combination of academic education, professional experience in accounting and auditing with proper supervision, and training, including accounting, auditing, independence, ethics, and other relevant continuing professional education. The proposed standard also notes that competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates. The auditor’s responsibilities under the proposal are consistent with the provisions in AS 1010, but streamlined by eliminating unnecessary descriptions, such as vague references to “general education” and “wide variances in practice.”

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<sup>32</sup> See AS 1010.01.

<sup>33</sup> See Section III.B.1 for discussion of the term “applicable professional and legal requirements.”



AS 1010 also includes requirements related to the extent of supervision and the supervision responsibilities of the engagement partner. Specifically, AS 1010 requires that the engagement partner exercise judgment in the varying degrees of supervision and review of work performed.<sup>34</sup> Because AS 1201 provides requirements for the extent of supervision under PCAOB standards, we are amending AS 1201 to further clarify the supervisory responsibilities of the engagement partner.<sup>35</sup>

### **3. Due professional care, including professional skepticism**

*See paragraphs .09 through .11 of the proposed standard in Appendix 1.*

Under AS 1015, the auditor is required to exercise due professional care in the planning and performance of the audit and the preparation of the report. This requirement is being retained in the proposed standard with clarifications.

The proposed standard would require the auditor to exercise due professional care “in all matters related to the audit” rather than “in the planning and performance of the audit and the preparation of the report.” We are proposing this change to clarify that the obligation to exercise due professional care encompasses all aspects of planning and performing an audit, including client acceptance and continuance procedures, and extends to periods after the issuance of the auditor’s report, such as completion of audit documentation,<sup>36</sup> reporting on Form AP,<sup>37</sup> and procedures performed in connection with filings under the federal securities statutes.<sup>38</sup>

Under the proposed standard, due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements. We are proposing to retain “reasonable care and diligence” and clarify that “good faith and integrity” means acting with “integrity.” Under a new standard we have recently proposed that would recodify the concepts of integrity and objectivity (EI 1000), “integrity” includes being honest and candid and not knowingly

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<sup>34</sup> See also Section 105(c)(6) of Sarbanes-Oxley (authorizing PCAOB to impose sanctions on a registered firm or person for failure to reasonably supervise an associated person of the firm).

<sup>35</sup> See Appendix 3 for proposed amendments to AS 1201.04-.05.

<sup>36</sup> See paragraph .15 of AS 1215, *Audit Documentation* (as proposed to be amended).

<sup>37</sup> See PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

<sup>38</sup> See AS 4101, *Responsibilities Regarding Filings Under Federal Securities Statutes*, which describes the auditor’s responsibilities when the auditor’s report is included in filings under federal securities statutes.

misrepresenting facts.<sup>39</sup>

The concept of due professional care is described in AS 1015 by quoting a 1932 legal treatise. We believe the reference to that treatise is unnecessary and are proposing to describe in plain language the concept of due professional care, without changing its meaning.

The proposed standard retains and makes more specific the engagement partner's responsibility to exercise due professional care. For engagement partners, due professional care includes (1) appropriately assigning responsibilities to, and supervising, engagement team members; (2) determining that the audit is properly planned and performed to obtain reasonable assurance; (3) evaluating that significant findings or issues are appropriately addressed; (4) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence; and (5) determining that required communications under applicable professional and legal requirements have been made. Under existing standards, the engagement partner is responsible for the audit and its planning and performance and thus is responsible for the assigned tasks and the supervision of engagement team members with due professional care.<sup>40</sup> The proposed clarification regarding the engagement partner's evaluation of significant findings or issues, determinations regarding significant judgments and conclusions, and determinations regarding required communications is consistent with the engagement partner's responsibility for the audit.<sup>41</sup>

As part of exercising due professional care, the engagement partner assigns activities to engagement team members that adequately match their levels of competence. In general, the engagement team members' competence should be commensurate with the level of professional judgment required to fulfill an assigned activity. For example, an inventory count that includes comparing actual quantities with what the company reported on inventory count sheets may require less expertise or experience, and a less experienced engagement team member may be suited to perform the task. On the other hand, the evaluation of an impairment analysis may involve complex judgments, and a more experienced engagement team member with appropriate training may be best suited to carry out this task. Further, the engagement partner is responsible for proper supervision of the work of engagement team members as described in AS 1201.

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<sup>39</sup> See proposed EI 1000, *Integrity and Objectivity*, in PCAOB Release No. 2022-006.

<sup>40</sup> See additional discussion of amendments to AS 1201.03-.06 in Section III.C.2.

<sup>41</sup> See, e.g., *In the Matter of Melissa K. Koeppe*, PCAOB File No. 105-2011-007, at 78 (Dec. 29, 2017) (stating that the engagement partner, as the "auditor with 'final responsibility' for the audit," must act with due professional care to see that the audit team performs all of the audit procedures that are required under the circumstances by PCAOB auditing standards, obtains reasonable assurance that the financial statements are free of material misstatement, and obtains sufficient appropriate evidence to afford a reasonable basis for the audit opinion).

The proposed clarifications of the engagement partner's responsibilities related to due professional care leverage existing requirements for planning and performing an audit and completing the corresponding audit documentation. For example, AS 1215 describes matters that are considered to be significant findings or issues in an audit and requires the auditor to document the significant findings or issues, including the actions taken to address them.<sup>42</sup> As part of the engagement partner's supervisory responsibilities under AS 1201, we believe that the engagement partner would need to timely evaluate the significant findings and issues identified by the engagement team to ensure appropriate action was taken.<sup>43</sup>

Similarly, significant judgments made by the engagement team, as described in AS 1220, would also warrant the engagement partner's review. Because the engagement partner has final responsibility for the engagement, they have final responsibility for the significant judgments made during the engagement, notwithstanding any involvement in or responsibility for those judgments by firm personnel outside of the engagement team, such as members of the firm's national office. Accordingly, the "significant judgments made by the engagement team" include all of the significant judgments made during the engagement.<sup>44</sup> By including these clarifications in the proposed standard, the engagement partner's supervisory and review activities would be aligned with existing auditor responsibilities.

We are also proposing to retain language related to an auditor's use of the work of other auditors, which emphasizes that other auditors are responsible for performing their work with due professional care.<sup>45</sup>

Professional skepticism is an important part of exercising due professional care in conducting an audit. Professional skepticism allows the auditor to recognize circumstances that may cause the financial statements to be materially misstated. The proposed standard retains the concept of professional skepticism in substantially the same form as it is described in AS 1015. The proposed standard describes professional skepticism as an attitude that includes a questioning mind and a critical assessment of information related to the audit. In describing the concept, we propose to use "information related to the audit" rather than "audit evidence" (as described in AS 1015) to emphasize that application of professional skepticism extends beyond the information used as audit evidence in arriving at conclusions on which the auditor's opinion is based. For example, by exercising professional skepticism in the preparation of Form AP, the

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<sup>42</sup> See AS 1215.12.

<sup>43</sup> See AS 1201.05.

<sup>44</sup> See Auditing Standard No.7 – *Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Controls Standards*, PCAOB Release No.2009-004 (July 28, 2009), at 4 n.7.

<sup>45</sup> See *Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm*, PCAOB Release No. 2022-002 (June 21, 2022) (amendments approved by SEC in Release No. 34-95488 (Aug. 12, 2022)), which amended AS 1015 to add this provision. We are proposing to retain the added language in a footnote to AS 1000.

auditor may become aware of inconsistencies in total audit hours reported by another accounting firm participating in the audit and take corrective action.

The proposed standard emphasizes that the auditor would exercise professional skepticism by objectively evaluating audit evidence obtained in an audit and considering the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence. The exercise of professional skepticism is particularly important in obtaining and evaluating audit evidence when responding to assessed risks of material misstatement, including fraud risks. Audit evidence is necessary to support the auditor's opinion. While it is primarily obtained from audit procedures performed during the audit, audit evidence may also include information obtained from other sources such as previous audits, client acceptance or continuance procedures, and understanding the company's relevant industry, regulatory environment, and legal and political environment. Audit evidence consists of both information that supports and corroborates management's assertions, and any information that contradicts such assertions.<sup>46</sup>

As part of exercising professional skepticism, the auditor also remains alert to conditions that may indicate possible misstatement due to error or fraud. This includes, for example, being alert to information that calls into question the reliability of documents and responses to inquiries the auditor plans to use as audit evidence. Such information could identify conditions that may indicate possible fraud or error in the financial statements.

Further, the proposed standard specifies that the auditor would exercise professional skepticism by not relying on evidence that is less than persuasive, and avoiding assumptions that management is honest or dishonest. In addition, in exercising professional skepticism, the auditor would consider the impact of management bias and the auditor's own bias that could affect the auditor's own judgments. For example, the tendency to seek confirming information can lead the auditor to seek audit evidence that is only consistent with management's explanations, or to favor conclusions that are consistent with the auditor's initial beliefs. In exercising professional skepticism, the auditor could mitigate such bias by being aware of "confirmation bias," considering alternatives provided by others, and seeking contradictory information as evidence.<sup>47</sup> The auditor also considers the impact of management bias, such as management bias in accounting estimates or in the selection and application of accounting principles.<sup>48</sup>

Auditors and management may have biases related to electronic information. For example, a tendency to favor output generated from automated systems, even when

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<sup>46</sup> See AS 1105.02.

<sup>47</sup> For a discussion of confirmation bias, see, e.g., Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology* 175 (1998).

<sup>48</sup> See, e.g., AS 2810 for examples of forms of management bias and the related auditor requirements.

contradictory information raises questions as to whether such output is reliable, illustrates a form of bias. Exercising professional skepticism, including critically assessing information related to the audit, helps the auditor address the effects of potential bias on professional judgment and decision-making.

AS 1015 states that “engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining.”<sup>49</sup> Other PCAOB standards already include these requirements. Specifically, (i) AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*,<sup>50</sup> and proposed QC 1000<sup>51</sup> address the assignment of tasks, and (ii) AS 1201 addresses supervision.<sup>52</sup> Therefore, rather than repeating the requirements, we added references to AS 2301 and AS 1201 in the proposed standard.

#### 4. Professional Judgment

*See paragraph .12 of the proposed standard in Appendix 1.*

Auditors exercise professional judgment throughout the audit. For example, the auditor exercises professional judgment in:

- Determining the areas to be tested and the nature, timing, and extent of the tests to be performed;
- Interpreting the results of audit testing and evaluating audit evidence;
- Evaluating the reasonableness of accounting estimates in significant accounts and disclosures, based on information that could reasonably be expected to be available through the date of the auditor’s report;<sup>53</sup>

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<sup>49</sup> See AS 1015.06.

<sup>50</sup> See Appendix 4 for proposed amendment to AS 2301.05.

<sup>51</sup> See proposed QC 1000.44c (providing, as a resource quality objective, that individuals who are assigned to engagements, including the engagement partner and engagement quality reviewer, have the competence, objectivity, and time to fulfill their responsibilities on such engagements in accordance with applicable professional and legal requirements and the firm’s policies and procedures); PCAOB Release No. 2022-006.

<sup>52</sup> See Appendix 3 for proposed amendment to AS 1201.06.

<sup>53</sup> See AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, which discusses the auditor’s responsibility to obtain sufficient appropriate evidence to determine whether accounting estimates in significant accounts and disclosures are properly accounted for and disclosed in the financial statements.

- Determining if there are any critical audit matters in the audit of the financial statements;<sup>54</sup> and
- Determining the nature and extent of documentation to comply with documentation requirements.<sup>55</sup>

Although the existing standards refer to the use of professional judgment, they do not explain what it means. We believe that describing professional judgment would be helpful because it is a general principle and responsibility. Therefore, the proposed standard would require the auditor to exercise professional judgment, and provides that professional judgment involves applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.<sup>56</sup> The reference to professional and legal requirements would provide context for the exercise of professional judgment, and is not intended to create a new requirement.

## 5. Conducting an audit

*See paragraphs .13 through .16 of the proposed standard in Appendix 1.*

The proposed standard would require the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence to (a) obtain reasonable assurance about whether: (1) in an audit of financial statements, the financial statements are free of material misstatement, whether due to error or fraud, or (2) in an audit of ICFR, material weaknesses exist as of the date specified in management's assessment; and (b) provide the auditor with a reasonable basis for forming an opinion. This requirement was retained from AS 1001 and AS 1015 but expanded to cover an audit of ICFR.

The proposed standard further retains the distinction between the responsibilities of the auditor and management and expands those responsibilities to include an audit of ICFR. We are proposing to streamline the language from AS 1001 and describe the respective responsibilities by leveraging the language used to describe the responsibilities in the auditor's reports on the audit of financial statements<sup>57</sup> and the audit of ICFR.<sup>58</sup> The phrase "the financial statements are management's responsibility" encompasses the preparation of the financial

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<sup>54</sup> See AS 3101 for requirements regarding critical audit matters.

<sup>55</sup> See AS 1215 for documentation requirements.

<sup>56</sup> The description of professional judgment is similar to the definition in the IAASB and AICPA standards.

<sup>57</sup> See AS 3101.09a-b.

<sup>58</sup> See AS 2201.85Da and c.

statements by management, including adopting sound accounting policies and establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

We are proposing to retain the concept of reasonable assurance and the corresponding description from AS 1015 as a high level of assurance. The term "reasonable assurance" describes the level of assurance auditors are required to obtain by performing audit procedures and evaluating the resulting audit evidence when expressing an opinion that the financial statements are fairly presented in conformity with the applicable financial reporting framework or, in an audit of ICFR, about whether material weaknesses exist. Reasonable assurance refers to the auditor's degree of satisfaction that the evidence obtained during the performance of the audit supports the assertions embodied in the financial statements. It is obtained by reducing audit risk to an appropriately low level (i.e., the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated or in an audit of ICFR, when a material weakness exists) through applying due professional care, including obtaining sufficient appropriate audit evidence.<sup>59</sup>

The auditor's report on the audit of financial statements explicitly states that "the audit was conducted in accordance with the standards of the PCAOB" and that those "standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud."<sup>60</sup> AS 1015 describes reasonable assurance with additional discussion of limitations of an audit.<sup>61</sup> We did not retain the descriptions of the limitations; rather we discussed how reasonable assurance can be obtained.

The proposed standard would also require the auditor to comply with applicable professional and legal requirements in conducting the audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors. This provision emphasizes that the overall objective of the auditor is achieved by complying with more than just the standards of the PCAOB. This includes compliance with requirements of Section 10A of the Securities Exchange Act of 1934 related to illegal acts, related party transactions, and an evaluation of whether there is substantial doubt about the ability of the company to continue as a going concern.<sup>62</sup> The proposed requirement also reminds auditors of the importance of keeping investor protection in mind when complying with the applicable professional and legal requirements.

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<sup>59</sup> See AS 1101.03-04.

<sup>60</sup> See AS 3101.09c and d.

<sup>61</sup> See, e.g., AS 1015.10-.13.

<sup>62</sup> See 15 U.S.C. § 78j-1.

The proposed standard would include a note providing that, as part of complying with all applicable professional and legal requirements in conducting the audit, the auditor should take into account relevant guidance applicable to the audit. This requirement is similar to the requirement in AS 1001 to consider the auditing interpretations issued by the AICPA in existence when the Board adopted the interim standards and which are still in effect.<sup>63</sup> The provision in the proposed standard, however, is not limited to those interpretations. It also includes taking into account relevant Board-issued guidance<sup>64</sup> and releases that accompany the rules and standards of the Board. The PCAOB supports the implementation of and compliance with its standards in many ways, including providing guidance in the rulemaking releases that accompany standards, amendments, or rules being adopted. We believe that it is important for auditors to take into account such guidance when conducting an audit in accordance with the standards of the PCAOB because it may help the auditor comply with complex provisions of those standards or rules. The proposed provision does not cover staff guidance.<sup>65</sup> Notwithstanding, auditors may find staff guidance useful to aid with the implementation and interpretation of PCAOB auditing standards.

The PCAOB has emphasized the importance of adequate audit documentation. When the PCAOB adopted the auditing standard on documentation (AS 1215), it stated that “the quality and integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work the auditor performed, the conclusions the auditor reached, and the evidence the auditor obtained that supports those conclusions.”<sup>66</sup> Because of the general importance of documentation to the planning and performance of the audit and to the supervision and review of work performed during the audit, the proposed standard would require the auditor to prepare audit documentation in accordance with AS 1215.

#### **i. Auditor Communications**

*See paragraphs .17 through .19 of the proposed standard in Appendix 1.*

AS 1001 describes the auditor’s report as the medium through which the auditor communicates the results of the audit (i.e., expresses an opinion, or if circumstances require,

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<sup>63</sup> See AS 1001.11.

<sup>64</sup> See, e.g., Policy Statement Regarding Implementation of Auditing Standard No. 2, *An Audit Of Internal Control Over Financial Reporting Performed In Conjunction With An Audit Of Financial Statements*

<sup>65</sup> The PCAOB staff develops guidance to assist in the implementation of PCAOB standards and rules. These documents represent the views of PCAOB staff and not necessarily those of the Board. The documents are not rules, policies, or statements of the Board. See, e.g., PCAOB Staff Audit Practice Alerts, which highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits under the existing requirements of PCAOB standards.

<sup>66</sup> See Paragraph A4 of AS 1215, Appendix A: Background and Basis for Conclusions.



asserts that an opinion cannot be expressed) to investors and other financial statement users. The proposed standard includes an explicit requirement for the auditor's report to contain: (i) an expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed; and if applicable, (ii) an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed.

Under the proposed standard, the auditor would be in a position to express an unqualified opinion only when the auditor has performed the audit in accordance with standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that: (i) in an audit of financial statements, the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; and (ii) in an audit of internal control over financial reporting, the company maintained in all material respects, effective internal control over financial reporting. This proposed requirement is consistent with provisions of AS 3101 and AS 2201, respectively.

The proposed standard briefly addresses when circumstances require an auditor to express a qualified opinion, adverse opinion, or disclaimer of opinion and refers to AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, and AS 2201.90-.98 and Appendix C of AS 2201 for a description of circumstances that require that the auditor express a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements or the company's internal control over financial reporting, and state the reasons for the departure from the unqualified opinion. We believe that such reference, also included in AS 3101, would serve as a helpful reminder for auditors complying with this standard.

*See paragraph .20 of the proposed standard in Appendix 1.*

In addition to reporting externally on the results of the audit, the auditor has a responsibility to make other communications, such as communication about audit results to the audit committee. These various external communications are addressed by applicable professional and legal requirements. We believe it is important to describe this responsibility in the proposed standard as an overarching responsibility to communicate externally. Therefore, the proposed standard would state that one of the objectives of the auditor is to communicate externally, as required by applicable professional and legal requirements. The auditor would look to the underlying requirements for the nature and timing of these required external communications (e.g., AS 1301, *Communications with Audit Committees*, for the auditor's requirements related to communications with audit committees). The requirement is not intended to limit other appropriate communications made by the auditor.

### C. Proposed Amendments Related to AS 1000

Appendices 2 through 4 to this release present proposed amendments to PCAOB standards related to AS 1000. The proposed amendments are described below.

## **1. Proposed amendments to AS 2810 and rescission of AS 2815 (Appendix 2)**

We are proposing to rescind AS 2815 and incorporate its requirements into AS 2810 for a more logical presentation of requirements regarding whether the financial statements are presented fairly in conformity with the applicable financial reporting framework. Currently, AS 2810 requires the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, and AS 2815 describes the meaning of this evaluation. The cross references between AS 2810 and AS 2815 are unnecessary and may be confusing for auditors trying to navigate the requirements. The proposed approach would eliminate such potential confusion by retaining and incorporating requirements of AS 2815 into AS 2810. We are not proposing to retain the remaining paragraphs in AS 2815 because the paragraphs contain no requirements and are explanatory in nature.

Our proposed movement of requirements from AS 2815 into AS 2810 includes an important clarification of the auditor's existing responsibilities. Specifically, the amendments would clarify that the auditor's evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. U.S. federal securities laws prohibit the financial statements and company disclosures from being materially misleading,<sup>67</sup> which is a broader concept than mere compliance with the applicable financial reporting framework. Presented fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework. However, the existing standards may not be sufficiently clear that the auditor's obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework. See Appendix 2 for these proposed amendments.

In proposed AS 1000, we are proposing to include a reference to AS 2810 addressing the auditor's responsibilities to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

## **2. Proposed amendments related to engagement partner responsibilities (Appendix 3)**

AS 1201 and AS 2101 establish the engagement partner's responsibility for the engagement and its performance, including planning, supervision, and review. They include provisions that enable the engagement partner to seek assistance in fulfilling those responsibilities. AS 1201 and AS 2101 use "seek assistance" to indicate that the engagement partner is allowed to use other engagement team members to help plan, supervise, and review

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<sup>67</sup> Exchange Act Rule 12b-20, 17 C.F.R. § 240.12b-20, requires that issuers disclose "such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading."

the engagement; however, they do not allow the engagement partner to delegate his or her primary responsibility for the engagement to another person or persons. We are proposing to amend the existing requirements in AS 1201 and AS 2101 to clarify that even when the engagement partner seeks assistance from other engagement team members, the engagement partner retains the primary responsibility for the engagement and its performance.

In this regard, other proposed amendments to AS 1201 would clarify the extent of the planning, supervisory, review, and documentation activities to be performed by the engagement partner by aligning those activities with existing auditor responsibilities under AS 1015. The extent of supervision necessary by an engagement partner is addressed in AS 1201. The PCAOB release that adopted AS 1201 in 2010 (which was designated at that time as AS No. 10) states that, although the extent of supervision of the work of an individual engagement team member may increase or decrease (based on factors such as risk of material misstatement and the nature of work assigned), supervision cannot be eliminated. The release noted that “the extent of supervision should be commensurate with the risks of material misstatement ... [and] that the higher risk areas of the audit require more supervisory attention from the engagement partner.”<sup>68</sup>

Proper supervision by the engagement partner includes evaluating that the work of engagement team members was performed and documented.<sup>69</sup> As explained in the PCAOB’s adopting release for the standard on audit documentation, “inadequate audit documentation diminishes audit quality on many levels. First, if audit documentation does not exist for a particular procedure or conclusion related to a significant matter, its absence casts doubt as to whether the necessary work was done. If the work was not documented, then it becomes difficult for members of the engagement team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached.”<sup>70</sup>

We believe that the engagement partner’s review of audit documentation is an important part of supervision. The proposed amendments reaffirm the engagement partner’s supervisory and review responsibilities in the context of exercising due professional care.<sup>71</sup> Specifically, we are proposing to add a note stating: notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner is required to review sufficient documentation to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner’s attention pursuant to

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<sup>68</sup> See *Auditing Standards Related to the Auditor’s Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, Release No. 2010-004 (August 5, 2010), at A10-17.

<sup>69</sup> See AS 1201.05.

<sup>70</sup> See *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Release No. 2004-006 (June 9, 2004), at A1-15.

<sup>71</sup> See proposed AS 1000.09 discussed above.

paragraph .05b, were appropriately addressed; (iii) the conclusions expressed in the auditor's report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. The proposed note also provides that the engagement partner's review includes review of documentation of significant findings or issues<sup>72</sup> and review of documentation that is also subject to review by the engagement quality reviewer.<sup>73</sup> We believe this amendment clarifies the engagement partner's existing obligations for supervision and review as the engagement team member with primary responsibility for the engagement.

We are also proposing other amendments to AS 1201 and AS 2101 to conform to proposed AS 1000. These technical and clarifying amendments include replacing references to titles of existing standards with the title of the proposed standard and updating cross-referenced terminology and paragraph citations.

### 3. Proposed amendments related to documentation (Appendix 3)

Good audit documentation improves the quality of the work performed in many ways, including, for example: (i) providing a record of actual work performed, which provides assurance that the auditor accomplished the planned objectives; (ii) facilitating the reviews performed by supervisors, managers, engagement partners, engagement quality reviewers, and internal and external inspection teams; and (iii) improving effectiveness and efficiency by reducing time-consuming, and sometimes inaccurate, oral explanations of what was done (or not done).<sup>74</sup> Documentation requirements should result in more effective and efficient oversight of registered public accounting firms and associated persons, thereby improving audit quality and enhancing investor confidence.<sup>75</sup>

AS 1215 provides that, prior to the report release date,<sup>76</sup> the auditor must have completed all necessary auditing procedures and obtain sufficient evidence to support the representations in the auditor's report.<sup>77</sup> Completing all necessary audit procedures includes "clearing review notes in audit workpapers and providing support for all final conclusions."<sup>78</sup>

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<sup>72</sup> See AS 1215.12.

<sup>73</sup> See AS 1220.09-.10 and .14-.15.

<sup>74</sup> See Paragraph A8. of AS 1215, Appendix A: Background and Basis for Conclusions.

<sup>75</sup> See AS 1215.A9.

<sup>76</sup> AS 1215.14 indicates that the "report release date" is "the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements."

<sup>77</sup> See AS 1215.15.

<sup>78</sup> See *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Release No. 2004-006 (June 9, 2004), at 5.

AS 1201 requires the engagement partner and, as applicable, other engagement team members performing supervisory activities, to review the work and evaluate whether the work was performed and documented,<sup>79</sup> and AS 1215 requires audit documentation to contain sufficient detail to determine who reviewed the work and the date of such review.<sup>80</sup> We propose to clarify these standards to emphasize that the engagement partner and other reviewers are also required to review such audit procedures prior to the report release date.<sup>81</sup> We propose to emphasize that audit documentation must clearly demonstrate who performed the work, who reviewed the work, and the date of such review.<sup>82</sup> In order for an engagement partner to conclude that the audit evidence obtained is sufficient and appropriate to support the opinion expressed in the auditor's report,<sup>83</sup> the audit work is required to be reviewed in a timely manner. We are proposing to amend AS 1215.15 to clarify that, before the report release date, the engagement partner and other engagement team members performing supervisory activities have completed their reviews of audit documentation. We do not believe this would result in a change in current practice.

Additionally, a complete and final set of audit documentation is required to be assembled for retention (i.e., archived) as of a date not more than 45 days after the report release date, known as the documentation completion date.<sup>84</sup> The period between the report release date and the documentation completion date (archive period) allows the auditor to assemble the complete and final set of audit documentation.

If additional documentation is needed after the report release date, auditors are required to document the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding the documentation. Furthermore, audit documentation must not be deleted or discarded after the documentation completion date.<sup>85</sup> In 2004, when AS 1215 was adopted, many firms documented their procedures, at least in part with a paper-based system. Based on our oversight activities, we understand that since the adoption of AS 1215, most firms have begun using electronic workpapers. The use of electronic workpapers may provide benefits to firms, such as: (i) enhancing the availability of documentation of audit procedures to engagement team members who are in different locations; (ii) facilitating the sharing of information across multi-office engagements; (iii) improving the ability to track the progress of the audit; (iv) facilitating

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<sup>79</sup> See AS 1201.05c(1).

<sup>80</sup> See AS 1215.06Ab (as proposed to be amended).

<sup>81</sup> See AS 1201.05 and 1215.15 (as proposed to be amended).

<sup>82</sup> See AS 1215.06 (as proposed to be amended).

<sup>83</sup> See AS 2810.02.

<sup>84</sup> See AS 1215.15.

<sup>85</sup> See AS 1215.16.

the timely review and updating of workpapers; and (v) improving efficiency in compiling a complete set of audit documentation for archiving.

We are proposing to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days. Documentation added to the workpapers after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed because it is difficult to reconstruct documentation after the work was performed.<sup>86</sup> The current archive period may also provide opportunities for unintentional mistakes (e.g., as memories fade and other assignments arise) and intentional manipulation (e.g., additional procedures and documentation completed after the report release date).<sup>87</sup> A 14-day period between the report release date and the documentation completion date would enable the Board to potentially begin the inspection process sooner after completion of an audit, which could enhance investor protection, ultimately enhancing investor confidence. We believe that this approach is consistent with the current financial reporting and auditing environment. For example, developments in the availability of financial reporting software enabled the acceleration of other regulatory reporting dates, such as periodic public company report filing dates.<sup>88</sup> Additionally, through our oversight activities, we are aware that some firms have already accelerated their archive period to less than 14 days.<sup>89</sup>

While we preliminarily believe that a 14-day archive period is appropriate, we acknowledge that in most situations firms currently have 35 days to file Form AP.<sup>90</sup> Part IV of the instructions to Form AP requires that a firm document the computation of total audit hours

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<sup>86</sup> See Paragraph A59. of AS 1215, Appendix A: Background and Basis for Conclusions.

<sup>87</sup> See, e.g., *In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Release No. 105-2022-033 (Dec. 6, 2022); *In the Matter of Deloitte LLP*, PCAOB Release No. 105-2021-014 (Sept. 29, 2021); and *In the Matter of Richard J. Bertuglia, CPA, John W. Green, CPA, and Lev Nagdimov, CPA*, SEC Release No. 34-84419 (Oct. 12, 2018).

<sup>88</sup> See, e.g., *Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports*, SEC Release No. 33-8128 (Sept. 5, 2002); and *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, SEC Release No. 33-8400 (Mar. 16, 2004).

<sup>89</sup> See Section IV.A.3. for discussion regarding current practices in archiving date of audit documentation.

<sup>90</sup> See Form AP – Auditor Reporting of Certain Audit Participants. Form AP has a filing deadline of 35 days after the date the auditor’s report is first included in a document filed with the SEC, or 10 days after the auditor’s report is first included in a document filed with the SEC for a registration statement under the Securities Act of 1933.

and include that computation in the files<sup>91</sup>. If auditors are unable to complete the computation of total audit hours, either actual or estimated, prior to the documentation completion date, the existing provisions of AS 1215 allow the auditor to add to the audit documentation and require an indication of the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.<sup>92</sup>

We are also proposing other amendments to AS 1215 to conform to proposed AS 1000. These technical and clarifying amendments include replacing references to titles of existing standards with the title of the proposed standard and updating cross-referenced terminology and paragraph citations.

#### **4. Other proposed amendments (Appendix 4)**

In connection with proposed AS 1000, we are proposing other amendments to several of the Board's auditing standards to conform to proposed AS 1000, proposed amendments to AS 2810, and proposed rescission of AS 2815. These amendments include superseding the foundational auditing standards.

The other changes include replacing references to titles of existing standards with the title of the proposed standard and updating cross-referenced terminology and paragraph citations. See Appendix 4 for these proposed amendments.

## **IV. ECONOMIC ANALYSIS**

The Board is mindful of the economic impacts of its standard setting. This section describes the economic baseline, need, and expected economic impacts of the proposed standard and related amendments, as well as alternative approaches considered by the Board. Due to data limitations, the economic analysis is generally qualitative in nature.

### **A. Baseline**

Section II describes important components of the baseline against which the economic impact of the proposed standard can be considered, including an overview of existing requirements. In the following subsections, we discuss additional matters that inform our understanding of the baseline for each of the proposed changes.

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<sup>91</sup> See *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, PCAOB Release No. 2015-008 (Dec. 15, 2015).

<sup>92</sup> See AS 1215.16.

## 1. Modernization of the foundational standards

Section II.A provides an overview of existing requirements of the auditing standards that describe the general principles and responsibilities of the auditor in conducting an audit in accordance with the standards of the PCAOB (i.e., foundational standards). The general principles and responsibilities addressed by the foundational standards are described in Section III.B and include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment.

The foundational standards are required to be followed in every audit conducted in accordance with PCAOB standards. The general principles and responsibilities in the foundational standards are reflected in firm methodologies, commercially published guidance, and other technical tools. Although there may be circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by how the foundational standards are organized and written, we do not have evidence that auditors are systematically confused about the meaning of the general principles and responsibilities or that the foundational standards as they are in effect today are insufficiently robust to support high-quality audits, when applied appropriately.

## 2. Clarification of engagement partner review

Under PCAOB standards, engagement partners are responsible for the engagement and its performance, including the proper planning and supervision of the engagement and its compliance with PCAOB standards. While engagement partners are permitted to seek assistance from other team members performing supervisory activities, engagement partners are responsible for proper supervision of the engagement and have primary responsibility for the engagement.

To obtain an understanding of firms' policies and practices for engagement partner review, the staff reviewed firms' available methodology documentation. A number of larger firms have developed specific guidance, checklists, and other tools to facilitate the engagement partner's review. For example, some firms mandate the use of tools that specify workpapers or topics that engagement partners are required to review directly. These tools require the engagement partner to document their review. Conversely, similar policies of some smaller firms are designed to be applied at a higher level and are not as specific about the required review.<sup>93</sup>

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<sup>93</sup> The observations in this paragraph are based on the staff's review of the policies of U.S. global network firms ("GNFs") and U.S. non-affiliate firms ("NAFs"). GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.). Some of the GNF member firms are based in the United States and others are based



### 3. Accelerating the documentation completion date

The auditor is required to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. Auditors may need some time after the report release date to assemble the final audit file and complete the audit documentation. The PCAOB standard for completing audit documentation currently requires completion within 45 days after the report release date. To obtain an understanding of firms' policies and practices for completing audit documentation, the staff reviewed firms' stated archiving policies and firms' archiving practices. We found a wide range of archiving periods among firms, from the full 45-day period to a much shorter period. In addition, PCAOB staff has observed that certain firms require audit documentation to be archive-ready upon completion of interim audit procedures. The PCAOB established the 45-day period when firms used paper documentation and needed time to copy, collate, finalize, and file workpapers. PCAOB staff has observed that most firms today have electronic audit tools and audit software that either make those tasks unnecessary or enable the tasks to be performed much faster.

Some U.S. GNFs require engagement teams to archive audit documentation within 10 days after the report release date. Other firms require engagement teams to archive audit documentation within longer periods (ranging from 30 to 45 days after the report release date). Of the firms with policies that allow longer periods, certain of them express expectations to complete documentation within a much shorter period.

All GNFs have established global policies for archiving to be used by their respective non-U.S. affiliate firms. The global policies generally allow for completion of documentation not more than 45 days after the report release date. The global policies of certain GNFs specify a documentation completion date within 14 days after the report release date, or sooner when required by local laws or regulations. In addition to the global policies, certain non-U.S. affiliates of GNFs have local policies requiring documentation completion dates earlier than their respective global policies. Examples observed through the PCAOB's 2022 inspections include non-U.S. affiliates that have local policies specifying completion of documentation by deadlines such as 2 days, 7 days, 10 days, 14 days, and 30 days after the report release date. Additionally, even among certain non-U.S. affiliates that have stated policies of 45 days after the report release date, their documentation systems require completion of documentation within 15 to 40 days (depending on the firm). Generally, non-U.S. affiliates of GNFs use electronic audit documentation systems for documentation and archiving.

The archiving policies of NAFs generally specify a documentation completion date of 45 days after the report release date. PCAOB staff has observed certain NAFs annually inspected by the PCAOB that, in practice, typically archive documentation within 40 days of the report

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outside the United States. NAFs are U.S. or non-U.S. accounting firms that are registered with the Board but are not GNFs. Some NAFs belong to international networks other than GNF networks.

release date. In addition, PCAOB staff has noted that certain other NAFs generally wait the full 45-day archiving period before completing their documentation. While most NAFs use electronic audit documentation systems, PCAOB staff is aware that some small firms still use paper-based workpapers.

## B. Need

The proposed changes are part of the Board's effort to continuously improve and update PCAOB standards. In practice, PCAOB standards are used primarily by auditors, who are responsible for applying the general principles and requirements of the foundational standards. Investors and other stakeholders may also rely on the foundational standards (directly or indirectly) to establish expectations about auditor responsibilities.

### 1. Problem to be addressed

#### i. Modernization of the foundational standards

Three concerns that could be raised about the foundational standards are: (i) compliance with the standards, (ii) soundness of the general principles and responsibilities, and (iii) clarity of the standards. The next three subsections explain that we do not see a need to make significant changes to the standards based on compliance with the standards or soundness of the general principles and responsibilities, but we do see a need to make changes to modernize and enhance the clarity of the foundational standards.

##### a. Compliance with the foundational standards

In some instances, auditors have not performed audits in accordance with the foundational standards. For example, for the years 2018-2022, the PCAOB issued almost two dozen enforcement orders that described the violation of at least one of the foundational standards (i.e., AS 1001, AS 1005, AS 1010, or AS 1015). However, lack of compliance with any auditing standard does not necessarily imply that the standard is wrong or needs to be amended because, for example, the auditor may not have been aware of the standard or may have chosen not to make the effort to comply.

##### b. Soundness of the general principles and responsibilities

The foundational standards address the general principles and responsibilities of due professional care, professional skepticism, reasonable assurance, independence, competence, and professional judgment. These principles are interconnected. For example, due professional care requires the auditor to exercise professional skepticism and allows the auditor to obtain reasonable assurance. Reasonable assurance involves professional judgment. There is ample published research that studies alternative versions of the general principles. We summarize here several papers that demonstrate an ongoing debate regarding alternatives.

Academic research on professional skepticism provides a model that identifies two components – skeptical judgment and skeptical action – that are necessary for the effective exercise of professional skepticism.<sup>94</sup> In a synthesis of literature on professional skepticism, researchers conclude that professional skepticism is foundational to the performance of a high-quality audit, and they note that academic research tends to focus on skeptical judgment while PCAOB inspections tend to focus on skeptical action.<sup>95</sup> When accountability to regulators is an incentive based on principles, research suggests that auditors may exhibit more skeptical judgment.<sup>96</sup> When accountability is based on a checklist mentality of following a set of strictly specific requirements, research suggests that auditors may engage in cognitive processing that reduces skeptical judgment.<sup>97</sup> On the other hand, a principles-only approach to standards may provide insufficient guidance to support the exercise of judgment.<sup>98</sup> Overall, therefore, there is a spectrum of possible approaches to audit regulation that lies between excessively vague principles and excessively specific requirements. In practice, effective auditing standards may fit into the middle of that spectrum by emphasizing core principles while including some specific requirements to help support skeptical judgment and skeptical action.<sup>99</sup> Monitoring whether auditors in practice are achieving the correct balance of those two objectives can inform a standard setter about whether a standard is properly situated along the spectrum.

Research also offers insights on the appropriate level of assurance for investors and other users of financial statements. Early research on the audit expectations gap concludes that 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

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<sup>94</sup> See Mark W. Nelson, *A Model and Literature Review of Professional Skepticism in Auditing*, 28(2) *Auditing: A Journal of Practice & Theory* 5 (2009).

<sup>95</sup> See R. Kathy Hurr, Helen Brown-Liburd, Christine E. Earley, and Ganesh Krishnamoorthy, *Research on Auditor Professional Skepticism: Literature Synthesis and Opportunities for Future Research*, 32 *Auditing: A Journal of Practice & Theory* 71-72 (2013). According to the authors, “Skeptical judgment occurs when an auditor recognizes that a potential issue may exist and that more work or effort is necessary. Skeptical action occurs when an auditor changes his/her behavior based on the skeptical judgment. Both skeptical judgment and skeptical action are essential to the audit, with skeptical judgment being a necessary condition for skeptical action.”

<sup>96</sup> See Hurr, et al., *Research on Auditor* 62.

<sup>97</sup> See M. David Piercey, *Documentation Requirements and Quantified versus Qualitative Audit Risk Assessments*, 30(4) *Auditing: A Journal of Practice & Theory* 242-243 (2011).

<sup>98</sup> See, e.g., SEC, *Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System* (Jul. 25, 2003).

<sup>99</sup> See, e.g., AS 1210, *Using the Work of an Auditor-Engaged Specialist*.

reasonable assurance.<sup>100</sup> Similarly, a more recent multi-country study finds that survey respondents appear to expect much more than reasonable assurance from auditors in order to prevent fraud and company failure.<sup>101</sup> However, the standard for reasonable assurance is driven by the benefits and costs of an audit engagement.<sup>102</sup>

Based on this cross-section of research, there is no clear mandate for changing the general principles and responsibilities of the foundational standards. The synthesis research supports professional skepticism as foundational to the performance of effective audits. Likewise, the research on audit assurance supports the principle of reasonable assurance as an appropriate level of assurance based on the underlying economics of an audit engagement.

### c. Clarity of the foundational standards

Some current features of the foundational standards do not support the most efficient use of the standards. The general principles and responsibilities are currently spread across multiple standards, including AS 1001, AS 1005, AS 1010, and AS 1015, which were not developed originally as a cohesive whole. Their current organization continues to reflect their origin as separate requirements that were not drafted to be read together. In addition, the foundational standards contain language that was used in the AICPA's former standards but is outdated and inconsistent for audits conducted today under the standards of the PCAOB. This could undermine understanding of the general responsibilities of the auditor for audits conducted in accordance with PCAOB standards. The foundational standards also do not conform to the structure of Board-issued standards, which may hinder an auditor's navigation of the requirements. Finally, the foundational standards do not reflect developments in the auditing environment since their adoption in 2003, including the PCAOB's adoption of standards and rules, such as standards on audit documentation and engagement supervision, and this lack of consistency or alignment may draw attention away from the general principles and responsibilities.

Overall, these current features of the foundational standards may reduce efficient use of the standards by requiring more time and attention than necessary to read, understand, and apply the standards and may lead to inconsistent application, potential misinterpretation, and ineffective regulatory intervention. Clarity of auditing standards requires effective communication through features such as relevant language, consistency with Board-issued standards and rules, and well-organized presentation, which appear throughout PCAOB and SEC rulemaking initiatives.

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<sup>100</sup> See Marc J. Epstein and Marshall A. Geiger, *Investor Views of Audit Assurance: Recent Evidence of the Expectation Gap*, 177 *Journal of Accountancy* 64 (1994).

<sup>101</sup> See The Association of Chartered Certified Accountants, *Closing the Expectation Gap in Audit* 12, 14-15 (May 2019).

<sup>102</sup> See Ernest L. Hicks, *Materiality*, 2(2) *Journal of Accounting Research* 158 (1964).

### (1) Characteristics of Modernized Auditing Standards

Academic research identifies three characteristics of effective disclosure documents that align well with the proposed features of modernized auditing standards: simplicity,<sup>103</sup> salience,<sup>104</sup> and standardization.<sup>105</sup> Simplicity can be achieved with an auditing standard that eliminates language that is outdated and inconsistent. Salience can be achieved with an auditing standard that emphasizes requirements while including explanations in the Board's release rather than the rule text and that incorporates the latest developments in the auditing environment, including the adoption of Board-issued standards and rules. Standardization can be achieved with an auditing standard that is well-organized, with general principles and responsibilities presented in a single standard that is structured similar to other standards.

In addition, we are aware of other regulatory initiatives that emphasize clear, well-organized writing as characteristics of effective communication with stakeholders. Two examples of other regulatory initiatives are the SEC Plain English Disclosure rule<sup>106</sup> for issuers' prospectuses, and the Plain Writing Act of 2010<sup>107</sup> for government communications with the public. The purpose of the Plain English Disclosure rule was to make financial and business information available to investors in a form they could read and understand, and the rule includes specific guidance for clear, concise language.<sup>108</sup> The purpose of the Plain Writing Act was to improve the effectiveness and accountability of federal agencies to the public by promoting clear communication that the public can understand and use, and the statute defines plain writing as writing that is clear, concise, and well-organized, and that follows other

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<sup>103</sup> See, e.g., R.E. Nisbett and L. Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* (1980), finding that individuals have limited cognitive resources to absorb and process information.

<sup>104</sup> See Daniel Kahneman, *Thinking, Fast and Slow* (2013), which suggests that individuals who focus their limited cognitive resources on a subset of information are able to give more weight to the subset when making decisions.

<sup>105</sup> See Jeffrey R. Kling, Sendhil Mullainathan, Eldar Shafir, Lee C. Vermeulen, and Marian V. Wrobel, *Comparison Friction: Experimental Evidence from Medicare Drug Plans*, 127 *The Quarterly Journal of Economics* 199 (2012), finding that standardized information better enables individuals to assess tradeoffs and make coherent, rational decisions.

<sup>106</sup> *Plain English Disclosure*, SEC Release No. 33-7497 (Oct. 1, 1998).

<sup>107</sup> *Plain Writing Act of 2010*, Public Law 111-274.

<sup>108</sup> The economic effects of easy-to-read disclosure documents are quantified in research that demonstrates a significant decrease in company valuation caused by a decrease in readability of disclosure documents. See Byoung-Hyoun Hwang and Hugh Hokwang Kim, *It Pays to Write Well*, 124 *Journal of Financial Economics* 373 (2017).

best practices appropriate to the subject and the intended audience.<sup>109</sup> While neither the Plain English Disclosure rule nor the Plain Writing Act imposes obligations on the PCAOB, their overall objective to promote effective communication for efficiency of stakeholders' understanding is aligned with the objectives of and approach to our proposed modernization of the foundational standards.

## (2) Useability of Modernized Auditing Standards

We believe that auditors generally understand their responsibilities under the foundational standards. Nonetheless, there could be certain circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by the current language and organization of the foundational standards. New entrants, for example, may need to spend more time navigating and distilling the general principles and responsibilities than they would with more modernized language and organization. These new entrants may include accounting students seeking to enter the auditing profession. They may also include auditors who are experienced in applying other auditing or attestation standards, such as those of the AICPA for entities other than issuers, but who are seeking to perform an audit under PCAOB standards for the first time and who need to confirm their responsibilities under PCAOB rules.

In addition, the current language and organization of the foundational standards could impede investors' abilities to form accurate expectations about auditor responsibilities under PCAOB standards. Investors form expectations from a number of sources, including potentially the language of the standards themselves, but also from third parties (e.g., media) who may write about PCAOB standards. Standards that are not modernized could contribute to an expectations gap—in this case, a gap between what investors expect from an audit and what audit standards require.<sup>110</sup> Such a gap could in principle exist in either direction. Investors could be led to expect more than what an audit is required to deliver, and thereby fail to price the risk appropriately. Alternatively, investors could be led to expect less than what an audit is required

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<sup>109</sup> Using the Plain Writing Act as an exogenous event, research has found that the Plain Writing Act resulted in improved readability of 10-Ks that caused stock price crash risk to fall. See Shiyun Yin, Thanaset Chevapatrakul, and Kai Yao, *The Causal Effect of Improved Readability of Financial Reporting on Stock Price Crash Risk: Evidence from the Plain Writing Act of 2010*, 216 *Economics Letters* (2022).

<sup>110</sup> Research finds evidence of a persistent gap between investors' expectations of an audit and auditors' performance based on requirements under audit standards. See, e.g., Klaus Ruhnke and Martin Schmidt, *The Audit Expectation Gap: Existence, causes, and the impact of changes*, 44 *Accounting and Business Research* 572 (2014) (finding that the public has expectations of auditors' responsibilities that do not exist under audit standards, such as conducting a management audit); and The Association of Chartered Certified Accountants, *Closing the Expectation Gap in Audit* (May 2019) (finding that the persistence of the audit expectation gap reflects, in part, the fact that public expectations of audit can grow in line with what auditors can accomplish).

to deliver, and thereby fail to appreciate the important functions performed by auditors regarding reasonable assurance.

Audit committees may also form inaccurate expectations about the content of PCAOB standards if the standards are not modernized, via mechanisms similar to investors. While we believe this is less likely to occur for audit committees than for investors, given audit committee members' greater familiarity with auditing through their position and responsibilities with the issuer and other relevant professional background, the negative impact of an audit committee member failing to correctly comprehend the auditor's general responsibilities under PCAOB standards could be more severe, given the audit committee's greater role in supervising the audit and the auditor under the Sarbanes-Oxley Act for the benefit of investors.

#### **ii. Clarification of engagement partner review**

One of the responsibilities of engagement partners is to review the work of engagement team members. Any uncertainty under the extant standards may give engagement partners an incentive, particularly under time pressures, to deemphasize or omit the review of workpapers. For example, PCAOB staff has observed instances in which engagement partners did not fulfill their responsibilities for review.<sup>111</sup> However, engagement partner review of workpapers is a critical step to promote audit quality. As noted in Section IV.A.2, firms have varying policies and tools on the extent of review required by the engagement partner. Clarification of the engagement partner's responsibility to review certain audit documentation is necessary to reinforce the existing minimum level of performance and promote consistency across audits regarding an engagement partner's oversight of the audit.

#### **iii. Accelerating the documentation completion date**

Section III.B. 5 and Section III.C.3 emphasize the importance of adequate audit documentation and the auditor's responsibilities for documentation under AS 1215, which currently specifies an audit documentation completion date no more than 45 days after the report release date. PCAOB standards require auditors to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. Separately, significant advancements in electronic audit tools and the use of audit software have occurred over the last two decades. Based on these observations and some firms' policies and practices summarized in section IV.A.3, the current documentation completion date that is 45 days after the report release date may provide more time than necessary to complete and finalize the audit documentation.

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<sup>111</sup> See, e.g., *In the Matter of Jin Tae Kim*, PCAOB Release No. 105-2022-013 (Aug. 16, 2022); *In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Release No. 105-2022-033 (Dec. 6, 2022).

The PCAOB inspection process generally cannot begin until after the documentation completion date, even if there is a potential problem with the firm or the audit. In cases where the PCAOB would like to initiate inspections earlier, the 45-day period imposes an unnecessarily long lag before PCAOB can provide notice of inspection and access audit documentation, which may prevent timely identification and resolution of audit deficiencies and delay information on firm performance that is useful to investors.

In addition, the 45-day period may increase the risk of improper alteration of audit documentation. Specifically, a lengthy period to finalize audit documentation may reduce firms' incentives to proactively complete all necessary auditing procedures, review those procedures, and collect sufficient appropriate audit evidence prior to releasing the audit report, as required under AS 1215.<sup>112</sup>

## **2. How the proposed changes would address the need**

### **i. Modernization of the foundational standards**

Some current features of the foundational standards would be changed to create a modernized standard with enhanced useability.

First, the proposed changes would reorganize and consolidate multiple standards by: (i) replacing AS 1001, AS 1005, AS 1010, and AS 1015 with one standard, AS 1000, and (ii) updating and incorporating the underlying requirements of AS 2815 into AS 2810 and rescinding AS 2815.

Second, the proposed changes would eliminate language that is no longer relevant by: (i) retaining existing requirements but replacing language with updated and modernized language used in other Board-issued standards and (ii) removing legacy AICPA language that is no longer relevant to audits conducted under the standards of the PCAOB.

Third, the proposed changes would establish conformity with the structure of Board-issued standards by: (i) including an introduction and objective; (ii) clarifying auditor responsibilities by expressing the requirements using Rule 3101 terms (e.g., "must" and "should"); and (iii) minimizing explanatory material that could instead be included in the release discussion.

Finally, the proposed changes would harmonize with PCAOB standards and rules issued after adoption of the interim standards in 2003. The proposed changes include updates related to: (i) changes to auditing requirements through Board-issued standards, such as using

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<sup>112</sup> See, e.g., *In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Release No. 105-2022-033 (Dec. 6, 2022); *In the Matter of Deloitte LLP*, PCAOB Release No. 105-2021-014 (Sept. 29, 2021); *In the Matter of Richard J. Bertuglia, CPA, John W. Green, CPA, and Lev Nagdimov, CPA*, SEC Release No. 84419 (Oct. 12, 2018).



framework neutral terms; (ii) clarifying the meaning of present fairly; (iii) an overarching objective for integrated audits; and (iv) new rules issued by the Board, such as additional incremental independence obligations.

These changes are designed to make AS 1000 a more efficiently used standard through a well-organized presentation with relevant language that is more consistent with other PCAOB standards.

#### **ii. Clarification of engagement partner review**

Paragraph .09 of the proposed standard specifies the engagement partner's due professional care responsibilities, including evaluating that significant findings are appropriately addressed and determining that significant judgments are appropriate and supported by sufficient evidence. In addition, related proposed amendments to AS 1201 and AS 2101 explicitly state that the engagement partner has primary responsibility for the engagement and its performance and that assistance provided by other engagement team members to supervise and review work does not reduce the engagement partner's responsibility. These changes would reinforce the existing responsibilities under due professional care and promote consistency across audits regarding an engagement partner's oversight of the audit.

#### **iii. Accelerating the documentation completion date**

Paragraph .16 of the proposed standard explains the fundamental role of audit documentation and the auditor's responsibility for preparing audit documentation. The related proposed amendment to AS 1215 would accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date. This change would enable PCAOB inspections staff earlier access to audit documentation. The change would also reduce the window of opportunity for improper alteration of audit documentation.

### **C. Economic Impacts**

This section discusses the expected benefits and costs of the proposed changes and potential unintended consequences. Overall, we expect that the economic impacts of the proposed changes, including both benefits and costs, would be relatively modest, especially for those firms that have already incorporated in practice an engagement partner's responsibility for review and an accelerated documentation completion date. We also expect that the benefits of the proposed changes would justify the costs and any unintended negative effects.

## 1. Benefits

### i. Modernization of the foundational standards

To the extent that the current features of the foundational standards reduce efficient use of the standards, the proposed changes should help enhance useability by making AS 1000 easier to read, understand, and apply in practice.

For users trying to navigate and understand the general principles and responsibilities, efficiency gains may be associated with each of the proposed changes as follows:

- The proposed change to reorganize and consolidate multiple standards into a single standard would reduce time and attention required to navigate several standards to locate the general principles and ensure relevant requirements are met.
- The proposed changes to eliminate language that is no longer relevant would reduce time and attention required to read, understand, and apply the standard by facilitating a focus on core requirements of the standard.
- The proposed changes to establish conformity with the structure of Board-issued standards would provide more uniformity among the PCAOB standards, which would help expedite navigation of the requirements and ensure relevant requirements are met.
- The proposed changes to harmonize with PCAOB-issued standards and rules since adoption of the interim standards in 2003 would reduce time and attention required to read, understand, and apply the standard by drawing attention to the underlying requirements and enhancing clarity of the Board's expectations about auditor responsibilities.

Auditors learning the general principles and responsibilities for the first time may do so more quickly and easily, thereby reducing the cost of training and potentially facilitating entry into the PCAOB audit environment.

In addition, a modernized standard may enhance investors' and audit committees' awareness and understanding of the auditor's responsibilities. Investors would be able to more appropriately price financial statement risk by better understanding the nature and extent of auditor responsibilities. Audit committees' oversight of the auditor would be enhanced, including if enhanced clarity of standards facilitates communication between the audit committee and the auditor.

## ii. Clarification of engagement partner review

To the extent that engagement partners currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as required under the existing standards,<sup>113</sup> the proposed changes should improve auditor performance and audit quality by: (i) improving the engagement partner's timing and evaluation of significant findings and judgments and audit evidence; (ii) enhancing the ability of the engagement partner to prevent or detect deficiencies; and (iii) facilitating improvements in the quality of the work of other engagement team members.

## iii. Accelerating the documentation completion date

The proposed amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date would likely support PCAOB efforts to enhance audit quality via timelier identification and resolution of audit deficiencies in cases where inspections are initiated earlier. In such cases, the proposed amendment could also facilitate earlier issuance of inspection reports and their availability to investors. In addition, the proposed amendment could enhance auditor performance and audit quality for firms that do not currently implement best practices, but would be more inclined to do so, by proactively focusing on sequencing of work, allocation of resources, and other operating practices.

The benefits associated with an accelerated documentation completion date are likely to be greater for firms that currently make use of the entire 45-day period permitted under current PCAOB standards due to current operating circumstances. These firms would need to make more significant adjustments to their sequencing of work and allocation of effort to archiving to meet the proposed accelerated period and the concomitant benefits to audit quality would therefore be greater. Based on firms' current archiving policies and practices summarized in Section IV.A, the benefits associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs experience operating efficiencies associated with changes in their sequencing of work, allocation of resources, and other operating practices to comply with the proposed documentation completion date.

The benefits associated with an accelerated documentation completion date would be lower for firms that either (i) have a policy that requires that documentation be completed in 14 days or fewer or (ii) have a policy that is closer to or equal to the current 45-day period but in practice complete their documentation in line with the proposed documentation completion date. Specifically, the benefits to audit quality would be lower for these firms, but the benefits

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<sup>113</sup> See *Jin Tae Kim*, PCAOB Release No. 105-2022-013; *KPMG Assurance and Consulting Services LLP*, PCAOB Release No. 105-2022-033.

to investors of earlier PCAOB inspections would still be achieved in cases where inspections are initiated earlier.

## **2. Costs**

### **i. Modernization of the foundational standards**

The primary costs of the modernization efforts reflected in the proposed standard would be one-time costs to firms for updating references within firm methodologies and related guidance to reflect the proposed standard and related conforming amendments. Large firms that develop their own methodologies would update references directly in those methodologies. Small firms generally purchase methodologies from third-party vendors. The implementation costs of the proposed changes may be offset over time because a more logical and easy-to-read-and-navigate standard could enable auditors to save time reading, understanding, and applying the standard. Third parties that refer to PCAOB standards (e.g., in textbooks, training, or review materials) would also need to update those materials.

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.

### **ii. Clarification of engagement partner review**

To the extent that the engagement partners of a firm currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as a result of any uncertainty under the extant standards, those firms may incur one-time costs to update firm methodologies and ongoing costs related to appropriate review. Large firms that develop their own methodologies would update references directly in those methodologies. Small firms generally purchase methodologies from third-party vendors.

### **iii. Accelerating the documentation completion date**

The proposed amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date would allow less time to assemble the final set of workpapers after the audit report is released. However, the PCAOB requirement to complete necessary auditing procedures, review those procedures, and collect sufficient appropriate audit evidence prior to the report release date should help limit any costs to implement the proposed amendment because the only activities that remain are assembling a complete and final set of audit documentation. In addition, the widespread use of electronic audit tools and audit software should help mitigate any costs associated with the proposed amendment.

The costs associated with an accelerated documentation completion date are likely to be greater for firms that currently specify by policy an archiving period that is near or equal to the maximum permitted under current AS 1215.15 and that currently take all or more of the full 45-day period to complete their archiving because of operating circumstances that inhibit faster completion. These firms will have to invest additional resources to enhance sequencing of their work, allocation of resources, and other operating practices, or may have to enhance their audit documentation systems, or both, in order to comply with the proposed documentation completion date. Based on firms' current archiving policies and practices summarized in Section IV.A, the costs associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs currently use the entire 45-day period. By contrast, GNFs that already require the completion of documentation by a date no longer than the proposed 14-day period would likely not incur substantial additional costs to comply with the proposed requirement.

Electronic audit tools and audit software may facilitate compliance with the proposed requirement in that they can automate, and thereby perform more quickly, certain processes. For firms without electronic systems in place, costs associated with an accelerated documentation completion date may include additional resources, such as in-house personnel or capital investments in audit software, that would be useful to assemble a complete and final set of audit documentation in the proposed time period. PCAOB staff is aware that some small NAFs still use paper-based systems. However, these firms generally perform smaller, less sophisticated audits, such that the firms do not have to mail audit workpapers from multiple locations; therefore, even with a paper-based system, effective sequencing of work, allocation of resources, and other operating practices could enable them to meet the proposed documentation completion date.

For firms with electronic audit tools and audit software in place, the earlier documentation completion date should not change the functionality or cost of software, which should facilitate a low-cost transition to the proposed archiving period. Some firms already have policies that require documentation completion within 14 days of the report release date, and some firms require audit documentation to be archive-ready upon completion of interim procedures. These practices suggest that much of the process involved in assembling a complete and final set of audit documentation, such as assembly, cleanup, and retention, is substantially finished in advance of 45 days. Any firms that currently have a policy or practice of completing audit documentation on or near the 45<sup>th</sup> day may do so merely because the current standard allows 45 days, and thus would not incur costs to meet the accelerated documentation completion date. Alternatively, any firms that currently complete audit documentation on or near the 45<sup>th</sup> day because of operating circumstances may incur costs associated with implementing best practices to effectively sequence work, allocate resources, and incorporate other operating practices to comply with the accelerated documentation completion date. In this case, we would expect the costs to be offset over time by improvements in operating efficiencies to the extent that operating circumstances are within the firm's control.

An accelerated documentation completion date may also impose costs on multi-firm audits if electronic audit documentation systems are not integrated across firms. GNFs are more likely than NAFs to perform multi-firm audits, but some NAFs do perform multi-firm audits.<sup>114</sup> If electronic systems are not integrated across firms, which is more likely for NAFs, other auditors may need to transmit documentation to the lead auditor to assemble the final set of workpapers. If electronic systems are integrated across firms, the lead auditor may be able to seamlessly archive the work of other auditors.

Any costs associated with the proposed requirements may be passed through to investors, or costs may be internalized by firms. The audit market is competitive, and issuers that engage audit firms that pass through any costs may switch firms.

### **3. Potential unintended consequences**

In addition to the benefits and costs discussed above, the new proposed standard could have unintended economic impacts. The following discussion describes potential unintended consequences and, where applicable, factors that mitigate the potential negative consequences, such as existing auditing requirements or the existence of other countervailing forces.

#### **i. Modernization of the foundational standards**

The proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards. Thus, no unintended consequences were identified apart from the benefits and costs discussed above.

#### **ii. Clarification of engagement partner review**

An unintended consequence of the proposal to clarify engagement partner review would occur if, contrary to the Board's expectations, some firms whose engagement partners currently do more than would be required under the proposal to meet the minimum requirement for engagement partner review, do less in the future to merely meet the minimum requirement.

This potential unintended consequence is mitigated by the extent to which engagement partners are aware that review is primarily their responsibility. In addition, economic reasons that generate enhanced performance in the first place, such as partner compensation, inspections, and litigation threat, help to mitigate this potential unintended consequence.

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<sup>114</sup> See PCAOB Release No. 2022-002, at 26-52.

### iii. Accelerating the documentation completion date

Unintended consequences of the proposal to accelerate the documentation completion date would occur if, contrary to the Board's expectations, (i) auditor time prior to the report release date that would previously have been spent focusing on audit procedures is now spent on assembling final workpapers or (ii) the proposed archiving period results in higher costs that cause firms with paper-based documentation systems to exit the audit market.

These potential unintended consequences are mitigated by the requirement that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date<sup>115</sup> and by firms that proactively sequence work, allocate resources, and incorporate other operating efficiencies. In addition, the widespread use of electronic audit tools and audit software by most firms mitigates these potential unintended consequences.

## D. Alternatives Considered

We have considered whether to update the foundational standards and keep them as individual standards, but we believe that combining general principles and responsibilities into one standard would be more logical and easier to navigate. This approach would also be consistent with the approaches of other standard-setters. For example, both the IAASB and the ASB address general responsibilities of the auditor in one standard (see IAASB's ISA 200 and ASB's AU-C 200).

We have also considered whether to incorporate the requirements of AS 2815 into AS 1000, but we believe that it would be more logical to incorporate the requirements of AS 2815 into AS 2810 because both standards address requirements for concluding audit procedures. This approach would also eliminate unnecessary cross-references between the two standards and make the auditor's responsibilities easier to locate. AS 1000 would include a reference to AS 2810 for the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

With respect to the engagement partner's responsibilities, we considered retaining the language of AS 1010 that describes the use of judgment in the context of the partner's responsibilities for supervision. However, we believe that leveraging the requirements of AS 1201, a more recent standard, would avoid potential confusion and align the engagement partner's responsibilities with Board-issued standards.

For the documentation completion date, we considered whether to propose a length of time between the current 45-day period and the 14-day period proposed herein, such as 21

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<sup>115</sup> See AS 1215.15 (as proposed to be amended).

days or 30 days. We believe that a shorter period of time may provide better protection for investors than a longer period: it could permit acceleration of PCAOB inspections and provide the strongest incentives for firms to implement operating efficiencies. Thus, in principle, the shortest feasible documentation completion date could achieve more benefits than a longer period. Our assessment of existing firm practice as described in Section IV.A leads us to believe that 14 days could be feasible for firms and that a longer period may therefore be unnecessary and could erode the benefits that could otherwise be achieved.

We also considered whether to specify different documentation completion dates for different classes of firms, based on specific firm characteristics that may make compliance with an accelerated documentation completion date especially challenging because of some practical obstacle or because of significant expense that is common to that class of firms. For example, we considered specifying a longer documentation completion date for NAFs as compared with GNFs. However, as noted above, we believe that the 14-day period could be a feasible period for all firms; we are not currently aware of any practical obstacle or significant expense that would make compliance with a 14-day period especially challenging for all firms within a particular class. In contrast, a uniform and consistent archiving period for all firms could facilitate implementation and compliance, especially for audits that involve multiple firms that could be subject to different archiving periods.

## V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups (“JOBS”) Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies (“EGCs”), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934 (“Exchange Act”), unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.”<sup>116</sup> As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about

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<sup>116</sup> See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The proposed standard does not fall within either of these two categories.



characteristics of EGCs.<sup>117</sup> As of the November 15, 2021, measurement date, PCAOB staff identified 3,092 companies that self-identified as EGCs and filed audited financial statements with the SEC between May 16, 2020, and November 15, 2021, that included an audit report signed by a firm.<sup>118</sup>

The discussion of the economic impacts of the proposed standard in Section IV.C is generally applicable to audits of EGCs. The proposed amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days could impact the audits of EGCs more than the audits of non-EGCs. Compared to non-EGCs, EGCs are more likely to be audited by NAFs.<sup>119</sup> As discussed in Section IV.C, NAFs are expected to require more changes than GNFs in their sequencing of work, allocation of resources, and other operating practices to comply with the proposed accelerated documentation completion date. Therefore, all else equal, both the benefits and costs of the proposed amendments, including the amendment to accelerate the documentation completion date, may be higher for EGC audits than for non-EGC audits.

While both the benefits and costs of the proposed amendment to accelerate the documentation completion date may be higher for EGC audits, the costs are unlikely to be more than proportional to the benefits based on certain characteristics of EGCs. For example, to the extent that EGCs are small companies, EGC audits may be less complex, which potentially facilitates expeditious assembly of the final workpapers.<sup>120</sup> In addition, as EGCs are not large accelerated filers (“LAFs”), the SEC Form 10-K filing deadline would be extended from 60 days after the fiscal year end to 75 days for accelerated filers or to 90 days for non-accelerated filers, which potentially delays the required assembly of the final workpapers by 15 or 30 days into an archiving period that may be proportionately less busy.<sup>121</sup>

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<sup>117</sup> For the most recent EGC report, *see Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2021* (Jan. 5, 2023), available at [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2021.pdf?sfvrsn=3be9c6f2\\_3](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2021.pdf?sfvrsn=3be9c6f2_3).

<sup>118</sup> *See id.* at 1. Based on staff analysis as of the Nov. 15, 2021, measurement date, 86 percent of firms that audited EGCs, audited both EGC and non-EGC issuer clients.

<sup>119</sup> *See id.* at 22. Based on staff analysis as of the Nov. 15, 2021, measurement date, U.S. firms audited 2,634 EGCs, of which 1,035 were audited by annually inspected U.S. NAFs and 825 were audited by triennially inspected U.S. NAFs.

<sup>120</sup> *See id.* at 30. Based on staff analysis as of the Nov. 15, 2021, measurement date, the average reported revenue for EGCs was \$65.5 million, and the average reported revenue for non-EGCs was \$5.8 billion.

<sup>121</sup> *See id.* at 26. Based on staff analysis as of the Nov. 15, 2021, measurement date, no EGC that filed a periodic report identified as an LAF.

The proposed amendment to accelerate the documentation completion date could improve efficiency and capital formation for EGCs to the extent that the amendment reduces uncertainty about the reliability of an EGC's financial statements via enhanced audit quality. Investors who face uncertainty about the reliability of an EGC's financial statements may require a larger risk premium that reduces the efficient allocation of capital or increases the cost of capital. Thus, any reduction of uncertainty via enhanced audit quality, including from firms' implementation of operating efficiencies, could improve the efficiency of capital allocation, lower the cost of capital, and enhance capital formation for those EGCs.

The proposed amendment to accelerate the documentation completion date could also impact competition in an EGC product market if any indirect costs to audited companies disproportionately affect EGCs relative to their competitors. For example, if EGCs are forced to raise prices in order to remain viable but their non-EGC competitors are not forced to raise prices, this may divert market share toward their competitors. This could increase competition in markets where EGCs have a dominant market share and decrease competition in markets where EGCs have a less than dominant market share. However, the incentives for firms to pass costs onto EGCs may also be limited by the competitive market for audits. Therefore, the potential impact of the proposed requirement on competition in EGC product markets is expected to be limited.

Overall, the proposed amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days is expected to enhance audit quality and protection of investors by supporting timelier inspections and by providing the strongest incentives for firms to implement operating efficiencies. We expect these benefits to be greater on EGC audits than non-EGC audits because EGCs are more likely to be audited by NAFs; however, costs of implementation may also be incrementally higher for audits of EGCs. On a net basis, we expect that the overall impact of the proposed amendment on EGC audits would not be disproportionate to the impact on non-EGC audits.

Accordingly, and for the reasons explained above, the Board anticipates that, if it adopts the proposed standard and related amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the proposed standard and related amendments to audits of EGCs.

## VI. EFFECTIVE DATE

The Board seeks comment on the amount of time auditors would need before the proposed standard and related proposed amendments would become effective, if adopted by the Board and approved by the SEC. We are considering whether compliance with the proposed standard and related proposed amendments should be required by June 30 in the year after they are approved by the SEC.

## VII. LIST OF QUESTIONS

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?
2. Is the approach to reorganize and consolidate the general principles and responsibilities appropriate? If not, why not?
3. Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?
4. Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not?
5. Are the proposed requirements related to ethics clear and comprehensive? If not, why not?
6. Are the proposed requirements related to the auditor's competence clear and comprehensive? If not, why not?
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?
8. Are the general principles and responsibilities appropriate in light of the availability of electronic audit tools and the use of audit software by both larger and smaller firms? If not, what changes should be made?
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?
10. Are the proposed amendments to clarify the meaning of "present fairly" appropriate? If not, why not?
11. Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?
12. Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?

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?
14. Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?
15. Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required?
16. Are the amendments to the general principles and responsibilities described in the PCAOB's attestation standards appropriate? Should other relevant amendments be made to the PCAOB's attestation standards? If so, what are they?
17. Are the amendments to the general principles and responsibilities described in AS 4105, *Reviews of Interim Financial Information*, appropriate? Should other relevant amendments be made to AS 4105? If so, what are they?
18. We request comment generally on the baseline for evaluating the economic impacts of the proposed standard. Are there additional factors we should consider? If so, what are they? Is there any evidence that auditors are failing to understand their obligations under today's standards, or that the standards set insufficiently robust expectations and obligations associated with the performance of an audit? If so, please explain.
19. We request comment generally on the analysis provided above regarding the need for the proposal. Should we consider any additional arguments, academic studies, or sources related to the need for standard setting? If so, please specify.
20. Are there additional potential benefits and costs that should be considered? If so, what are they? Please provide relevant data or other reference information.
21. We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?
22. Are there any other economic impacts we did not describe above that are relevant for consideration? If so, please specify.

23. What academic studies or data should the Board consider in evaluating the potential benefits and costs of the proposed requirements? Please provide citations and other reference information for such studies and data.

24. The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.

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?

## VIII. OPPORTUNITY FOR PUBLIC COMMENT

The Board is seeking comments on all aspects of its proposal, as well as specific comments on the proposed standard and amendments. Among other things, the Board is seeking comment on the economic analysis relating to its proposal, including potential costs. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the proposed standard and amendments.

Comments should be sent by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's website at [www.pcaobus.org](http://www.pcaobus.org). Comments may also be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 049 in the subject or reference line and should be received by the Board by May 30, 2023.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules, with or without changes from the proposal. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of Sarbanes-Oxley, proposed rules of the Board do not take effect unless approved by the SEC. Standards are rules of the Board under Sarbanes-Oxley.

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On the 28th day of March, in the year 2023, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown  
Secretary

March 28, 2023

## APPENDIX 1 – Proposed Auditing Standard

### AS 1000: General Responsibilities of the Auditor in Conducting an Audit

#### INTRODUCTION

.01 Auditors have a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports, and that obligation governs the auditor’s work under the standards of the PCAOB. An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company’s financial statements are presented fairly and, if applicable, on the effectiveness of the company’s internal control over financial reporting. A properly conducted audit and the related auditor’s report enhance the confidence of investors and other market participants in the company’s financial statements and, if applicable, internal control over financial reporting.

.02 This standard describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the Public Company Accounting Oversight Board (“PCAOB”). This standard sets out the objectives of the auditor, establishes requirements for the auditor’s professional qualifications and the auditor’s general responsibilities applicable in all audits, and describes auditing principles relevant to conducting the audit.

#### OBJECTIVES OF THE AUDITOR

.03 The objectives of the auditor are as follows:

- a. In an audit of financial statements – To (1) obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud; and (2) issue an auditor’s report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework;
- b. In an audit of internal control over financial reporting – To (1) obtain reasonable assurance about whether, material weaknesses exist as of the date specified in management’s assessment; and (2) issue an auditor’s report that expresses an opinion on the effectiveness of the company’s internal control over financial reporting; and

- c. Communicate externally, as required by applicable professional and legal requirements.<sup>1</sup>

## PROFESSIONAL QUALIFICATIONS OF THE AUDITOR

### Independence and Ethics

.04 The auditor must be independent of its audit client both in fact and in appearance throughout the audit and professional engagement period.<sup>2</sup> The auditor is not independent with respect to an audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed within the engagement.<sup>3</sup>

.05 The auditor must satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) under the federal securities laws.<sup>4</sup>

.06 The auditor must comply with applicable ethics requirements, including the rules and standards of the PCAOB.<sup>5</sup>

### Competence

.07 The audit must be performed by an auditor who has the competence to conduct an

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<sup>1</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in Appendix A of [proposed QC 1000, *A Firm’s System of Quality Control*, PCAOB Release No. 2022-006 (Nov. 18, 2022)], which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. *See, e.g.*, Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

<sup>2</sup> *See* PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term “audit and professional engagement period.”

<sup>3</sup> *See* Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01.

<sup>4</sup> *See, e.g.*, Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01, and Section 3, Part 5 of PCAOB rules. To the extent that a provision of one rule is more restrictive than that of another rule, the auditor is required to comply with the more restrictive provision. *See* Rule 3500T, *Interim Ethics and Independence Standards*.

<sup>5</sup> *See, e.g.*, Section 3, Part 5 of PCAOB rules; [proposed EI 1000, *Integrity and Objectivity*, PCAOB Release No. 2022-006].



audit in accordance with applicable professional and legal requirements.<sup>6</sup> Competence consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. The measure of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time.

Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

.08 The auditor should develop and maintain competence through an appropriate combination of:

- a. Academic education;
- b. Professional experience in accounting and auditing, with proper supervision;<sup>7</sup> and
- c. Training, including accounting, auditing, independence, ethics, and other relevant continuing professional education.<sup>8</sup>

## DUE PROFESSIONAL CARE, INCLUDING PROFESSIONAL SKEPTICISM

.09 The auditor must exercise due professional care in all matters related to the audit.<sup>9</sup> Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional

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<sup>6</sup> See also [proposed QC 1000.44c, PCAOB Release No. 2022-006 (providing, as a resource quality objective, that individuals who are assigned to engagements, including the engagement partner and engagement quality reviewer, have the competence, objectivity, and time to fulfill their responsibilities on such engagements in accordance with applicable professional and legal requirements and the firm's policies and procedures)].

<sup>7</sup> Paragraphs .05 and .06 of AS 1201, *Supervision of the Audit Engagement*, (as proposed to be amended) describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members.

<sup>8</sup> See also [proposed QC 1000.36 and .48, PCAOB Release No. 2022-006], for the requirements for the firm to provide mandatory training. In addition to mandatory training provided by the firm, auditors may need to undertake additional training to develop and maintain their competence.

<sup>9</sup> For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care. The lead auditor's responsibilities for planning the audit and supervising the other auditors' work are set forth in AS 2101, *Audit Planning*, and AS 1201 (as proposed to be amended).

skepticism, acting with integrity, and complying with applicable professional and legal requirements.<sup>10</sup> For engagement partners,<sup>11</sup> due professional care includes (1) appropriately assigning responsibilities to,<sup>12</sup> and supervising,<sup>13</sup> engagement team members;<sup>14</sup> (2) determining that the audit is properly planned<sup>15</sup> and performed to obtain reasonable assurance;<sup>16</sup> (3) evaluating that significant findings or issues are appropriately addressed;<sup>17</sup> (4) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence;<sup>18</sup> and (5) determining that required communications under applicable professional and legal requirements have been made.<sup>19</sup>

.10 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit.

.11 The auditor's exercise of professional skepticism includes:

- a. Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;<sup>20</sup>

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<sup>10</sup> See also note to AS 1201.05b (as proposed to be amended).

<sup>11</sup> The term "engagement partner," as used in this standard, has the same meaning as defined in Appendix A of AS 1201.

<sup>12</sup> Paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding the assignment of engagement team members.

<sup>13</sup> See AS 1201 (as proposed to be amended).

<sup>14</sup> The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)].

<sup>15</sup> See AS 2101.03, which describes the engagement partner's responsibilities for planning an audit.

<sup>16</sup> See paragraph .13 of this standard.

<sup>17</sup> See paragraph .12 of AS 1215, *Audit Documentation*.

<sup>18</sup> See AS 2810, *Evaluating Audit Results*.

<sup>19</sup> See paragraph .20 of this standard.

<sup>20</sup> See AS 1105, *Audit Evidence*, which explains what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.

- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not relying on evidence that is less than persuasive;
- d. Not assuming that management is honest or dishonest; and
- e. Consideration of potential bias on the part of management and the auditor.

## PROFESSIONAL JUDGMENT

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.<sup>21</sup>

## CONDUCTING AN AUDIT

.13 The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to:

- a. Obtain reasonable assurance about whether:
  - (1) In an audit of financial statements, the financial statements are free of material misstatement,<sup>22</sup> whether due to error or fraud;<sup>23</sup>
  - (2) In an audit of internal control over financial reporting, material weaknesses exist as of the date specified in management's assessment; and

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<sup>21</sup> References to judgment of the auditor in other PCAOB standards have the same meaning as "professional judgment." See, e.g., AS 1215.07, and paragraph .02 of AS 1220, *Engagement Quality Review*.

<sup>22</sup> The term "misstatement," as used in this standard, has the same meaning as defined in Appendix A of AS 2810, *Evaluating Audit Results*.

<sup>23</sup> See AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, for requirements regarding the auditor's consideration of materiality in planning and performing an audit. See AS 2401, *Consideration of Fraud in a Financial Statement Audit*. See also paragraph .05 of AS 2405, *Illegal Acts by Clients*.

- b. Provide the auditor with a reasonable basis for forming an opinion.<sup>24</sup>

Note: In an audit of financial statements, the financial statements are management's responsibility and the auditor's responsibility is to express an opinion on the financial statements. In an audit of internal control over financial reporting, management is responsible for maintaining effective internal control over financial reporting and for assessing the effectiveness of internal control over financial reporting, and the auditor's responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting.

.14 Reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence.<sup>25</sup> The auditor is able to obtain reasonable, but not absolute, assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected.

.15 The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors.

Note: The auditor should take into account relevant guidance<sup>26</sup> applicable to the audit.

.16 The auditor must prepare audit documentation in connection with each engagement conducted in accordance with the standards of the PCAOB.<sup>27</sup> Audit documentation facilitates the planning, performance, and supervision of the engagement and is the basis for reviewing the quality of the work performed in an audit because it provides the engagement partner and other reviewers with written documentation of the evidence supporting the auditor's

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<sup>24</sup> In circumstances when the auditor is not able to obtain sufficient appropriate audit evidence to provide a reasonable basis for forming an opinion, PCAOB standards require the auditor to disclaim an opinion or withdraw (or resign) from the engagement. See AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, for a financial statement audit and paragraphs .90 through .98 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and Appendix C of AS 2201, for an audit of internal control over financial reporting.

<sup>25</sup> See paragraph .03 of AS 1101, *Audit Risk*.

<sup>26</sup> Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the Board.

<sup>27</sup> See, e.g., AS 1215; AS 1301, *Communications with Audit Committees*; and AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

significant conclusions.<sup>28</sup> AS 1215 also sets forth requirements for the assembly and retention of audit documentation.<sup>29</sup>

## Auditor Communications

.17 The auditor's report must contain:

- a. An expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed;<sup>30</sup> and
- b. In an audit of internal control over financial reporting, an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed.

.18 The auditor should express an unqualified opinion only when the auditor has performed the audit in accordance with the standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that:

- a. In an audit of financial statements, the financial statements, taken as a whole, are presented fairly,<sup>31</sup> in all material respects, in conformity with the applicable financial reporting framework;<sup>32</sup>
- b. In an audit of internal control over financial reporting, the company maintained, in all material respects, effective internal control over financial reporting.<sup>33</sup>

.19 When the auditor conducts an audit in accordance with the standards of the PCAOB,

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<sup>28</sup> See generally AS 1215.

<sup>29</sup> See AS 1215.14-.20.

<sup>30</sup> The auditor's report also contains other elements, such as those included in the basis for opinion or basis for disclaimer of opinion sections, and, if applicable, critical audit matters. See AS 3101 and AS 3105.

<sup>31</sup> Paragraphs .30-.31 of AS 2810 (as proposed to be amended) describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

<sup>32</sup> See AS 3101 for requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements. The auditor should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

<sup>33</sup> See AS 2201.85-.98 for the form and content of the auditor's report when the auditor conducts an audit of internal control over financial reporting.

some circumstances require that the auditor express a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements or the company's internal control over financial reporting, and state the reasons for the departure from the unqualified opinion.<sup>34</sup>

.20 The auditor must communicate externally, as required by applicable professional and legal requirements.<sup>35</sup>

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<sup>34</sup> See AS 3105 for reporting requirements related to departures from unqualified opinions and other reporting circumstances. See also AS 2201.90-.98 and Appendix C of AS 2201, for special reporting situations in an audit of internal control over financial reporting.

<sup>35</sup> See, e.g., AS 1301; PCAOB Rule 3211.

## APPENDIX 2 – Proposed Amendments to AS 2810; Rescission of AS 2815

Language that would be deleted by the proposed amendments to AS 2810 is ~~struck through~~. Language that would be added is underlined.

### AS 2810: Evaluating Audit Results

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.17 *Evaluation of the Effect of Uncorrected Misstatements.* The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors. (See Appendix B.)

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Note: As a result of the interaction of quantitative and qualitative considerations in materiality judgments<sup>9A</sup>, uncorrected misstatements of relatively small amounts could have a material effect on the financial statements. For example, an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility<sup>10</sup> that it could lead to a material contingent liability or a material loss of revenue.<sup>11</sup> Also, a misstatement made intentionally could be material for qualitative reasons, even if relatively small in amount.

<sup>9A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in proposed AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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### Evaluating the Presentation of the Financial Statements, Including the Disclosures

.30 The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.<sup>17A</sup>

~~Note: AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles,”* establishes requirements for evaluating the presentation of the financial statements. AS 2820, *Evaluating Consistency of Financial Statements*, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.~~

Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.<sup>17B</sup>

<sup>17A</sup> For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose “in a statement or report ... such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”).

<sup>17B</sup> AS 2820, *Evaluating Consistency of Financial Statements*, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.

.30A When evaluating whether the financial statements present fairly the financial position, results of operations, cash flows, and disclosures, in all material respects, in conformity with the applicable financial reporting framework, the auditor should evaluate whether:<sup>17C</sup>

- a. The information in the financial statements is presented and classified appropriately and in a manner that would be informative and not misleading to a reasonable investor;
- b. The accounting principles selected and applied by the company’s management are in conformity with the applicable financial reporting framework and appropriate in the circumstances; and
- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements.

<sup>17C</sup> The concept of materiality is inherent in the auditor’s judgment. That concept involves qualitative as well as quantitative factors (see AS 2105, *Consideration of Materiality in Planning and Performing an Audit*).

.31 As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>18</sup> Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

~~Note: According to AS 3105, if the financial statements, including the accompanying notes, fail to disclose information that is required by the applicable financial reporting framework, the auditor should express a qualified or adverse opinion and should provide the information in the report, if practicable, unless its omission from the report is recognized as appropriate by a specific auditing~~



~~standard.~~<sup>18</sup> The auditor should also evaluate whether the substance of transactions or events differs materially from their form.

<sup>18</sup> See AS 3105.24–.27 for auditor reporting considerations related to inadequate disclosures.

~~<sup>18</sup> AS 3105.24–.27.~~

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### ~~AS 2815: The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles~~

~~.01 — An independent auditor's report contains an opinion as to whether the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. An identification of the applicable financial reporting framework is required (see paragraph .08e of the AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion).~~

~~The purpose of this section is to explain the meaning of “present fairly” as used in the phrase “present fairly . . . in conformity with generally accepted accounting principles.” In applying this section, the auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.~~

~~[.02] [Paragraph deleted.]~~

~~.03 — The independent auditor's judgment concerning the “fairness” of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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.~~

~~.04 — The auditor's opinion that financial statements present fairly an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles should be based on his or her judgment as to whether (a) the accounting principles selected and applied have general acceptance; (b) the accounting principles are appropriate in the circumstances; (c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation (see paragraph .31 of AS 2810, Evaluating Audit Results); (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed (see AS 2810.31); and (e) the financial statements reflect the underlying~~

~~transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.<sup>4</sup>~~

~~<sup>4</sup>—— The concept of materiality is inherent in the auditor's judgments. That concept involves qualitative as well as quantitative judgments (see AS 2105, Consideration of Materiality in Planning and Performing an Audit, and AS 3105.19).~~

~~[.05] [Paragraph deleted.]~~

~~.06—— Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.~~

~~[.07] [Paragraph deleted.]~~

~~.08—— The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. Paragraph .04 of AS 3310, Special Reports on Regulated Companies, and AS 3305, Special Reports, provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.~~

~~[.09 .18] [Paragraphs deleted.]~~

## APPENDIX 3 – Proposed Amendments to AS 1201; AS 1215; and AS 2101

Language that would be deleted by the proposed amendments to AS 1201, AS 1215, and AS 2101 is ~~struck through~~. Language that would be added is underlined.

### AS 1201: Supervision of the Audit Engagement

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#### Responsibility of the Engagement Partner for Supervision

.03 The **engagement partner**<sup>1A</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members<sup>1B</sup> including engagement team members outside the engagement partner's firm). The engagement partner also is responsible for compliance with PCAOB standards, including standards regarding: using the work of specialists,<sup>2</sup> internal auditors,<sup>4</sup> and others who are involved in testing controls;<sup>5</sup> and dividing responsibility with another accounting firm.<sup>5A</sup> Paragraphs .05–.06 of this standard describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members. Paragraphs .07–.15 of this standard further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth in this standard.<sup>6A</sup> [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>1B</sup> See also paragraph .09 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for an additional description of due professional care as it relates to engagement partners.

~~<sup>6</sup> See also paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*.~~

[<sup>6</sup> Footnote deleted.]

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#### Responsibility of the Engagement Partner for Supervision

.04 The engagement partner may seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in this standard with

respect to the supervisory responsibilities assigned to them. [As adopted by PCAOB and approved by SEC, *see* SEC Release No. 34-95488 (Aug. 12, 2022)].

Note: Even when the engagement partner seeks assistance, the engagement partner retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner’s responsibility.

### Supervision of Engagement Team Members

.05 The engagement partner and, as applicable, other engagement team members performing supervisory activities, should:

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- a. Inform engagement team members of their responsibilities,<sup>7</sup> including:

<sup>7</sup> ~~AS 1015.06 and~~ Paragraph .05 of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*, establishes requirements regarding the appropriate assignment of engagement team members. See also AS 1000.09, for an additional description of due professional care as it relates to engagement partners.

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- b. Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards;

Note: In applying due professional care in accordance with ~~AS 1015~~ AS 1000, each engagement team member has a responsibility to bring to the attention of appropriate persons, disagreements or concerns the engagement team member might have with respect to accounting and auditing issues that he or she believes are of significance to the financial statements or the auditor’s report regardless of how those disagreements or concerns may have arisen.

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- c. Review the work of engagement team members to evaluate whether:

- (1) The work was performed and documented;
- (2) The objectives of the procedures were achieved; and
- (3) The results of the work support the conclusions reached.<sup>10</sup>

Note 1: The review and evaluation must be completed prior to the report release date (see AS 1215.06 and .15).

Note 2: Notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner, as the individual primarily responsible for the engagement and its performance, must review sufficient documentation to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner’s attention pursuant to paragraph .05b, were appropriately addressed; (iii) the conclusions expressed in the auditor’s report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. 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*).

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.06 To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, the engagement partner and other engagement team members performing supervisory activities should take into account:

- d. The knowledge, skill, and ability of each engagement team member.<sup>12</sup>

<sup>12</sup> See also AS 2301.05a and AS 1015.06.

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### **Appendix C – Supervision of the Work of Auditor-Employed Specialists**

.C4 Pursuant to paragraph .05a(3) of this standard, the engagement partner and, as applicable, other engagement team members performing supervisory activities should inform the specialist about matters that could affect the specialist’s work. This includes, as applicable, information about the company and its environment, the company’s processes for developing the related accounting estimate, the company’s use of specialists in developing the estimate,

relevant requirements of the applicable financial reporting framework, possible accounting and auditing issues, and the need to apply professional skepticism.<sup>1</sup>

<sup>1</sup> See paragraphs .10-.11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism ~~AS 1015.07-.09~~.

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## AS 1215: Audit Documentation

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.02 *Audit documentation* is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer (e.g., engagement partner or other reviewers) with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

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.06 The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.<sup>2</sup> Audit documentation must clearly demonstrate that the work was in fact performed, who performed the work, the person or persons who reviewed the work, and the date of such review. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions.

.06A Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person or persons who reviewed the work and the date of such review.

.07 In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;
- Extent of judgment<sup>2A</sup> required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;

<sup>2A</sup> Reference to the judgment of the auditor has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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.11 Certain matters, such as auditor independence, staff competence and training, ~~and proficiency~~ and client acceptance and retention, may be documented in a central repository for the public accounting firm (“firm”) or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

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.15 Prior to the report release date, (i) the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor’s report, and (ii) the engagement partner and other engagement team members performing supervisory activities must have completed their reviews of audit documentation. A complete and final set of audit documentation should be assembled for retention (i.e., archived) as of a date not more than 4514 days after the report release date (*documentation completion date*). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 4514 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 4514 days from the date the engagement ceased.

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## AS 2101: Audit Planning

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.03 The **engagement partner**<sup>1</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate **engagement team** members (which may include engagement team members outside the engagement partner’s firm) in fulfilling this responsibility. Engagement team members who assist the engagement partner with audit planning also should comply with the relevant requirements in this standard. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

Note: Even when the engagement partner seeks assistance, the engagement partner retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner’s responsibility.

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### Planning Activities

.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor’s previous experience with the company, and changes in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, the auditor should evaluate whether the following matters are important to the company’s financial statements and internal control over financial reporting and, if so, how they will affect the auditor’s procedures:

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- The auditor’s preliminary judgments<sup>4A</sup> about materiality,<sup>5</sup> risk, and, in integrated audits, other factors relating to the determination of material weaknesses;

<sup>4A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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.09 In establishing the overall audit strategy, the auditor should take into account:

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d. The nature, timing, and extent of resources necessary to perform the engagement.<sup>10</sup>

<sup>10</sup> See, e.g., ~~AS 1015-06~~, paragraph .16 of this standard, and AS 2301.05a. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488]

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## APPENDIX 4 – Other Proposed Amendments to Related PCAOB Auditing Standards

In connection with the proposal of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (“AS 1000”), the Board is proposing related amendments to several of its auditing standards.<sup>1</sup> We are also proposing other technical and clarifying amendments.

The following PCAOB interim auditing standards would be superseded in their entirety.

- AS 1001: *Responsibilities and Functions of the Independent Auditor*
- AS 1005: *Independence*
- AS 1010: *Training and Proficiency of the Independent Auditor*
- AS 1015: *Due Professional Care in the Performance of Work*
- AS 2815: *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*

Language that would be deleted by the proposed amendments is ~~struck through~~.  
Language that would be added is underlined.

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<sup>1</sup> The Board’s pending rulemaking projects, *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Release No. 2022-006 (Nov. 18, 2022), and *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*, PCAOB Release No. 2022-09 (Dec. 20, 2022), include proposed changes that may supersede, amend, or delete paragraphs of PCAOB auditing standards for which other proposed amendments are included in this appendix. If, prior to the conclusion of this rulemaking, the Board adopts standards and related amendments that affect the proposed amendments in this release, the Board may make conforming changes to the proposed amendments.

OTHER PCAOB STANDARDS PROPOSED TO BE AMENDED<sup>2</sup>

| PCAOB Standard   | Paragraphs | Subject Heading of Paragraph Affected | Action(s)                               | Page(s) |
|--|------------|---------------------------------------|---|---------|
| AS 1101, <i>Audit Risk</i>   | .03        | Audit Risk                            | Make conforming amendment to footnote 3 | p.A4-10 |
| AS 1105, <i>Audit Evidence</i>   | .B2        | N/A                                   | Add footnote 1A                         | p.A4-10 |
| AS 1220, <i>Engagement Quality Review</i>  | .02        | Objective                             | Add footnote 1A                         | p.A4-11 |
| AS 1220  | .12        | Concurring Approval of Issuance       | Make conforming amendment to footnote 6 | p.A4-11 |
| AS 2201, <i>An Audit of Internal Control Over Financial Reporting that is integrated with An Audit of Financial Statements</i> | .03        | Introduction                          | Make conforming amendment to footnote 5 | p.A4-11 |
| AS 2201  | .04        | Introduction                          | Make conforming amendment               | p.A4-12 |
| AS 2201  | .09        | Planning the Audit                    | Add footnote 8A                         | p.A4-12 |

<sup>2</sup> This table is a reference tool for the proposed amendments that follow. “Add” refers to a new footnote or other text proposed to be added to existing PCAOB standards. “Make conforming amendment” refers to proposed technical changes to existing PCAOB standards, such as changes to cross-references and defined terms. “Delete” refers to removing an existing paragraph, footnote, or other text. “Move” refers to moving an existing footnote to another location within the same standard.

PCAOB Release No. 2023-001

March 28, 2023

Appendix 4 – Other Proposed Amendments  
to Related PCAOB Auditing Standards

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| <b>PCAOB Standard</b>   | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b>    | <b>Action(s)</b>                                | <b>Page(s)</b> |
|---|-------------------|---|---|----------------|
| AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i> | .05a              | Overall Response                                | Delete footnote 1                               | p.A4-13        |
| AS 2301   | .05d              | Overall Response                                | Make conforming amendment to footnote 3         | p.A4-13        |
| AS 2301   | .07               | Overall Response                                | Make conforming amendment to footnote 4         | p.A4-13        |
| AS 2305, <i>Substantive Analytical Procedures</i>                             | .09               | Analytical Procedures Used as Substantive Tests | Add footnote 1A                                 | p.A4-14        |
| AS 2310, <i>The Confirmation Process</i>                                      | .15               | The Confirmation Process                        | Make conforming amendment                       | p.A4-14        |
| AS 2315, <i>Audit Sampling</i>  | .02               | N/A   | Add footnote 2A                                 | p.A4-15        |
| AS 2401, <i>Consideration of Fraud in a Financial Statement Audit</i>         | .01               | Introduction and Overview                       | Make conforming amendment                       | p.A4-15        |
| AS 2401   | .04               | Introduction and Overview                       | Amend   | p.A4-15        |
| AS 2401   | .12               | Description and Characteristics of Fraud        | Make conforming amendment to .12 and footnote 7 | p.A4-16        |

| <b>PCAOB Standard</b>   | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b>   | <b>Action(s)</b>                         | <b>Page(s)</b> |
|---|-------------------|--|--|----------------|
| AS 2401   | .13               | The Importance of Exercising Professional Skepticism                                       | Make conforming amendments               | p.A4-16        |
| AS 2405, <i>Illegal Acts by Clients</i>   | .05               | Relation to Financial Statements   | Make conforming amendment                | p.A4-16        |
| AS 2410, <i>Related Parties</i>   | .02               | Objective  | Make conforming amendment to footnote 2  | p.A4-17        |
| AS 2501, <i>Auditing Accounting Estimates, Including Fair Value Measurements</i>            | .27               | Evaluating Audit Evidence from Events or Transactions Occurring After the Measurement Date | Make conforming amendment to footnote 23 | p.A4-17        |
| AS 2501   | .30               | Evaluating Audit Results   | Make conforming amendment to footnote 28 | p.A4-18        |
| AS 2505, <i>Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments</i> | .13               | Limitations on the Scope of a Lawyer's Response  | Make conforming amendment to footnote 7  | p.A4-18        |
| AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i>                  | .32               | Reports on Controls Placed in Operation  | Add footnote 2A                          | p.A4-19        |
| AS 2605, <i>Consideration of the Internal Audit Function</i>                                | .19               | Extent of the Effect of the Internal Auditors' Work  | Add footnote 6A                          | p.A4-19        |

| <b>PCAOB Standard</b>  | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b> | <b>Action(s)</b>   | <b>Page(s)</b> |
|--|-------------------|--|--|----------------|
| AS 2610, <i>Initial Audits— Communications Between Predecessor and Successor Auditors</i>                                  | .11               | Other Communications                         | Add footnote 7A  | p.A4-20        |
| AS 2710, <i>Other Information in Documents Containing Audited Financial Statements</i>                                     | .05               | N/A  | Add footnote 3   | p.A4-20        |
| AS 2805, <i>Management Representations</i>   | .02               | Reliance on Management Representations       | Make conforming amendments to footnote 1   | p.A4-21        |
| AS 3101, <i>The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion</i> | .01               | Introduction                                 | Delete the first sentence, move location of footnote 1 within the same paragraph, move footnote 2 to paragraph .02 and delete footnote 3 | p.A4-22        |
| AS 3101  | .02               | Introduction                                 | Move footnote 2 from paragraph .01, make   | p.A4-22        |

| PCAOB Standard  | Paragraphs | Subject Heading of Paragraph Affected  | Action(s)                                     | Page(s) |
|---|------------|--|---|---------|
|   |            |  | conforming amendment to footnote 4            |         |
| AS 3101   | .11        | Critical Audit Matters<br>Determination of Critical Audit Matters  | Add footnote 20A                              | p.A4-23 |
| AS 3105,<br><i>Departures from Unqualified Opinions and Other Reporting Circumstances</i> | .50        | Reports on Comparative Financial Statements  | Make conforming amendment                     | p.A4-23 |
| AS 3305, <i>Special Reports</i>   | .03        | Financial Statements Prepared in Conformity With a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles | Make conforming amendment, add footnote 1A    | p.A4-24 |
| AS 3305   | .09        | Evaluating the Adequacy of Disclosure in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting     | Make conforming amendment                     | p.A4-24 |
| AS 4105,<br><i>Reviews of Interim Financial Information</i>                               | .01        | Introduction   | Make conforming amendment, delete Footnote 1A | p.A4-24 |
| AS 4105   | .07        | Objective of a Review of Interim Financial Information   | Add footnote 5A                               | p.A4-25 |
| AS 6105,<br><i>Reports on the Application of Accounting Principles</i>                    | .07        | Performance Standards  | Make conforming amendment                     | p.A4-26 |

| <b>PCAOB Standard</b>  | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b>   | <b>Action(s)</b>                           | <b>Page(s)</b> |
|--|-------------------|--|--|----------------|
| AS 6105  | .08               | Performance Standards  | Make conforming amendment, add footnote 5A | p.A4-26        |
| AS 6115,<br><i>Reporting on Whether a Previously Reported Material Weakness Continues to Exist</i>               | .21               | Applying the Standards of the PCAOB  | Make conforming amendment                  | p.A4-26        |
| AS 6115  | .38               | Using the Work of Others   | Add footnote 4                             | p.A4-27        |
| AI 11, <i>Using the Work of a Specialist: Auditing Interpretations</i>   | .04               | 1. The Use of Legal Interpretations As Evidential Matter to Support Management’s Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraph 9(a) of Financial Accounting Standards Board Statement No. 140 | Add footnote 4A                            | p.A4-27        |
| AI 18,<br><i>Consideration of an Entity’s Use of a Service Organization: Auditing Interpretations of AS 2601</i> | .03               | 1.Describing Tests of Operating Effectiveness and the Results of Such Tests  | Add footnote 1A                            | p.A4-27        |
| AI 23,<br><i>Departures from Unqualified Opinions and Other Reporting</i>  | .06               | 1. Report of an Outside Inventory-Taking Firm as an Alternative Procedure for Observing Inventories  | Add footnote 1C                            | p.A4-28        |



| <b>PCAOB Standard</b>   | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b>   | <b>Action(s)</b>   | <b>Page(s)</b> |
|---|-------------------|--|--|----------------|
| <i>Circumstances: Auditing Interpretations of AS 3105</i>                                   |                   |  |  |                |
| <i>AI 24, Special Reports – Auditing Interpretations of AS 3305</i>                         | .61               | 12.Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis | Make conforming amendment, add footnote 12                                     | p.A4-28        |
| <i>AT No.1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers</i> | .06               | Performing the Examination Engagement General Requirements   | Make conforming amendment, add footnotes 10A, 11A, and 11B, delete footnote 11 | p.A4-29        |
| <i>AT No.1</i>  | .07               | Performing the Examination Engagement General Requirements   | Add footnote 12A   | p.A4-30        |
| <i>AT No.2, Review Engagements Regarding Exemption Reports of Brokers and Dealers</i>       | .05               | Performing the Review Engagement General Requirements  | Make conforming amendment, add footnotes 7A, 8A, and 8B, delete footnote 8     | p.A4-31        |
| <i>AT No.2</i>  | .06               | Performing the Review Engagement General Requirements  | Add note 9A  | p.A4-32        |
| <i>AT Section 101, Attest Engagements</i>   | .40               | Due Professional Care  | Make conforming amendment, add footnote 7A and 7B                              | p.A4-32        |

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Appendix 4 – Other Proposed Amendments  
to Related PCAOB Auditing Standards

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| <b>PCAOB Standard</b>  | <b>Paragraphs</b> | <b>Subject Heading of Paragraph Affected</b> | <b>Action(s)</b> | <b>Page(s)</b> |
|--|-------------------|--|------------------|----------------|
| AT Section 101   | .41               | Due Professional Care                        | Delete           | p.A4-33        |
| AT Section 301,<br><i>Financial Forecasts and Projections</i>  | .66               | Other Information                            | Add footnote 2A  | p.A4-33        |
| AT Section 601,<br><i>Compliance Attestation</i>               | .31               | Attestation Risk                             | Add footnote 8A  | p.A4-34        |
| AT Section 701,<br><i>Management's Discussion and Analysis</i> | .29               | Attestation Risk                             | Add footnote 17A | p.A4-34        |

## AS 1101: Audit Risk

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.03 To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement<sup>2</sup> due to error or fraud. Reasonable assurance<sup>3</sup> is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence.

<sup>3</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, ~~AS 1001, Responsibilities and Functions of the Independent Auditor, and paragraph .10 of AS 1015, Due Professional Care in the Performance of Work~~, for a further discussion of reasonable assurance.

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## AS 1105: Audit Evidence

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### **Appendix B—Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results**

.B2 If in the auditor's judgment<sup>1A</sup> additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>1A</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting and Audit*.

\*\*\*

## AS 1220: Engagement Quality Review

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### Objective

.02 The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments<sup>1B</sup> made by the engagement team<sup>1A</sup> and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.<sup>1</sup> [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>1B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

\*\*\*

### Concurring Approval of Issuance

.12 In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care<sup>6</sup> the review required by this standard, he or she is not aware of a significant engagement deficiency.

Note: A significant engagement deficiency in an audit exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client.

<sup>6</sup> See AS 1000.09-.11 for a discussion of the concept of due professional care.~~AS 1015, *Due Professional Care in the Performance of Work*.~~

\*\*\*

## AS 2201: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

\*\*\*

.03 The auditor’s objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company’s internal control over financial

reporting. Because a company’s internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance<sup>5</sup> about whether material weaknesses exist as of the date specified in management’s assessment. A material weakness in internal control over financial reporting may exist even when financial statements are not materially misstated.

<sup>5</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, AS 1015, *Due Professional Care in the Performance of Work*, for further a discussion of the concept of reasonable assurance in an audit.

~~.04 The standards, AS 1005, *Independence*, AS 1010, *Training and Proficiency of the Independent Auditor*, and AS 1015, *Due Professional Care in the Performance of Work*, AS 1000 is~~ are applicable to an audit of internal control over financial reporting. ~~Those~~ That standards requires the auditor to be independent and to comply with independence and ethics requirements, be competent, technical training and proficiency as an auditor, independence, and the to exercise of due professional care, including professional skepticism. This standard establishes the fieldwork and reporting standards applicable to an audit of internal control over financial reporting.

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## Planning the Audit

.09 The auditor should properly plan the audit of internal control over financial reporting and properly supervise the engagement team<sup>7A</sup> members. When planning an integrated audit, the auditor should evaluate whether the following matters are important to the company’s financial statements and internal control over financial reporting and, if so, how they will affect the auditor’s procedures – [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

- The auditor’s preliminary judgments<sup>8A</sup> about materiality, risk, and other factors relating to the determination of material weaknesses;

<sup>8A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000.

\*\*\*

## AS 2301: The Auditor's Responses to the Risks of Material Misstatement

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### Overall Responses

.05 The auditor should design and implement overall responses to address the assessed risks of material misstatement as follows:

a. Making appropriate assignments of significant engagement responsibilities. The knowledge, skill, and ability of engagement team<sup>1A</sup> members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.<sup>‡</sup>[As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>‡</sup> ~~See also paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*.~~

[<sup>1</sup> Footnote deleted.]

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d. Evaluating the company's selection and application of significant accounting principles. The auditor should evaluate whether the company's selection and application of significant accounting principles, particularly those related to subjective measurements and complex transactions,<sup>3</sup> are indicative of bias that could lead to material misstatement of the financial statements.

<sup>3</sup> AS 2110.12-.13 discuss the auditor's responsibilities regarding obtaining an understanding of the company's selection and application of accounting principles. See also paragraphs .66-.67A of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, and paragraphs ~~.30-.31~~<sup>04</sup> and ~~06~~ of ~~AS 2810, *Evaluating Audit Results*~~. ~~AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."*~~

\*\*\*

.07 Due professional care requires the auditor to exercise professional skepticism.<sup>4</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence. The auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence. Examples of the application of professional skepticism in response to the assessed fraud risks are (a) modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management's explanations or

representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources.

<sup>4</sup> ~~AS 1000.10-.11AS 1015.07-.09.~~

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## AS 2305: Substantive Analytical Procedures

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### Analytical Procedures Used as Substantive Tests

.09 The auditor’s reliance on substantive tests to achieve an audit objective related to a particular assertion<sup>1</sup> may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedure or procedures to use to achieve a particular audit objective is based on the auditor’s judgment<sup>1A</sup> on the expected effectiveness and efficiency of the available procedures. For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient. (See paragraph .11 of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*.)

<sup>1A</sup> Reference to the judgment of the auditor has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 2310: The Confirmation Process

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### The Confirmation Process

.15 The auditor should exercise an appropriate level of professional skepticism throughout the confirmation process (see AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* ~~AS 1015, *Due Professional Care in the Performance of Work*~~). Professional skepticism is important in designing the confirmation request, performing the confirmation procedures, and evaluating the results of the confirmation procedures.

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## AS 2315: Audit Sampling

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.02 The auditor often is aware of account balances and transactions that may be more likely to contain misstatements.<sup>2</sup> He considers this knowledge in planning his procedures, including audit sampling. The auditor usually will have no special knowledge about other account balances and transactions that, in his judgment,<sup>2A</sup> will need to be tested to fulfill his audit objectives. Audit sampling is especially useful in these cases.

<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

\*\*\*

## AS 2401: Consideration of Fraud in a Financial Statement Audit

### Introduction and Overview

.01 Paragraph ~~02.13~~ of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*~~AS 1001, Responsibilities and Functions of the Independent Auditor~~, states, requires “the auditor ~~to~~ has a responsibility plan and perform the audit to obtain sufficient appropriate audit evidence to obtain reasonable assurance about whether the financial statements, are free of material misstatement, whether ~~due to~~ caused by error or fraud. ~~[footnote omitted]~~”<sup>1</sup> This section establishes requirements and provides direction relevant to fulfilling that responsibility, as it relates to fraud, in an audit of financial statements.

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.04 Although this section focuses on the auditor’s consideration of fraud in an audit of financial statements, it is management’s responsibility to design and implement programs and controls to prevent, deter, and detect fraud. ~~That responsibility is described in AS 1001.03, which states, “Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management’s assertions embodied in the financial statements.”~~ Management, along with those who have responsibility for oversight of the financial reporting process (such as the audit committee, board of trustees, board of directors, or the owner in owner-managed entities), should set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud. When



management and those responsible for the oversight of the financial reporting process fulfill those responsibilities, the opportunities to commit fraud can be reduced significantly.

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.12 As indicated in paragraph .01, the auditor has a responsibility to plan and perform the audit to obtain sufficient appropriate audit evidence for the auditor to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether ~~due to caused by~~ fraud or error.<sup>7</sup> However, absolute assurance is not attainable and thus even a properly planned and performed audit may not detect a material misstatement resulting from fraud. A material misstatement may not be detected because of the nature of audit evidence or because the characteristics of fraud as discussed above may cause the auditor to rely unknowingly on audit evidence that appears to be valid, but is, in fact, false and fraudulent. Furthermore, audit procedures that are effective for detecting an error may be ineffective for detecting fraud.

<sup>7</sup> For a ~~further~~ discussion of the concept of reasonable assurance, see AS 1000.1410 through .13 of AS 1015, *Due Professional Care in the Performance of Work*.\*\*\*

.13 Due professional care requires the auditor to exercise professional skepticism. See AS 1000.10 and .11 AS 1015.07 through .09. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the fraud risks. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit~~audit evidence~~. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. In exercising professional skepticism in gathering and evaluating evidence, the auditor should not rely on~~be satisfied with less than persuasive evidence that is less than persuasive and avoid assumptions because of a belief that~~ management is honest or dishonest.

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## AS 2405: Illegal Acts by Clients

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.05 The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. For example, tax laws affect accruals and the amount recognized as expense in the accounting

period; applicable laws and regulations may affect the amount of revenue accrued under government contracts. However, the auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statements assertions rather than from the perspective of legality per se. The auditor's responsibility to detect and report misstatements resulting from illegal acts having a direct and material effect on the determination of financial statement amounts is the same as that for misstatements due to error or fraud as described in ~~AS 1001, *Responsibilities and Functions of the Independent Auditor*~~, paragraph .13 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

\*\*\*

## AS 2410: Related Parties

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### Objective

.02 The objective of the auditor is to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements.<sup>2</sup>

<sup>2</sup> See, e.g., paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*. ~~See also paragraph .04 of AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."*~~

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## AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements

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### ***Evaluating Audit Evidence from Events or Transactions Occurring After the Measurement Date***

.27 Events and transactions that occur after the measurement date can provide relevant evidence to the extent they reflect conditions at the measurement date.<sup>23</sup>

<sup>23</sup> Evaluating audit evidence from events or transactions occurring after the measurement date, as contemplated in this standard, is a substantive test that differs from the other auditing procedures performed under paragraph .12 of AS 2801, *Subsequent Events*. ~~See also paragraph .11 of AS 1015, *Due Professional Care in the Performance of Work*, which provides that the auditor's evaluation of accounting estimates is to be based on information that could reasonably be expected to be available through the date of the auditor's report.~~

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***Evaluating Audit Results***

.30 AS 2810 requires the auditor to evaluate the results of audit procedures performed on accounting estimates. This includes:

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d. Evaluating the presentation of the financial statements, including the disclosures and whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>28</sup>

<sup>28</sup> See AS 2810.30-31.

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**AS 2505: Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments**

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.13 A lawyer’s refusal to furnish the information requested in an inquiry letter either in writing or orally (*see* paragraphs .09 and .10) would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion (*see* paragraphs .05 and .06 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*).<sup>7</sup> A lawyer’s response to such an inquiry and the procedures set forth in paragraph .05 provide the auditor with sufficient evidential matter to satisfy himself concerning the accounting for and reporting of pending and threatened litigation, claims and assessments. The auditor obtains sufficient evidential matter to satisfy himself concerning reporting for those unasserted claims and assessments required to be disclosed in financial statements from the foregoing procedures and the lawyer’s specific acknowledgement of his responsibility to his client in respect of disclosure obligations (*see* paragraph .09g). This approach with respect to unasserted claims and assessments is necessitated by the public interest in protecting the confidentiality of lawyer-client communications.

<sup>7</sup> A refusal to respond should be distinguished from an inability to form a conclusion with respect to certain matters of judgment (*see* paragraph .14). Also, lawyers outside the United States sometimes follow practices at variance with those contemplated by this section to the extent that different procedures from those outlined herein may be necessary. In such

circumstances, the auditor should exercise professional judgment in determining whether alternative procedures are adequate to comply with the requirements of this section.

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## AS 2601: Consideration of an Entity’s Use of a Service Organization

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.32 The service auditor should consider conditions that come to his or her attention that, in the service auditor’s judgment,<sup>2A</sup> represent significant deficiencies in the design or operation of the service organization’s controls that preclude the service auditor from obtaining reasonable assurance that specified control objectives would be achieved. The service auditor should also consider whether any other information, irrespective of specified control objectives, has come to his or her attention that causes him or her to conclude (a) that design deficiencies exist that could adversely affect the ability to initiate, record, process, or report financial data to user organizations without error, and (b) that user organizations would not generally be expected to have controls in place to mitigate such design deficiencies.

<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 2605: Consideration of the Internal Audit Function

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.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor divides responsibility for the audit with another public accounting firm,<sup>6</sup> this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments<sup>6A</sup> about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor’s report should always be those of the auditor. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>6A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 2610: Initial Audits—Communications Between Predecessor and Successor Auditors

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### Other Communications

.11 The successor auditor should request that the client authorize the predecessor auditor to allow a review of the predecessor auditor’s working papers. The predecessor auditor may wish to request a consent and acknowledgment letter from the client to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized.<sup>6</sup> It is customary in such circumstances for the predecessor auditor to make himself or herself available to the successor auditor and make available for review certain of the working papers. The predecessor auditor should determine which working papers are to be made available for review and which may be copied. The predecessor auditor should ordinarily permit the successor auditor to review working papers, including documentation of planning, internal control, audit results, and other matters of continuing accounting and auditing significance, such as the working papers containing an analysis of balance sheet accounts, those relating to contingencies, related parties, and significant unusual transactions. Also, the predecessor auditor should reach an understanding with the successor auditor as to the use of the working papers.<sup>7</sup> The extent, if any, to which a predecessor auditor permits access to the working papers is a matter of judgment.<sup>7A</sup>

<sup>7A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 2710: Other Information in Documents Containing Audited Financial Statements

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.05 If, while reading the other information for the reasons set forth in paragraph .04, the auditor becomes aware of information that he believes is a material misstatement of fact that is not a material inconsistency as described in paragraph .04, he should discuss the matter with the client. In connection with this discussion, the auditor should consider that he may not have the expertise to assess the validity of the statement, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment<sup>3</sup> or opinion between the auditor and client. If the auditor concludes he has a valid basis for concern he

should propose that the client consult with some other party whose advice might be useful to the client, such as the client’s legal counsel.

<sup>3</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 2805: Management Representations

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### Reliance on Management Representations

.02 During an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit. Written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.<sup>1</sup>

<sup>1</sup> See AS 100015, *Due Professional Care in the Performance of Work* *General Responsibilities of the Auditor in Conducting an Audit*, states, “The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest which describes the auditor’s general responsibilities, including the responsibility for exercising professional skepticism, which includes not relying on evidence that is less than persuasive and not assuming that management is honest or dishonest.

\*\*\*

## AS 3101: The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion

### Introduction

.01 ~~The auditor’s report contains either an expression of opinion on the financial statements,<sup>1</sup> taken as a whole,<sup>2</sup> or an assertion that an opinion cannot be expressed. This standard establishes requirements regarding the content of the auditor’s written report when the auditor expresses an unqualified opinion on the financial statements<sup>1</sup> (the “auditor’s unqualified report”).<sup>3</sup>~~

<sup>1</sup> ~~This standard uses the term “financial statements” as used by the U.S. Securities and Exchange Commission (“SEC”) to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 CFR 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, *Identifying and Assessing Risks of Material Misstatement*.~~

<sup>1</sup> This standard uses the term “financial statements” as used by the U.S. Securities and Exchange Commission (“SEC”) to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, *Identifying and Assessing Risks of Material Misstatement*.

<sup>2</sup> ~~“Taken as a whole” applies equally to a complete set of financial statements and to an individual financial statement with appropriate disclosures.~~

<sup>3</sup> ~~Paragraphs .85–.98 and Appendix C, *Special Reporting Situations*, of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, address the form and content of the auditor’s report when the auditor performs an audit of internal control over financial reporting~~

<sup>[3]</sup> [Footnote deleted.]

.02 The auditor is in a position to express an unqualified opinion on the financial statements when the auditor conducted an audit in accordance with the standards of the Public Company Accounting Oversight Board (“PCAOB”) and concludes that the financial statements, taken as a whole,<sup>2</sup> are presented fairly, in all material respects,<sup>4</sup> in conformity with the applicable financial reporting framework.<sup>5</sup>

<sup>2</sup> “Taken as a whole” applies equally to a complete set of financial statements and to an individual financial statement with appropriate disclosures.

<sup>4</sup> ~~AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles,”* describes the basis for an auditor’s responsibility for forming an opinion on whether the company’s financial statements are presented fairly in conformity with the applicable financial reporting framework. AS 2810.30-.31 describe the auditor’s responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.~~

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#### *Determination of Critical Audit Matters*

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period’s financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. <sup>20A</sup> Critical audit matters are not a substitute for the auditor’s departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

<sup>20A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit.*

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#### AS 3105: Departures from Unqualified Opinions and Other Reporting Circumstances

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.50 During the audit of the current-period financial statements, the auditor should be alert for circumstances or events that affect the prior-period financial statements presented (see paragraph .52) or the adequacy of informative disclosures concerning those statements. (See AS 2810.30-31.) In updating his or her report on the prior-period financial statements, the auditor should consider the effects of any such circumstances or events coming to his or her attention.

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## AS 3305: Special Reports

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.03 An independent auditor’s judgment<sup>1A</sup> concerning the overall presentation of financial statements should be applied within an applicable financial reporting identifiable framework (see AS 2810, Evaluating Audit Results~~AS 2815, The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”~~). Normally, the framework is provided by generally accepted accounting principles, and the auditor’s judgment in forming an opinion is applied accordingly (~~see 2815.05~~). In some circumstances, however, a comprehensive basis of accounting other than generally accepted accounting principles may be used.

<sup>1A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, General Responsibilities of the Auditor in Conducting an Audit.

\*\*\*

.09 When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other comprehensive basis of accounting as he or she does to financial statements prepared in conformity with generally accepted accounting principles. Therefore, the auditor’s opinion should be based on his or her judgment regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in AS 2810.30A~~AS 2815.04~~.

\*\*\*

## AS 4105: Reviews of Interim Financial Information

### Introduction

.01 The purpose of this section is to establish standards and provide guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of interim financial information (as that term is defined in paragraph .02 of this section). AS 1000, General Responsibilities of the Auditor in Conducting an Audit, requires the auditor to comply with independence and ethics requirements, be competent, and exercise due professional care, including professional skepticism. The same professional qualifications and general principles~~The general standards~~<sup>1A</sup> are applicable to a review of

interim financial information conducted in accordance with this section. This section provides guidance on the application of the field work and reporting standards to a review of interim financial information, to the extent those standards are relevant.

~~<sup>1A</sup> See AS 1005, *Independence*, AS 1010, *Training and Proficiency of the Independent Auditor*, and AS 1015, *Due Professional Care in the Performance of Work*.~~

<sup>[1A]</sup> [Footnote deleted.]

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### **Objective of a Review of Interim Financial Information**

.07 The objective of a review of interim financial information pursuant to this section is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with the standards of the PCAOB. A review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) obtaining corroborating evidence in response to inquiries; or (d) performing certain other procedures ordinarily performed in an audit. A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit. Paragraph .22 of this section provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles. Likewise, the auditor's responsibility as it relates to management's quarterly certifications on internal control over financial reporting is different from the auditor's responsibility as it relates to management's annual assessment of internal control over financial reporting. The auditor should perform limited procedures quarterly to provide a basis for determining whether he or she has become aware of any material modifications that, in the auditor's judgment,<sup>5A</sup> should be made to the disclosures about changes in internal control over financial reporting in order for the certifications to be accurate and to comply with the requirements of Section 302 of the Act.

<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 6105: Reports on the Application of Accounting Principles

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### Performance Standards

.07 The reporting accountant should exercise due professional care in performing the engagement and should have the competence to conduct such an engagement ~~adequate technical training and proficiency~~. The reporting accountant should also plan the engagement adequately, supervise the work of assistants, if any, and accumulate sufficient information to provide a reasonable basis for the professional judgment described in the report. The reporting accountant should consider the circumstances under which the written report or oral advice is requested, the purpose of the request, and the intended use of the written report or oral advice.

.08 To aid in forming a judgment,<sup>5A</sup> the reporting accountant should perform the following procedures: (a) obtain an understanding of the form and substance of the transaction(s); (b) review applicable ~~generally accepted~~ accounting principles (see AS 2810, *Evaluating Audit Results* ~~AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*~~); (c) if appropriate, consult with other professionals or experts; and (d) if appropriate, perform research or other procedures to ascertain and consider the existence of creditable precedents or analogies.

<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AS 6115: Reporting on Whether a Previously Reported Material Weakness Continues to Exist

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.21 The engagement to report on whether a previously reported material weakness continues to exist must be performed by a person or persons having the competence ~~adequate technical training and proficiency as an auditor~~ to conduct such an engagement. In all matters

related to the assignment, an independence in mental attitude must be maintained. Due professional care must be exercised in the performance of the engagement and the preparation of the report.

\*\*\*

.38 AS 2201.18-.19 should be applied in the context of the engagement to report on whether a previously reported material weakness continues to exist. There may, therefore, be some circumstances in which the scope of the audit procedures to be performed in this engagement will be so limited that using the work of others will not provide any tangible benefit to the company or its auditor. Additionally, the auditor should perform any walkthroughs himself or herself because of the degree of judgment<sup>4</sup> required in performing this work.

<sup>4</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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### AI 11: Using the Work of a Specialist: Auditing Interpretations

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.04 *Interpretation*—During the audit, an auditor may encounter complex or subjective matters potentially material to the financial statements. Such matters may require special skill or knowledge and in the auditor’s judgment<sup>4A</sup> require using the work of a specialist to obtain appropriate evidential matter.

<sup>4A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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### AI 18: Consideration of an Entity’s Use of a Service Organization: Auditing Interpretations of AS 2601

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.03 In describing the nature, timing, and extent of the tests applied, the service auditor also should indicate whether the items tested represent a sample or all of the items in the population, but need not indicate the size of the population. In describing the results of the

tests, the service auditor should include exceptions and other information that in the service auditor's judgment<sup>1A</sup> could be relevant to user auditors. Such exceptions and other information should be included for each control objective, whether or not the service auditor concludes that the control objective has been achieved. When exceptions that could be relevant to user auditors are noted, the description also should include the following information:

<sup>1A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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### AI 23: Departures from Unqualified Opinions and Other Reporting Circumstances: Auditing Interpretations of AS 3105

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.06 Thus, the auditor would examine the outside firm's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis and apply appropriate tests to the intervening transactions. The independent auditor ordinarily may reduce the extent of the work on the physical count of inventory because of the work of an outside inventory firm, but any restriction on the auditor's judgment<sup>1C</sup> concerning the extent of his or her contact with the inventory would be a scope restriction.

<sup>1C</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

\*\*\*

### AI 24: Special Reports: Auditing Interpretations of AS 3305

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.61 *Interpretation*—Financial statements prepared on a statutory basis are financial statements prepared on a comprehensive basis of accounting other than GAAP according to AS 3305.04. AS 3305.09 states that “When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other

comprehensive basis of accounting as those applied to financial statements prepared in conformity with generally accepted accounting principles. Therefore, the auditor’s opinion should be based on his or her judgment<sup>12</sup> regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in paragraphs ~~.30A-.31~~ ~~04~~ of AS 2810, *Evaluating Audit Results*. ~~AS 2815, The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles.”~~

<sup>12</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## Attestation Standard No. 1: Examination Engagements Regarding Compliance Reports of Brokers and Dealers

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### Performing the Examination Engagement

#### General Requirements

06. An auditor who performs an examination engagement pursuant to this standard must:

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- d. Exercise due professional care, ~~which includes~~ including the application of professional skepticism<sup>11A</sup>, in planning and performing the examination and the preparation of the report.

Note: Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>11B</sup> ~~Due professional care imposes a responsibility on each engagement team<sup>10A</sup> member to comply with this standard.~~ The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>11C</sup> exercised by those assisting in the engagement, including preparing the report.<sup>11</sup>

<sup>10A</sup> ~~The term “engagement team,” as used in this standard for examination engagements, has a meaning analogous to the term’s definition in Appendix A of AS~~

~~2101, *Audit Planning*, for audit engagements.~~ [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

~~<sup>11</sup> The auditor’s responsibility to exercise due professional care is consistent with the description in paragraphs .40-.41 of AT sec. 101, *Attest Engagements*.~~

<sup>11A</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. See paragraphs .10-.11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism.

<sup>11B</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in paragraph .A2 of Appendix A of [proposed QC 1000, see PCAOB Release No. 2022-006], which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

<sup>11C</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

\*\*\*

07. The engagement partner is responsible for the examination engagement and performance of the examination procedures. Accordingly, the engagement partner is responsible for proper planning of the examination engagement, proper supervision of the work of engagement team<sup>12A</sup> members, and compliance with the requirements of this standard. The engagement partner may seek assistance from appropriate engagement team members in fulfilling these responsibilities.

<sup>12A</sup> The term “engagement team,” as used in this standard for examination engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

\*\*\*

## Attestation Standard No. 2: Review Engagements Regarding Exemption Reports of Brokers and Dealers

\*\*\*

### Performing the Review Engagement

#### General Requirements

05. An auditor who performs a review engagement must:

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- d. Exercise due professional care, ~~which includes~~ including the application of professional skepticism<sup>8A</sup>, in planning and performing the review and preparation of the report.

Note: Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>8B</sup> Due professional care imposes a responsibility on each engagement team<sup>7A</sup> member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>8C</sup> exercised by those assisting in the engagement, including preparing the report.<sup>8</sup>

<sup>7A</sup> ~~The term “engagement team,” as used in this standard for review engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, Audit Planning, for audit engagements.~~ [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

<sup>8</sup> ~~The auditor’s responsibility to exercise due professional care is consistent with the description in paragraphs .40-.41 of AT sec. 101.~~

<sup>8B</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. See paragraphs .10-.11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism.

<sup>8C</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in paragraph .A2 of Appendix A of [proposed QC 1000, see PCAOB Release No. 2022-006], which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is



required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

<sup>8C</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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6. The engagement partner is responsible for the review engagement and performance of the review procedures. Accordingly, the engagement partner is responsible for proper planning of the review engagement, proper supervision of the work of engagement team<sup>9A</sup> members, and compliance with the requirements of this standard. The engagement partner may seek assistance from appropriate engagement team members in fulfilling these responsibilities.

<sup>9A</sup> The term “engagement team,” as used in this standard for examination engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning, for audit engagements*. [As adopted by PCAOB and approved by SEC, see SEC Release No. 34-95488 (Aug. 12, 2022)]

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## AT Section 101: Attest Engagements

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### Due Professional Care

.40 Due professional care concerns what the practitioner does and how well the practitioner does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism<sup>fn 7A</sup>; acting with integrity; and complying with applicable professional and legal requirements.<sup>fn 7B</sup> ~~imposes a responsibility on each practitioner involved with the engagement to observe each of the attestation standards.~~ The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report.

<sup>fn 7A</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. See paragraphs .10-.11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism.

<sup>fn 7B</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in in paragraph .A2 of Appendix A of [proposed QC 1000, see PCAOB Release No. 2022-006], which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

~~.41 *Cooley on Torts*, a legal treatise, describes the obligation for due care as follows:~~

~~Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon mere errors of judgment.<sup>fn 8</sup>~~

<sup>fn 8</sup> ~~D. Haggard, *Cooley on Torts*, 472 (4th ed., 1932).~~

[.41] [Paragraph deleted.]

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## AT Section 301: Financial Forecasts and Projections

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.66 If, after discussing the matter as described in paragraph .65, the practitioner concludes that a material misstatement of fact remains, the action he or she takes will depend on his or her judgment<sup>fn2A</sup> in the particular circumstances. The practitioner should consider steps such as notifying the responsible party in writing of his or her views concerning the information and consulting his or her legal counsel about further appropriate action in the circumstances.

<sup>fn2A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AT Section 601: Compliance Attestation

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.31 In an engagement to examine compliance with specified requirements, the practitioner seeks to obtain reasonable assurance that the entity complied, in all material respects, based on the specified criteria. This includes designing the examination to detect both intentional and unintentional material noncompliance. Absolute assurance is not attainable because of factors such as the need for judgment<sup>fn8A</sup>, the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between personnel of the entity and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the practitioner.

<sup>fn8A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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## AT Section 701: Management’s Discussion and Analysis

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.29 In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment<sup>fn17A</sup> regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence (a) failure to obtain reasonable assurance; (b) inadequate planning, performance, or judgment on the part

of the practitioner; (c) the absence of due professional care; or (d) a failure to comply with this section.

<sup>fn17A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.



|                        |
|------------------------|
| <b>Exhibit 2(a)(B)</b> |
|------------------------|

| <b>Alphabetical List of Commenters on Proposed Rules in<br/>PCAOB Release No. 2023-001</b> |   |
|--|---|
| 1  | American Accounting Association, Auditing Standards Committee, Auditing Section |
| 2  | American Bar Association, Business Law Section                                  |
| 3  | AuditClub   |
| 4  | BDO USA, LLP  |
| 5  | Center for Audit Quality  |
| 6  | CFA Institute   |
| 7  | Robert A. Conway, CPA (2 Letters)   |
| 8  | Council of Institutional Investors  |
| 9  | Crowe LLP   |
| 10   | Deloitte & Touche LLP (2 Letters)   |
| 11   | Ernst & Young LLP (2 Letters)   |
| 12   | Grant Thornton LLP (2 Letters)  |
| 13   | ICAEW   |
| 14   | Johnson Global Accountancy  |
| 15   | KPMG LLP  |
| 16   | Jon Lukomnik  |
| 17   | Mazars USA LLP  |
| 18   | Members of the IAG  |
| 19   | National Association of State Boards of Accountancy                             |
| 20   | Plante & Moran, PLLC; Plante Moran, P.C.  |
| 21   | PricewaterhouseCoopers LLP  |
| 22   | Public Citizen; Americans for Financial Reform Education Fund                   |
| 23   | Saul Roe  |

This list includes six comment letters that were submitted in connection with PCAOB Release No. 2022-006. Although those comment letters appear in a different docket on the PCAOB's website, they are included in this list because they contain perspectives that are relevant to the definition of "applicable professional and legal requirements" in this rulemaking.

| <b>Alphabetical List of Commenters on Proposed Rules in<br/>PCAOB Release No. 2023-001</b> |   |
|--|---|
| 24   | RSM US LLP (2 Letters)  |
| 25   | Thomas H. Spitters, CPA   |
| 26   | Texas Society of Certified Public Accountants   |
| 27   | U.S. Chamber of Commerce, Center for Capital Markets Competitiveness  |
| 28   | Rick C. Warne, PhD, CPA, CFE, Professor, University of San Diego; Robert M. Cornell, PhD, CMA, Professor Associate, University of Nevada, Las Vegas |
| 29   | Stephen Zeff, Keith Anderson Professor of Accounting, Rice University   |

**Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB’s *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards***

**May 24, 2023**

**Participating Committee Members**

Colleen M. Boland (University of Wisconsin – Milwaukee)  
Matthew S. Ege (Texas A&M University)  
Noel Harding (UNSW Sydney)  
Dana R. Hermanson (Chair, Kennesaw State University)  
Kyleen W. Prewett (University of Arkansas at Little Rock)  
Jonathan S. Pyzoha (Miami University)

**SUMMARY:** On March 28, 2023, the Public Company Accounting Oversight Board (the Board or PCAOB) issued a request for comment on its *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (PCAOB 2023). This commentary summarizes the participating committee members’ views on selected questions.

**Note:** The views expressed in this letter are those of the participating members of the Committee and do not reflect an official position of the American Accounting Association. The comments do not necessarily reflect the views of every member.

**Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB’s *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms***

**I. INTRODUCTION**

We are pleased to provide feedback on the PCAOB *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (PCAOB 2023). This commentary summarizes the participating committee members’ views on selected questions.<sup>1</sup>

The PCAOB has adopted a framework to conduct an economic analysis of all new and potential regulations. This framework has “four main elements: (1) the need for the rule, (2) the baseline for measuring the rule impacts, (3) the alternatives considered, and (4) the economic impacts of the rule (and alternatives), including the benefits and costs” (PCAOB 2014).

In this Release, the primary need for the rule is to consolidate/streamline and standardize the general principles and responsibilities of the auditor when conducting an audit (the “foundational standards”). These foundational standards have held “interim” status since the creation of the PCAOB, and more recently issued standards and others in development, or under review, may not conform to the interim standards (e.g., revised independence rules). In addition, the Release includes requirements that consider technology advancement and other changes in the auditing environment. While we commend the PCAOB for its modernizing efforts, as described in some of the responses below, we have some reservations regarding whether alternatives other than the proposal were adequately considered, and we offer some specific suggestions in certain areas.

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<sup>1</sup> We use or adapt certain language from the PCAOB (2023) proposal throughout our response.



## II. RESPONSES TO SELECTED QUESTIONS

**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?

The proposed standard speaks to auditors' foundational obligation to protect investors and notes that the audit primarily benefits investors. While we do not object to highlighting the central role of investors, we harbor reservations about the reference in paragraph .15 to auditors being mindful of their role in protecting investors. This encourages auditors to adopt an investor perspective when making judgments, and research highlights that this may be detrimental to audit quality. Altiero, Kang, and Peecher (2022) show that auditors prompted to take an investor perspective are less likely to assess a misstatement as material. Similarly, Dong, Wang, and Chien (2022) highlight that taking an investor perspective can decrease assessed risk of material misstatement.

We therefore encourage the PCAOB to consider redrafting paragraph .15 such that it speaks to the auditor's requirement to comply with applicable professional and legal requirements in conducting an audit *without* reference to auditors keeping in mind their role in protecting investors.

**Question 3:** Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?

With reference to the objectives of the auditor, we believe that the proposed standard does not effectively recognize auditor's objectives with regard to communication with the

company (i.e., internal communication with the client). Para .03c speaks of external communication, but the standard is silent on internal communication.

The Sarbanes-Oxley Act expanded and emphasized “the role of audit committees in ensuring the quality of reported financial results. This increased responsibility requires improved and expanded dialogue between audit committees and external auditors” (Cohen, Gaynor, Krishnamoorthy, and Wright 2007, 166). Current audit standards also require a myriad of internal communications by the external auditor. Furthermore, research supports the value of these internal communications which have been shown to reduce audit risk, increase audit quality, and improve audit committee oversight of the audit function (Cohen et al. 2007). We, therefore, encourage the PCAOB to consider expanding paragraph .03c to capture both external and internal communications.

**Question 4:** Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not?

In responding to this question, we refrain from commenting on the various independence principles, rules, and regulations that the provisions in the proposed standard give effect to. Rather, we focus on the clarity and comprehensiveness of the proposed standard.

With reference to auditor independence, we note that the related pronouncements supporting auditor independence have elements of both principles and rules, and that the research on independence rules versus independence principles suggests that a combination of both is likely to be the most effective approach (e.g., Herron and Gilbertson 2004; Church, Jenkins, and Stanley 2018). We believe, therefore, that the provisions of the proposed standard should give effect to both the principles and the rules of the related pronouncements, and to reinforce that

compliance with the rules and regulations is necessary, but not sufficient, to fulfill expectations for auditor independence.

As presently drafted, the proposed standard refers to the principles underlying independence in paragraph .04. However, paragraph .05 speaks to the rules that must be complied with and has the potential to be interpreted as meaning that compliance with such rules is sufficient. We encourage the PCAOB to re-phrase paragraph .05 to be clear that compliance with the rules and regulations of the various authorities, while necessary, is not sufficient to fulfill expectations as to independence. We make similar recommendations in our response to Question 5 relating to ethics.

**Question 5:** Are the proposed requirements related to ethics clear and comprehensive? If not, why not?

In responding to this question, we refrain from commenting on the various current and proposed ethical principles, rules, and regulations that the provisions in the proposed standard give effect to. Rather, we focus on the clarity and comprehensiveness of the proposed standard. With reference to auditor ethics, we note that the related pronouncements supporting an ethical disposition have elements of both principles and rules, and that the research on ethical principles versus ethical rules suggests that a combination of both is likely to be the most effective approach (e.g., Herron and Gilbertson 2004; Church et al. 2018). We believe, therefore, that the provisions of the proposed standard should give effect to both the principles and the rules of the related pronouncements, and to reinforce that compliance with the rules and regulations is necessary, but not sufficient, to fulfill ethical expectations.

As presently drafted, the proposed standard (paragraph .06) speaks to the requirement to comply with applicable ethical requirements, rules, and standards. There is no statement, however, of the broad ethical principles that guide auditor behaviors.

Current ET Section 102 and proposed EI 1000 *Integrity and Objectivity* (see PCAOB 2022a) refer to the broad principles of integrity and objectivity, and we encourage the PCAOB to include an additional paragraph (preceding paragraph .06) noting these broad principles (in a similar manner to that which is done for independence in paragraph .04). In addition, and consistent with our recommendations in response to Question 4, we further encourage the PCAOB to re-phrase paragraph .06 to be clear that compliance with the noted ethical requirements, rules, and standards, while necessary, is not sufficient to support the expected ethical disposition of auditors.

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

With reference to the research literature, we believe that the proposed requirements related to the auditor’s competence and the means by which auditors develop and maintain competence are comprehensive (e.g., Bonner and Lewis 1990; Tan and Libby 1997; Nelson and Tan 2005; Dierynck, Kadous, and Peters 2023). We do note, however, that the terms “knowledge,” “skill,” and “ability” are broad terms. While capturing the breadth of determinants of competence evidenced in the academic literature, the interpretation of these terms may be such that the particular tacit skills and individual dispositions supporting ability (e.g., confidence, courage, ethics) may not be immediately evident.

We believe that the proposed standard would be strengthened with a clearer recognition of professional competencies (AICPA 2018) and further elaboration in the note accompanying

paragraph .07 to reinforce the breadth of determinants of competence underlying knowledge, skill, and ability.

**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??

In responding to this question, we do not speak to the appropriateness of other pronouncements that the provisions in this standard reinforce. Rather, we speak to the clarity and completeness with which the requirements and related descriptions have been captured in the proposed standard.

We agree with the added emphasis in paragraph .09 on supervision and review of work performed. Research has long highlighted the importance of and variation in direction, supervision, and review of audit work (see Rich, Solomon, and Trotman (1997) and Nelson and Tan (2005) for reviews). However, we are concerned that the responsibilities of engagement partners are expressed as being a substitute for, rather than in addition to, the broad principles expressed for all auditors at the beginning of paragraph .09. We encourage the PCAOB to emphasize in paragraph .09 that for engagement partners, the additional activities are in addition to those noted for all auditors.

Moreover, we are concerned that such additional responsibilities are framed as being limited to engagement partners. Direction, supervision, and review are functions that are performed by auditors at different levels of experience, and research highlights that the effectiveness of such work can vary across hierarchical levels (e.g., Ramsay 1994; Harding and Trotman 1999). We encourage the PCAOB to extend the scope of the additional responsibilities

to include engagement partners *and* those auditors performing planning, supervision, and review tasks.

We further note the additional information provided in paragraph .11 on what the auditor's exercise of professional skepticism includes, and express our concern that these descriptions may not be sufficiently comprehensive. We feel that the descriptions in paragraph .11 focus on the evaluation of information with insufficient recognition of the exercise of professional skepticism in first obtaining that information. We note paragraph .10 of proposed QC1000 speaks to both obtaining and evaluating information and that research highlights the merits of focusing on both (e.g., Grenier 2017; Harding and Trotman 2017). We encourage the PCAOB to expand paragraph .11 to focus on both obtaining and evaluating information / evidence.

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

The proposed standard sets out to specify the engagement partner's due professional care responsibilities and the supervision and review of audit documentation and engagements. The standard builds off the existing requirements for engagement partner oversight, including reviewing the subordinates' work (AS 1010.03), being knowledgeable of the standards and client (AS 1015.06), and supervising and reviewing audit documentation (AS 1201.04-.05 and AS 2101.03). The new standards seek to clarify the existing standards, for example, by removing vague language regarding an engagement partner's responsibilities. We agree with the need for clear standards for engagement partner responsibilities because academic research finds substantial evidence that the engagement partner can negatively impact audit quality when they do not follow standards, such as by not promoting the need for professional skepticism, ethical

behaviors, continuing education, etc. (e.g., Dennis and Johnstone 2016; Gissel and Johnstone 2017; Harding and Trotman 2017; Koch and Salterio 2017; Messier and Schmidt 2018; Alberti, Bedard, Bik, and Vanstraelen 2020).

We believe that the amendments made to clarify the engagement partner requirements are generally reasonable and clear; however, as the noted in the Release, the standard could present unintended consequences. For example, we noted that the PCAOB's analysis lacks direct evidence suggesting that engagement partners do not understand their responsibilities or that the firms do not have adequate incentives to help them understand them (also see Question 18 below for evidence of fundamental auditing issues). Instead, the analysis asserts that the proposed language reinforces auditors' existing responsibilities at little cost. As we noted in our response to the proposed quality control standard, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (PCAOB 2022a), a key ingredient of audit quality is the auditing profession's ability to attract and retain talent. We continue to encourage the PCAOB to closely monitor trends in the firms' abilities to attract and retain talent and also to carefully monitor how the PCAOB's regulatory efforts and even public messaging may be affecting the attractiveness of the profession, especially in periods when auditors have many other options for employment. Overly burdensome regulation can create unintended consequences, including the potential for lower audit quality if people leave the profession or if it creates additional, unforeseen costs.

**Question 12:** Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?

The proposed amendments related to the audit documentation standards are designed to clarify audit documentation supervision and review (AS 1201, AS 1215, and AS 2101), as well

as to accelerate the timeline for completing audit documentation from 45 days to 14 days (AS 1215). As discussed above, we agree that proper supervision of audit documentation from the engagement partner is critical as it relates to ensuring higher audit quality. We further agree with the Release that high quality documentation is important and necessary for enhancing audit quality. However, we encourage the PCAOB to consider new, unintended costs of additional regulations. For example, academic studies find that there can be unintended consequences of additional regulation, including new costs associated with extensive audit documentation, auditors taking a “box-ticking” approach to extensive documentation requirements, and, in-turn, reduced auditor retention (Brivot, Roussy, and Mayer 2018; Boland, Daugherty, and Dickins 2019). Furthermore, some research exists suggesting that before the 2015 inspection cycle, auditors perceived that the PCAOB may be changing auditing standards *within* inspections, specifically regarding documentation (Boland, Brown, and Dickins 2020). We discuss the implications of the accelerated timeline from 45 days to 14 days in more detail within our responses below to Questions 13-15.

**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?

The analysis suggests the rationale for the acceleration is that inspections might begin earlier in the year, yet no alternatives other than accelerating the archival of workpapers are presented. The basis for the proposal is that many, although not all, auditors already comply with the acceleration and that technology exists to accomplish the acceleration. While not a perfect analogy, research investigating the Securities and Exchange Commission’s (SEC) acceleration of



reporting deadlines in the 2000s suggests that accelerating reporting deadlines more quickly than 15 days was costly to issuers regarding misstated financial statements (Bryant-Kutcher, Peng, and Weber 2013; Boland, Bronson, and Hogan 2018; Alsabah 2023). It is likely that the audit firms currently requiring more than 29 days (i.e., proposed 14-day requirement plus 15-day acceleration) would likely incur nontrivial compliance costs.

If some firms already comply with an accelerated timeline, we wonder why accelerating the archival timing is required and furthermore why 14 days is considered an ideal timeline. We encourage the PCAOB to consider alternatives to accelerating inspection scheduling timing for those not meeting the proposed 14-day deadline. We encourage the PCAOB to reconsider adding requirements to audit firms that provide little additional benefit. As noted above, a heavier regulatory hand may impact audit quality by affecting the profession's attractiveness. As noted below, it is also reasonable to believe the size of the firm and/or the complexity of an engagement could influence the ability to meet an accelerated timeline without some unintended consequences (e.g., increased chances for error and/or increased costs). Therefore, we encourage the PCAOB to reconsider the impact of internalizing these new costs and how it could create undue burden for some firms and engagement teams.

**Question 14:** Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?

As we indicated in Question 13, the limited research on accelerating reporting deadlines (e.g., audited financial statements) suggests that accelerations greater than 15 days may be problematic.

**Question 15:** Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required?

We are not able to opine on the feasibility of audit firm processes. Larger, more complex engagements could likely take longer. However, such engagements also are likely to have better systems and be more efficient.

**Question 18:** We request comment generally on the baseline for evaluating the economic impacts of the proposed standard. Are there additional factors we should consider? If so, what are they? Is there any evidence that auditors are failing to understand their obligations under today's standards, or that the standards set insufficiently robust expectations and obligations associated with the performance of an audit? If so, please explain.

Regarding evidence of auditors failing to understand their responsibilities under existing standards, we note that research suggests that audit failures often relate to basic areas of audit responsibility. For example, SEC enforcement actions against auditors in fraudulent financial reporting cases most commonly relate to the following deficiencies: "failure to gather sufficient competent audit evidence (73 percent of the cases), failure to exercise due professional care (67 percent), insufficient level of professional skepticism (60 percent), and failure to obtain adequate evidence related to management representations (54 percent)" (Beasley, Carcello, Hermanson,

and Neal 2013, 3). These all reflect foundational failures in the audit process. Contributors to such basic failures appear to be firm disincentives to be skeptical (Brazel, Jackson, Schaefer, and Stewart 2016; Brazel, Gimbar, Maksymov, and Schaefer 2019) and high auditor workloads (Persellin, Schmidt, Vandervelde, and Wilkins 2019). The current shortage of accounting graduates (AICPA 2022; Foley 2022) may exacerbate audit quality issues.

Further, the PCAOB inspection program reveals ongoing issues with audit deficiencies. For example, Prasad and Webster (2022) examine trends in PCAOB inspection reports from 2003 to 2017, with no widespread, obvious improvement in inspection results revealed. Likewise, a recent PCAOB (2022b) staff update highlights the lack of improvement in inspection results from 2019 to 2021, as well as areas of recurring deficiency and an increase in the number of audits with deficiencies in 2021.

Overall, audit deficiencies persist, despite SEC and PCAOB enforcement and many cycles of PCAOB inspections. While we recognize that the PCAOB inspection process may be becoming more rigorous over time, the fact remains that the number of audit deficiencies remains a concern. This suggests that it is important to further improve auditors' understanding of and compliance with foundational auditing principles.

**Question 19:** We request comment generally on the analysis provided above regarding the need for the proposal. Should we consider any additional arguments, academic studies, or sources related to the need for standard setting? If so, please specify.

With respect to the need for clarification of engagement partner review, we would highlight academic research that suggests that audit partners impact the audit. For example, Cameran, Campa, and Francis (2022, 753) find evidence of significant variation in audit outcomes across audit partners for U.K. listed companies and that audit partners are potentially

the “most important auditor-related characteristic in explaining audit quality.” Using Swedish data, Knechel, Vanstraelen, and Zerni (2015) find evidence suggesting that partners have persistent reporting styles. Using U.S. data, Francis, Golshan, and Hallman (2022, 947) find that “audit quality is lower when partners reside farther from their clients,” which is consistent with distance making it harder for partners to understand clients and oversee audit teams. Using data from Taiwan, Aobdia, Lin, and Petacchi (2015) find evidence that suggests variation in the quality of audit partners and that the market responds to audit partner quality. Overall, partners appear to matter for audit quality (see Lennox and Wu (2018) for a review of archival audit partner research).

**Question 20:** Are there additional potential benefits and costs that should be considered? If so, what are they? Please provide relevant data or other reference information.

Please refer to our responses to Questions 11, 12, and 13 above.

**Question 21:** We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?

Please refer to our responses to Questions 11, 12, and 13 above.

**Question 23:** What academic studies or data should the Board consider in evaluating the potential benefits and costs of the proposed requirements? Please provide citations and other reference information for such studies and data.

With respect to benefits of accelerating the document completion date, if the PCAOB will more quickly inspect auditors and, thus, more quickly release inspection reports, then there could be market benefits (also see our response to Question 13 above). For example, J. Krishnan, J. Krishnan, and H. Song (2017) find evidence consistent with improvements in audit quality after

PCAOB inspections, and DeFond and Lennox (2017) find internal control audits to improve in the wake of PCAOB inspections. Aobdia (2018) finds increases in auditor effort after PCAOB inspections find audit deficiencies. Also, Shroff (2020) finds evidence consistent with PCAOB inspections ultimately reducing financing frictions, as evidenced by company investment decisions after deficiency-free inspection reports. Of course, these benefits would be contingent on the PCAOB accelerating the public release of inspection reports and ensuring that the content of inspection reports is meaningful.

We appreciate the opportunity to comment on this proposed standard.

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**Via Electronic Submission**

June 29, 2023

Ms. Phoebe Brown  
Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803**Re: PCAOB Rulemaking Docket Matter No. 049  
Proposed Auditing Standard – General  
Responsibilities of the Auditor in Conducting an Audit  
and Proposed Amendments to PCAOB Standards**

Dear Ms. Brown,

This letter is submitted on behalf of the Law and Accounting Committee (the "Committee" or "we") of the Business Law Section of the American Bar Association (the "ABA"), 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 "Proposed Standard" or the "Release"). We appreciate the opportunity to comment on the Proposed Standard.

The views expressed herein have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association and should not be construed as representing policy of the Association. In addition, this letter does not represent the official position of the ABA Business Law Section, nor does it necessarily reflect the views of all members of the Committee, the drafting committee or their respective firms or clients.

We are pleased to offer our thoughts on the Release and thank the PCAOB for this opportunity. We generally support the initiative by the PCAOB to update its standards regarding the general responsibilities of auditors in conducting an audit. We recognize the important role that auditors play in the financial reporting system and concur with the PCAOB's views of the necessity for auditors to perform their responsibilities with utmost professionalism and independence. We believe, however, that certain aspects of the proposed standard and accompanying Release could pose certain problems and warrant further analysis and consideration. In this letter, we address four specific observations and offer suggestions that the PCAOB may wish to consider before adopting any final standard.

**1. Further revisions to Proposed AS 1000 might better reflect the principal aspects of an auditor's responsibilities.**

We are concerned that Proposed AS 1000 fails to adequately set forth what we consider to be certain of the principal aspects of an auditor's responsibilities. We note initially the importance of three areas of responsibility in connection with financial reporting: (a) the obligation of companies and their managements to design and implement effective systems of internal control over financial reporting, (b) the obligation of preparers to prepare financial statements in accordance with a specified set of accounting standards,<sup>1</sup> and (c) the obligation of auditors to audit those financial statements in accordance with a specified set of auditing standards and, if applicable, to audit internal control over financial reporting in accordance with a specified set of internal control standards. We believe that it is important that auditors perform their obligations in a manner that reflects the nature of their obligations.<sup>2</sup>

Our specific comments with respect to the Proposed Standard are as follows:

- Although one of the roles of the auditor is to protect investors as contemplated in Paragraph .01 of Proposed AS 1000, there are other considerations integral to the protection landscape. As discussed below in

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<sup>1</sup>The Securities and Exchange Commission ("SEC") has recognized the Financial Accounting Standards Board ("FASB") as a Designated Private-Sector Standard Setter. Sec. Exch. Comm'n, Release No. 33-8221, *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter* (April 25, 2003), <https://www.sec.gov/rules/policy/33-8221.htm>. The FASB was created following a study commissioned by the American Institute of Certified Public Accountants ("AICPA") on the establishment of accounting principles, often referred to as the Wheat Report. Am. Inst. Of Certified Pub. Accts., *Study on the Establishment of Accounting Principles* (Mar. 29, 1972), [https://www.fasb.org/page/ShowPdf?path=1.+Report+of+the+Study+on+Establishment+of+Accounting+Principles+-+Wheat+report.pdf&title=Report%20of%20the%20Study%20on%20Establishment%20of%20Accounting%20Principles,%20AICPA,%20March%201972%20\(%E2%80%9CWheat%20Report%E2%80%9D\)](https://www.fasb.org/page/ShowPdf?path=1.+Report+of+the+Study+on+Establishment+of+Accounting+Principles+-+Wheat+report.pdf&title=Report%20of%20the%20Study%20on%20Establishment%20of%20Accounting%20Principles,%20AICPA,%20March%201972%20(%E2%80%9CWheat%20Report%E2%80%9D)).

<sup>2</sup> We believe that a reasonable balancing of responsibilities is critical. An auditor should not, in our view, be induced to take overly aggressive positions during the course of an audit in order to mitigate the potential of its own liability, but should instead have the confidence that a professionally conducted audit in accordance with applicable auditing standards will not result in auditor liability.

Section 4, the Release omits certain key language in the existing standards and seems to focus heavily on management’s controls. Many may assert that accounting standards constitute the principal basis upon which users of financial statements rely. The entities responsible for the creation of accounting standards, including the Financial Accounting Standards Board (FASB), have sought to adopt decision-useful standards that provide the transparency that users require. Although the auditor plays a critical role in helping to assure that the financial statements have been prepared in accordance with applicable accounting standards, the auditor is not responsible for the accounting standards adopted by the company in conformity with specified accounting principles. Enhanced auditing standards should not be deemed to be a substitute for accounting standards that the PCAOB does not consider to be optimal.

- Paragraph .03 of Proposed AS 1000 relates to the objectives of the auditor. We substantively agree with this provision, but we believe it would be better stated to refer to the objectives of the audit rather than the auditor, insofar as it is the audit, and the procedures that are to be undertaken in connection with the audit, that define the purposes of the audit, and therefore the objectives.
  - With respect to the audit of internal control over financial reporting in clause (b) of Proposed AS 1000.03, we consider it notable that the paragraph does not reflect that the auditor’s role is to make a determination against the backdrop of an applicable standard, such as The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework. Similar to the manner in which the provisions relating to an audit of financial statements reference conformity with the applicable financial reporting framework, the audit of internal control over financial reporting should also refer to conformity with the applicable internal control framework. This is a significant point in that it will underscore that it is management’s responsibility to determine the applicable internal control standard that is to govern the internal control audit.
- Paragraph .15 of Proposed AS 1000 provides that the auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor is obligated to conduct an audit in accordance with applicable auditing standards. Whether the audit protects investors is extrinsic to this analysis. If an auditor believes a particular accounting standard should be more robust, it is not the role of the auditor to audit around its own self-created standards. Just as a baseball umpire makes calls based upon the rules of baseball, the auditor’s responsibility is to conduct audits in accordance with applicable accounting and internal control standards. Neither the baseball umpire nor the auditor is permitted to digress from the adopted rules just because he or she believes “protection” deserves something more. As such, it is unclear what the Board’s intended objective of

this proposed language is, what actions auditors would be required to take to satisfy this standard, and what consequences might flow from the text of the standard.

## **2. The Board should consider revising the reference to “relevant guidance” in Proposed AS 1000.**

Proposed AS 1000 paragraph .15 includes a note that “[t]he auditor should take into account relevant guidance applicable to the audit,” which is defined to include “PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the Board.” *Id.* at n.26. We agree that these materials can be helpful to auditors in applying PCAOB Auditing Standards. That said, we have some concerns with the inclusion of this language in the Proposed Standard.

As an initial matter, we suggest that the Board define what is included within “Board-issued guidance,” as this nomenclature is not clearly defined in existing standards or on the Board website. Additionally, we note that the Board may issue multiple documents, including concept and proposing releases, over a period of years setting out its intent in relation to proposed standards that are ultimately adopted. If it retains the note to Proposed AS 1000.15, it would be helpful for the PCAOB to codify and clearly delineate what parts of a document are considered “relevant guidance” in an accompanying release (*e.g.*, the Executive Summary, Background, Overview of Final Rules). In this regard, we are of the view that only documents accompanying the final standards should be authoritative, as previous discussions in proposals or concept releases may have been superseded as a result of cumulative changes made during the standard setting process, and requiring auditors to reconcile discussions between proposed and final standards could potentially give rise to conflicts that could result in reasonable auditors reaching different conclusions.

## **3. Clarifying the intended application in practice of the revised “competence” framework may be necessary to mitigate concerns with respect to staffing and potential liability.**

We have the following concerns about the discussion of competence in Section III.B.2.ii. of the Release and paragraphs .07-.08 of Proposed AS 1000: (a) the Proposed Standard may inhibit the development and training of younger audit staff; (b) the Proposed Standard may impose unclear requirements for competence and expertise on audit staff members; and (c) the Proposed Standard may require audit staff members to have an unreasonable level of legal expertise for non-lawyers.

### **a. Development and Training of Junior Audit Staff**

The accounting profession is facing staffing challenges.<sup>3</sup> With the critical function accountants serve in the capital markets, it is critical for the profession to attract and retain new talent at the entry level. The auditing practice has traditionally

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<sup>3</sup> See Neihaus, *Fixing the Crisis in Accounting*, CPA Journal (Nov. 2022), available at <https://www.cpajournal.com/2022/11/25/fixing-the-crisis-in-accounting/>.

relied on a tiered staffing model with junior, less experienced auditors performing much of the detailed work in the audit. It also has relied upon a significant amount of on-the-job training, which is desirable given the hands-on nature of the work.

Developing the talent requires giving junior professionals challenging work that provides opportunities for growth. The Proposed Standard could be interpreted to limit the ability to assign such work to junior talent because they may lack significant experience. The example at page 22 of the Release (under due professional care) of the less experienced staff performing inventory counts is helpful in suggesting less experience may be necessary for accountants on simpler audit functions, but it may also imply that junior staff persons can only perform the most basic functions. We recommend adding clarifying language to the adopting release to state that the competence required for an audit may be achieved through a combination of a staff member's individual competence and the supervisor's oversight and review of the audit work.

### **b. Unclear Competence and Expertise Requirements**

The Proposed Standard would replace the term “adequate technical training and proficiency” included in the current AS 1010 with the term “competence.” Proposed AS 1000, paragraph .07 also adds that competence includes “expertise” in SEC rules and regulations, a term that is not used in AS 1010 of the current standard. The Release and Proposed AS 1000 include a general discussion of competence. The Release is not clear as to whether the changes are intended to impose a higher standard of competence or proficiency beyond what is expected in current practice. If it is the Board's intent not to impose a higher standard, we recommend that the adopting release include a statement to that effect and to state that the Board intends only to clarify and modernize the language. If the Board intends to impose a higher standard than currently exists for competence in auditing, we recommend that, as part of the rulemaking process, the Board clearly state (i) such intent, (ii) the perceived problems which require such a higher standard, (iii) a clearer description of the new requirements imposed by the Proposed Standard, and (iv) the Board's rationale for the change.

We believe it is important to have clarity on these points to guide audit firms on what is expected in practice and also to avoid potentially unintended and unwarranted liability for audit firms.

### **c. Requirements for Legal Expertise**

The Release and the text of the Proposed Standard include several references to “legal requirements” and a cross reference to the definition of “applicable professional and legal requirements.” That definition<sup>4</sup> includes several specific items and, at the end

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<sup>4</sup> The Release at page 17 states, “The term “applicable professional and legal requirements,” as defined in the recently proposed quality control standard (“proposed QC 1000”), includes: (i) professional standards, as defined in PCAOB Rule 1001(p)(vi); (ii) rules of the PCAOB that are not professional standards; and (iii) to the extent related to the obligations and responsibilities of accountants or auditors

of the definition, “other legal requirements.” In addition, paragraph .07 of Proposed AS 1000 includes a requirement that the auditor should have expertise in SEC rules and regulations. We have no argument with the general intent of the standard that auditors should conduct their audit in accordance with such legal requirements. However, the Proposed Standard could have the effect of imposing upon individual auditors an inappropriate duty to have legal expertise and to apply a lawyer’s expertise in identifying legal issues. We recommend adding clarifying language in the release to state that although the auditor is expected to comply with applicable legal requirements, the auditor is not expected to have the expertise of a lawyer or to express opinions on matters of law.

#### **4. Referring to SEC Rule 12b-20 in Proposed AS 2810 may cause confusion and present practical difficulties.**

In conjunction with the Proposed Standard, the Board proposes to amend AS 2810, *Evaluating Audit Results*.<sup>5</sup> AS 2810, paragraph .30 currently requires that auditors “evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.” The proposed amended standard enumerates various matters that the auditor should evaluate pursuant to the standard.<sup>6</sup> In addition, the proposed amended standard includes a footnote following the statement of the auditor’s obligation in paragraph .30. The footnote refers to the SEC’s Rule 12b-20 under the Securities Exchange Act (“Exchange Act”) “for additional considerations regarding the fairness of presentation of financial statements.”<sup>7</sup> For the reasons set forth below, we are concerned about the inclusion of this reference in the amended auditing standards and the implicit incorporation of legal standards into auditing standards that this reference represents.

First, we question the relevance of Rule 12b-20 to audits or auditing standards. Rule 12b-20 is an SEC disclosure rule governing company disclosures in Exchange Act registration statements and required reports.<sup>8</sup> The rule provides: “In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the

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or to the conduct of engagements, rules of the SEC, other provisions of U.S. federal securities law, and other applicable statutory, regulatory, and other legal requirements.”

<sup>5</sup> The Board also proposes to delete in its entirety AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*.

<sup>6</sup> See Proposed AS 2810, ¶ .30A, Release at p. A2-2. AS 2810, ¶ .31 currently provides that the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable reporting framework and identifies matters that the auditor should consider in that regard. The Board does not propose to amend AS 2810, ¶ .31, but it does add more specific matters to consider in new paragraph .30A. At the same time, the Board would delete AS 2815’s current discussion of specific factors upon which the auditor should base its judgement regarding fair presentation. Release at p. A2-3 to A2-4.

<sup>7</sup> Proposed AS 2810, ¶ .30n.17A, Release at p. A2-2.

<sup>8</sup> See Exchange Act Rule 12b-1, 17 C.F.R. § 240.12b-1 (Regulation 12B “governs all registration statements pursuant to sections 12(b) and 12(g) of the [Securities Exchange] Act and all reports filed pursuant to sections 13 and 15(d) of the Act . . .”).

required statements, in the light of the circumstances under which they are made not misleading.” Along with other rules, Rule 12b-20 establishes legal requirements for company disclosures under the Securities Exchange Act and related regulations. Rule 12b-20 reflects the fundamental policy of the securities laws that disclosure must be truthful and not misleading.<sup>9</sup> While Rule 12b-20’s general language encompasses information in financial statements (as well as all other information in the filing) in an Exchange Act filing, nothing in the rule regulates the substance of the information included in financial statements, much less what constitutes “fair presentation” of such financial statements for purposes of an auditor’s opinion on those financial statements. It is therefore difficult to see what “additional considerations” Rule 12b-20 provides with respect to an auditor’s consideration of the fairness of presentation of the financial statements.

In addition, the Board’s rationale for including the reference to Rule 12b-20 in Proposed AS 2810 is somewhat difficult to follow. It seems from the Release that the Board wishes to analogize to Rule 12b-20 to support the proposition that “the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework.”<sup>10</sup> Citing Rule 12b-20, the Board states that the securities laws “prohibit financial statements and company disclosures from being materially misleading” and characterizes “presented fairly” as a “parallel concept.”<sup>11</sup> It seems a stretch to go from a legal standard for securities disclosure by companies to setting parameters for an auditor’s evaluation of the fairness of an issuer’s presentation of its financial position, results of operations, and cash flows.<sup>12</sup>

Secondly, and perhaps more importantly, we are concerned about the practical implications of the reference to Rule 12b-20 in the “present fairly” standard. As noted, Proposed AS 2810.30 n.17A refers to Rule 12b-20 as a source of “additional considerations regarding the fairness of presentation of financial statements.” The standard provides no guidance as to what these “additional considerations” might be or how the auditor should evaluate them. Absent any other guidance, the reference to Rule 12b-20 might be construed to require the auditor to evaluate whether the financial

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<sup>9</sup> See Exchange Act Rule 10b-5(b), 17 C.F.R. § 10b-5; Securities Exchange Act § 18(a), 15 U.S.C. § 78r(a).

<sup>10</sup> Release at p. 30.

<sup>11</sup> *Id.*

<sup>12</sup> We do not take a position on whether auditors should have an obligation to “go beyond” compliance with the applicable financial reporting framework in its evaluation of the fairness of presentation if the applicable standards provide clear and workable guidance to auditors on how to do so. However, we do question whether this obligation currently exists “under extant PCAOB standards,” as the Board suggests. Current AS 2815, ¶ .03 provides, “The independent auditor’s judgment concerning the ‘fairness’ of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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.” This statement seems contrary to the Board’s position in the Release. The Release does not attempt to reconcile its current position with this statement. Nor does it cite any authority—other than the analogy to Rule 12b-20—to support its characterization of “extant PCAOB standards.” Instead, the Board, without discussion, deletes AS 2815, including ¶ .03, from the auditing standards.

statements complied with Rule 12b-20, *i.e.*, whether the statements did not omit material information necessary to make the financial statements not misleading. In this context, the auditor would have to consider whether there is material information, not required by the accounting standards themselves, that the company and its management should have included in the financial statements but did not. If this is the case, we believe it would constitute a substantial expansion of the auditor's responsibilities; if that is the Board's intention, it should be spelled out more clearly and justified explicitly.

We believe that there would be substantial problems with such a standard. It would require the auditor to prove (or, more precisely, obtain reasonable assurance about) a negative—that there is no material information that needs to be added to the financial statements to make them not misleading. How the auditor is to obtain the information necessary to prove or disprove this assertion is not clear. The standard might also require the auditor to make what are primarily legal judgments about what information needs to be added to the financial statements and to substitute the auditor's judgment for that of management and its counsel. Yet the auditor's ability to make such determinations will be inherently limited by its access to information. As the Board's current auditing standards recognize, "The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of these matters and internal control is limited to that acquired through the audit."<sup>13</sup> In addition to these concerns, the proposed standard likely would lead to increased costs – direct and indirect – as auditors make inquiries of companies in seeking to prove the negative.

Another potential difficulty is obtaining audit evidence to support the auditor's determination regarding the issuer's compliance with Rule 12b-20. Yet such evidence would be required by the Proposed Standard in order for the auditor to issue an unqualified opinion.<sup>14</sup> Again, it is unclear what (if any) audit evidence would suffice to support the negative proposition that there is no material information that needs to be added to the financial statements to make them not misleading.

Finally, we are concerned that the reference to Rule 12b-20 may contribute to an "expectations gap." Investors and other users might assume, based on the reference, that the auditor's expression of a "fairly presents" opinion means that the auditor has determined that no material information has been omitted from the financial statements. Audit committees might also operate under this expectation. If the Board

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<sup>13</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*, ¶ .03. Interestingly, this language is not included in the Proposed Standard.

<sup>14</sup> See Proposed AS 1000, ¶ .18.a, (auditor should express unqualified opinion only when the auditor "has obtained sufficient appropriate audit evidence to conclude that . . . the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework"), Release at p. A1-7. A footnote to this paragraph cites Proposed AS 2810, ¶¶ .30-.31, which includes the footnote reference to Rule 12b-20. See *id.* at n.31.



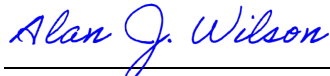
does not mean to impose on the auditor such a broad obligation to evaluate the completeness of a company's disclosures, it should make that clear.

In sum, we do not believe that the reference to Rule 12b-20 materially enhances proposed amended AS 2810. To the contrary, we believe that incorporating Rule 12b-20 into the auditing standards regarding fair presentation of financial statements is likely to create confusion about the auditor's responsibilities with respect to compliance with that rule and about the scope and substance of the auditor's opinion that the financial statements "are presented fairly, in all material respects, in conformity with the applicable financial reporting framework." Accordingly, we recommend that the Board omit any such reference to Rule 12b-20. If the Board does decide to include the reference, it should be accompanied by a disclaimer that the reference does not create any substantive audit requirements over and above those expressly outlined in Proposed AS 2810. Moreover, any attempt to impose a substantive requirement on the auditors that they consider whether in fact the financial statements have omitted material information necessary to make them not misleading must be accompanied by much more detailed discussion of how the auditors must make and document such a finding.

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We appreciate the opportunity to participate in this process and respectfully request that the Board consider our observations and suggestions. We are available to meet and discuss these comments or any questions that the Board and its staff may have, which may be directed to the individuals listed below.

Very truly yours,




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Alan J. Wilson  
Chair of the Law and Accounting Committee

Drafting Committee:

Robert Buckholz  
Bob Dow  
Daniel L. Goelzer  
Jeffrey Rubin  
Michael Scanlon  
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May 30, 2023

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, DC 20006-2803  
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Re: PCAOB Release No. 2023-001: PCAOB Rulemaking Docket Matter No. 049, Proposed Auditing Standard – *General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCOAB Standards*

Secretary Brown and PCAOB Board Members:

AuditClub is writing to share our views on the proposed auditing standard regarding the general responsibilities of the auditor and other amendments to PCOAB standards.

At AuditClub, we are committed to transforming how public accounting firms deliver audit and assurance services. We are backed by a licensed accountancy corporation based in the United States and registered with the PCAOB. Through our unique subscription access model, AuditClub provides on-demand AICPA and PCAOB audit and assurance support to top 10, regional and local CPA firms throughout the United States. Our solutions include support for audit and assurance, quality management, regulatory matters, training, and transformation.

As a company, it is our mission to make the accounting and auditing profession better. With our week-to-week subscription model, CPA firms can gain access to our entire team of highly experienced Chief Auditors and dedicated Crew members to assist in providing high quality audit and assurance services. It is our goal that this will provide a more positive working experience for our members and the profession overall. With this in mind, we kindly ask you to fully consider our comments on certain areas related to the proposed standard and other proposed amendments.

#### I. Core Auditor Principles and Responsibilities

We understand the main purpose of the proposed standard, AS 1000, is to modernize the professional standards that were first adopted on an interim basis back in 2003 to reinforce the essential role auditors play in protecting investors in the capital markets. We further believe it is the PCAOB's intention to reemphasize the foundational principles and responsibilities of the



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auditor considering today's current financial environment to further promote high-quality auditing and reduce the number of audit deficiencies identified in PCAOB inspections.

We agree that the principles around reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment are important to the foundation of a quality audit, which is fundamental in our obligation to protect investors. We are supportive of the proposed changes that seek to modernize and streamline these core principles and responsibilities. However, if it is truly the PCAOB's intent to promote the protection of investors through high quality audits, there are other underlying issues that need to be addressed that are not necessarily related to the auditing standards itself.

### *Time & Resource Constraints*

Specifically, time and resource constraints are negatively impacting an auditor's ability to appropriately exercise the aforementioned core principles. It is our belief that most auditors have a general understanding of their roles and responsibilities via other resources (e.g., CPA exam, Ethics exam, other continuing professional education requirements, etc.), but often may not have the capacity to execute them appropriately. Given the tight regulatory timelines, auditors find themselves in a position to "just get it done" rather than exercising the due professional care and skepticism that is critical to a quality audit. We have further discussed these issues and potential solutions in the sections that follow.

## II. Role of the Engagement Partner

We acknowledge the importance of the active role of the engagement partner throughout the phases of an audit and proactively emphasize this point to the partners of the member firms that we provide audit and assurance support. We commend the PCAOB for reinforcing this point around what is expected of the engagement partner in the planning, supervising, reviewing, and documenting of engagement activities within the proposed amendment. However, like the paragraph above, there are other underlying issues related to the roles of engagement partners that are not specifically related to the auditing standards.

### *Business Models*

Specifically, the traditional business model is contributing to the resource constraint challenges mentioned. It is our view that the average partner-to-staff compensation ratio is outlandish in relation to the number of hours staff work, particularly within "busy season." The current partner mentality that "I paid my dues to get where I am" means some partners are unwilling to take a pay cut to invest in the well-being of their employees and to fairly compensate them based on the number of hours worked. Unfortunately, the reality is that many partners push their staff to



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achieve billable hour targets which leads to overworked staff, increased overtime hours, and discouragement when employees exceed budgeted hours.

### *Collaboration with the AICPA*

The AICPA recently released their Pipeline Acceleration Plan to address the talent shortage of CPAs. One of the root causes to be addressed is current firm culture and the business model challenge. We encourage the PCAOB to actively join the AICPA and to be an advocate for change by offering suggestions for how CPA firms might reassess their business models and strategy to cultivate an environment meant to attract, retain, and develop staff to ensure the overall success of the profession. This, we believe, should lead to better audit quality and greater confidence from investors in the capital markets.

### III. Audit Documentation Standard Amendment

We disagree with the proposal to shorten the time to assemble final audit documentation from no more than 45 days to 14 days. Although it is the Board's intention to modernize the audit documentation standard given the advancements in audit software and technology, it is not universally true that it takes accounting firms significantly less time to compile a complete set of audit documentation from when the original audit documentation standard was released in 2004.

### *Complexity and Human Capital Challenges*

In the past twenty years, the financial accounting, reporting, and auditing landscape has only become more and more complex. There have been several significant Accounting Standard Updates issued by the FASB (e.g., ASC 606, ASC 842, ASC 326, etc.), along with new standards issued by the PCAOB, on top of the introduction of other new and complex matters in the financial marketplace (e.g., crypto currency, SPACs, offshoring, etc.) that consume a significant amount of an auditor's time. Furthermore, as mentioned above, the current talent crisis the profession is facing is causing a shortage in qualified resources to not only complete audit procedures within the already compressed Form 10-K filing deadlines, but will present even greater challenges to complete the audit documentation in a shortened timeline.

The regional and local accounting firms that AuditClub often supports are already struggling with human capital issues and compressing timelines even further will just continue to worsen the situation. This endless pattern of added regulation and compressed timelines, when combined with the known shortage of audit professionals, will likely lead to more audit quality issues and an unintended consequence of the Board's proposal. It will also further contribute to the talent shortage as current professionals, who are already reportedly working on average over 72 hours a week during busy season (based on study cited within the Board's proposal on A Firm's System



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of Quality Control), will now have more stringent deadlines after report release date to complete audit documentation. The Board should reconsider its proposal on shortening the audit documentation deadline and should even advocate to the SEC for a reconsideration of filing deadlines given the increased complexities in the capital markets as well as the shortage of qualified professionals.

### *The PCAOB Inspection and Remediation Process*

Lastly, another relevant factor to discuss that appears to be contributing to the time and resource constraints of accounting firms is the PCAOB's inspection process. At AuditClub, we offer CPA firms support on regulatory matters including assistance in responding to PCAOB inspection comments and remediation efforts. During our support of these firms, we have observed firsthand that the overall inspection process is disruptive to their day-to-day business and difficult to manage, especially for smaller firms who already lack resources. As an example, there have been instances where firms had received initial comment forms from an inspection that had occurred months prior and yet were only given a week to provide responses. In other instances, we have seen follow-up questions received from inspection teams on remediation responses that were provided more than a year after the inspection had originally occurred, and yet again firms were required to provide responses within a week. In some cases, certain members of the engagement team who were involved in the inspection process were no longer employed with the firm, putting more pressure on current resources to accommodate the gap. Such long and unknown gaps in communications between firms and the inspection process creates a "drop what you're doing and all hands-on deck" atmosphere for firms, who are already scrambling to keep up with business as usual. This can certainly be seen as a contributing factor to the long hours and extended overtime our profession has been experiencing. We would encourage the PCAOB to revisit the overall inspection process and timelines and look to provide more transparency and structure to the remediation process, while being sensitive to the burdens it creates. This will allow firms to properly allocate resources to better manage working hours and ultimately help to make the profession better.

### *Summary*

At AuditClub, we specifically focus on our human capital experience as part of our mission to make the accounting and auditing profession better. We offer a year-round 4-day work week with a maximum of 36 hours per week. We believe this allows our employees to operate at their peak levels in order to support our member firms to the best of their ability with the highest quality in mind. We have consciously limited our capacity to make this available to our employees, which undoubtedly has reduced our top-line revenue potential. However, at AuditClub we value our purpose over profits.



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In conclusion, AuditClub appreciates the opportunity to comment on Matter No. 049 related to the PCAOB proposal to modernize standards on core auditing principles and responsibilities. Within the proposed standard, the PCAOB states:

*Through this standard-setting project, we are reaffirming the general principles and responsibilities to ensure that the foundation continues to be solid and appropriate for maintaining high-quality audits. These principles and responsibilities, together with modernized auditing standards, should equip the auditor with better tools to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.*

We believe that the proposed standard, while well-intentioned, misses a greater opportunity to effect change around more critical issues underlying the profession. We thank the PCAOB for the opportunity to comment and would be pleased to discuss with you further if needed.

Sincerely,

*AuditClub*

AuditClub



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330 North Wabash, Suite 3200  
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May 30, 2023

Via E-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

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

**Re: PCAOB Rulemaking Docket Matter No. 049**

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB” or the “Board”) Proposed Auditing Standard - *General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (the “Release”). We are supportive of the Board’s overall objectives of modernizing and streamlining the existing foundational standards that establish the general principles and responsibilities of the auditor when conducting an audit in accordance with the standards of the PCAOB.

We believe that general principles and responsibilities addressed by the existing foundational standards relating to the concepts of reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment to be appropriate general principles for audits performed under PCAOB standards, and that these principles continue to provide an appropriate foundation for the performance of audits in accordance with the PCAOB standards.

Our comments below align with those points noted in the Executive Summary on page 4 of the Release, as well as other matters noted in our consideration of the proposal.

### **Combination of General Principles and Responsibilities**

We find the Board’s approach of combining the general principles and responsibilities under the extant standards<sup>1</sup> into one standard (proposed AS 1000) to be reasonable; however, we believe that there are consequences, intended or otherwise, resulting from the amendments in the Release that might impact the current remit within the industry and have other deleterious effects.

Specifically:

- The proposed amendments may have an unintended consequence of expanding rather than diminishing the audit expectation gap. For example:

<sup>1</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*



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- The note to paragraph .07 indicates that expertise in SEC rules and regulations is necessary to exhibit competence. Proposed QC 1000.47(e) states that “the audit partner obtain and maintain the competence to fulfill their respective assigned engagement roles, including an understanding of the following: e) The industry in which the client operates and its relevant characteristics (e.g., applicable standards, industry-specific risks, and industry-specific estimates)”. Both “expertise” and “obtaining an understanding” are terms that are open to interpretation and do not necessarily equate. In presenting auditors as experts in SEC rules and regulations, it may be interpreted that we are able to and should make legal determinations in relation to those rules and regulations.
- Using the phrase “related to the audit” in place of “in the planning and performance of the audit and preparation of the report” (para. .09) and “audit evidence” (para. 10) respectively does not appear to provide clarity. It can be interpreted as broadening these activities and, in the case of paragraph .10, may render the action increasingly difficult to perform.

Paragraph 10 states we are to maintain an attitude that includes a “critical assessment of information related to the audit”. This can be viewed as including aspects of the audit outside of where an applicable framework would provide the criteria to assess against as we would do with audit evidence.

- Certain guidance, such as releases accompanying the standards and rules, may be perceived as being elevated in the hierarchy of authoritative guidance. There should be a clear hierarchy of authoritativeness amongst those materials, contrasted with the final standards and rules of the board as released. Additionally, the proposed AS 1001.15 states that auditors should “take into account relevant guidance”. This phrase may leave auditors confused as to the level of authority that is placed on the various documents and the associated level of documentation needed to evidence in the workpapers.

Footnote 26 to the proposed 1001.15 defines relevant guidance to include PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the board. An analogy can be drawn to Q2 of PCAOB Staff Questions & Answers, *References to Authoritative Accounting Guidance in PCAOB Standards* which, in response to the FASB Codification, notes an acknowledgement by FASB staff that certain wording changes might theoretically lead an issuer to conclude differently. If auditor responsibilities with regards to literature mentioned in paragraph 1001.15 changes, or is perceived to change, this could lead to over-reliance on other guidance provided by the PCAOB which could, theoretically, lead an auditor to conclude differently.

Extant AS 1001.01 states that we perform our audit in accordance with the standards of the PCAOB. Additionally, extant PCAOB Rules of the Board Section





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1. General Provisions Rule 1001 (a)(viii) (and Rule 1001(p)(vi) further articulates) defines, when used in the Rules, unless context otherwise requires, “auditing and related professional practice standards” as meaning “the auditing standards, related attestation standards, quality control standards, ethical standards, and independence standards (including any rules implementing Title II of the Act), and any other professional standards, that are established or adopted by the Board under Section 103 of the Act.”

There may be a perceived need to increase documentation at the engagement team level as teams perceive a need to explicitly document how this other relevant guidance is addressed. Whereas currently, these pieces of guidance would have informed the auditor’s decision process and might be reflected in documentation but not explicitly addressed in the documentation.

**Engagement partner’s responsibility to exercise due professional care related to supervision and review of the audit**

Proposed amendment to AS 1201.05 Note 2 states that the engagement partner must review “sufficient documentation to determine that (i) the engagement was performed as planned...”. As planning of an audit is a broad activity, this may be construed as expanding the partner review requirements beyond review of documentation of “significant findings or issues”. AS 1215.12(c) defines “significant findings or issues” in relation to planning activities as “Results of auditing procedures that indicate a need for significant modification of planned auditing procedures”. This requirement is more limited than the proposed change to AS 1201.05.

**Acceleration of the Documentation Completion Date**

We believe that the acceleration of the documentation completion date could increase audit quality overall. Although this accelerated period may allow for the Board to begin the inspection process sooner after completion of an audit, issuers may have various filing deadlines, or require extensions that would necessitate the full attention of professionals on those engagements. Consideration may be needed for these situations, so inspections are not running concurrently.

**Evaluation of Whether the Financial Statements are “Presented Fairly”**

SEC Rule 12b-20 17, CFR § 240.12b-20 indicates an issuer’s responsibility to disclose “such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading”. The explicit inclusion of it in 2810.30 FN 17a may be interpreted as applying to the auditor. This, coupled with the previously mentioned note to paragraph .07 which indicates that expertise in SEC rules and regulations are required attributes, may provide a reader with the sense that auditors are able to and should provide some sort of legal determination.



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This would conflict with AS 2410.05 which, in the case of fraud, states that auditors do not make legal determinations.

### **Effective Date**

We are concerned that the proposed effective date for compliance with the proposed standard and related amendments by June 30 in the year after they are approved by the SEC may not provide sufficient time for audit firms to implement the amended standards. We believe that there are certain aspects of the proposed standard and related amendments that will require additional time, beyond the proposed effective date, to design and implement necessary changes to firm methodologies and policies, particularly within global network firms and other firms with significant cross-border audits.

Consistent with the Board's other recent standards-setting activities, and assuming the SEC approves the final standard before the end of calendar year 2023, we recommend that the effective date of the final standard should be no earlier than for audits of financial statements for fiscal years ending on or after December 15, 2024.

\* \* \* \*

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Ashwin Chandran at 214-689-5667 ([achandran@bdo.com](mailto:achandran@bdo.com)), or James D'Arcangelo at 203-905-6234 ([jdarcangelo@bdo.com](mailto:jdarcangelo@bdo.com)).

Very truly yours,

*BDO USA, LLP*

BDO USA, LLP



May 30, 2023

By email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

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

**Re: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards; PCAOB Rulemaking Docket Matter No. 049**

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's (PCAOB or the Board) proposed new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (proposed standard or proposed AS 1000) and other proposed amendments to PCAOB Standards. We support the objectives of the proposal as set forth by the Board to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand and apply.

**General Observations**

We support the PCAOB's mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The principal areas of focus in the Sarbanes-Oxley Act of 2002 were the following four key areas: 1) independent oversight of public company audits by the PCAOB, 2) audit committee responsibility for hiring, firing, and overseeing the external auditor, including fees and independence, 3) enhanced transparency and executive accountability, including the requirement for the CEO and CFO to certify financial reports quarterly and internal control over financial



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reporting (ICFR) annually and the independent external auditor attestation on ICFR (based on size of the issuer, as defined), and 4) enhanced auditor independence rules (as overseen and approved by the independent audit committee).

These provisions, which have proved to be durable, protect investors. The auditing profession is committed to its role among the various stakeholders in the US financial reporting ecosystem to protect investors. The provisions of the Sarbanes-Oxley Act reflect a recognition that the quality of financial reporting is not solely the responsibility of auditors. Rather, it takes company management, audit committees, auditors, and regulators working in concert to foster a system that supports both high-quality financial reporting and audits.

As the Board acknowledges in the release text accompanying the proposed standard, "...investors form expectations from a number of sources, including potentially the language of the standards themselves..."<sup>1</sup> As such, it is in the interest of investors and other stakeholders that the auditing standards are clear regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor's report, including the potential limitations.

The Board states on Page 50 of the release text, "The proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards. Thus, no unintended consequences were identified apart from the benefits and costs discussed above."<sup>2</sup> Notwithstanding this assertion, in our view, certain elements of the Board's proposal would expand the auditor's responsibilities and will create confusion for stakeholders, including investors and other users of auditors' reports regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor's report. These consequences – intended or not – have not been contemplated in the Board's economic analysis.

### **Key Observations**

- The proposed standard and related amendments will result in more significant changes than what the Board describes within the release text. Certain aspects of the proposed AS 1000 go beyond current standards and expand the auditor's responsibilities. As such, it does not appear the economic impact of such changes has been contemplated within the Board's economic analysis.
- We agree with the auditor's fundamental role to serve the public interest within the financial reporting ecosystem and enhance the confidence and trust of investors in financial reporting. However, the auditor's role should not be confused with a legal duty owed to investors.
- It is not appropriate for the auditor to be required to make an evaluation of fairness that goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. As stated in extant AS 2815.03, "The independent auditor's judgment concerning the "fairness" of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that

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<sup>1</sup> Proposed AS 1000 release text, Page 42.

<sup>2</sup> Proposed AS 1000 release text, Page 50.



framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements.”

- Certain proposed changes, such as those related to the principles of due professional care, reasonable assurance, and professional judgment, and the distinction between the responsibilities of management and the auditor, may lead to misunderstanding about the auditor’s role and inject confusion into the established legal landscape associated with the role of the auditor. This is not in investors’ best interests and will introduce needless uncertainty for auditors and other stakeholders.
- The proposed language used to describe the requirements related to the auditor’s competence may imply that the competence required of an auditor to conduct an audit cannot be achieved through the composition of an engagement team with appropriate collective knowledge, skill and ability. Additionally, such language may imply an inappropriate expectation of expertise in areas beyond accounting and auditing.
- Certain of the proposed requirements – specifically those related to the proposed definitions of professional skepticism and the proposed requirement for the auditor to take into account relevant guidance such as releases accompanying the standards, amendments, and rules of the PCAOB - are overly broad and do not provide the auditor with sufficient detail, nor a sufficient framework to allow them to effectively and consistently comply with the proposed requirements.
- We support the proposal to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, subject to sufficient time to implement such a proposal.

See below for responses to specific questions outlined in the release with further details and our recommendations related to these observations.

### **Specific Feedback**

*Q1. 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 believe that reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment are appropriate general principles for audits performed under PCAOB standards, and that these principles and related responsibilities provide a foundation for the proper performance of the audit in accordance with the PCAOB standards.

However, the language in proposed AS 1000.01 may lead to misunderstanding about the auditor’s responsibilities. We are concerned the proposed language will inject confusion into the established legal landscape in this area. We agree with the auditor’s fundamental role to serve the public interest within



the financial reporting ecosystem and enhance the confidence and trust of investors in financial reporting. As noted in the release text, “the independent public accountant... owes ultimate allegiance to the corporation’s creditors, stockholders, as well as [the] independent public.”<sup>3</sup> However, this “allegiance” should not be confused with a legal duty owed to investors.

As such, we recommend the following revisions to paragraph .01 of proposed AS 1000 (language to be deleted is ~~struck through~~; language to be added is underlined) as follows:

.01 Auditors have a fundamental obligation to ~~protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports, and that obligation governs the auditor’s~~ conduct an audit in accordance with work under the standards of the PCAOB. ~~An audit primarily benefits investors, who rely on the audit to~~ in order to provide an objective and independent opinion on whether the company’s financial statements are presented fairly, in all material respects, and, if applicable, on the effectiveness of the company’s internal control over financial reporting. ~~An audit properly conducted~~ in accordance with PCAOB standards and the related auditor’s report are intended to enhance the confidence of investors and other market participants in the company’s financial statements and, if applicable, internal control over financial reporting.

*Q6. Are the proposed requirements related to the auditor’s competence clear and comprehensive? If not, why not?*

With respect to the competence requirements described in .07 and .08 of proposed AS 1000, we believe it is appropriate that such requirements are applicable to the engagement team collectively, including specialists used to assist the auditor. This is consistent with AS 1010, which refers to the audit being performed by “a person or persons having adequate technical training and proficiency as an auditor.” (*emphasis added*).

We appreciate the importance of the engagement team collectively having a sufficient understanding of the industry in which the company being audited operates. While this understanding is typically the result of the engagement partner having industry knowledge and experience, there could be circumstances in which the engagement partner relies on other senior members of the engagement team or other individuals within the firm for industry support. For example, some companies may operate in multiple or emerging industries, in which case the engagement team could be composed of a mix of people with knowledge of the different relevant industries. The “Note” in proposed AS 1000.07,<sup>4</sup> when considered in combination with the example in the release text that states, “For example, an engagement partner with significant experience in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee the audit of a financial institution,”<sup>5</sup> could suggest that such an engagement team, even if assisted by specialists and supported by subject matter experts within the firm, may not have the competence to perform an audit of that issuer.

<sup>3</sup> Proposed AS 1000 release text, Page 16, FN 21.

<sup>4</sup> Proposed AS 1000.07, Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

<sup>5</sup> Proposed AS 1000 release text, Page 20.



Additionally, while we believe it is reasonable to expect an auditor (i.e., an engagement team, collectively) to have expertise in auditing and accounting and to have knowledge of relevant SEC rules and regulations, we do not believe the auditor is expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation, including the legal profession. Proposed AS 1000.07 may be interpreted to mean that an auditor is expected to have a level of expertise in SEC rules and regulations similar to that which would be expected of a lawyer. Lastly, we believe the reference to “the firm’s policies and procedures” in proposed AS 1000.07 is unnecessary and redundant.

As such, and to more closely align the language in proposed AS 1000 with that used in other PCAOB standards, we recommend the following revisions to paragraph .07 of proposed AS 1000 (language to be deleted is ~~struck through~~; language to be added is underlined):

.07 The audit must be performed by an auditor or auditors who, with the appropriate assistance of specialists as needed, collectively ~~has~~ the competence to conduct an audit in accordance with applicable professional and legal requirements. [FN 6 excluded] Competence consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements ~~and the firm’s policies and procedures, including experience in the industry in which the company being audited operates and knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations.~~ The measure of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time.

~~Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.~~

*Q7. 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?*

It is in the best interest of investors and other stakeholders that the auditing standards provide transparency regarding the responsibility of the auditor within the financial reporting ecosystem and the level of assurance provided by an auditor’s report, including the potential limitations of an auditor’s report. While we support the Board’s objective of modernizing the auditing standards, as noted above, we are concerned that certain elements of the Board’s proposal, including the proposed elimination of certain contextual language from the extant standards, may have the effect of introducing confusion and reducing the level of such transparency. Some of the concepts in the auditing standards are relatively technical and complex, making contextual language helpful in describing and facilitating a reader’s understanding of what they are and sometimes, even more importantly, what they are not.

Specifically, our observations and related recommendations are as follows:

*Due professional care*





As stated within the release text, “The concept of due professional care is described in AS 1015 by quoting a 1932 legal treatise. We [the Board] believe the reference to that treatise is unnecessary and are proposing to describe in plain language the concept of due professional care, without changing its meaning.”<sup>6</sup> While we agree that referring to a 1932 legal treatise seems outdated, we recommend certain concepts regarding the potential limitations of an auditor’s report and what investors and other stakeholders can expect of an auditor in the performance of an audit – which is good faith and integrity, but not infallibility – should be retained, particularly because the proposal expressly states that the meaning of due professional care is not changing. Retaining this concept provides investors and other stakeholders with information that may be important to their capital allocation decisions.

As such, we recommend the following revisions to paragraph .09 of proposed AS 1000 (language to be added is underlined):

.09 The auditor must exercise due professional care in all matters related to the audit. [FN 9 excluded] Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements, [FN 10 excluded] but does not imply infallibility. An auditor should possess the degree of skill commonly possessed by others in the public accounting profession. But even a skilled auditor acting in good faith may at times make an error in judgment. The auditor may be determined to be responsible for losses caused by the auditor's own negligence, bad faith, or dishonesty, but not for losses related to pure errors of judgment. For engagement partners, [FN 11 excluded] due professional care includes (1) appropriately assigning responsibilities to, [FN 12 excluded] and supervising, [FN 13 excluded] engagement team members; [FN 14 excluded] (2) determining that the audit is properly planned [FN 15 excluded] and performed to obtain reasonable assurance; [FN 16 excluded] (3) evaluating that significant findings or issues are appropriately addressed; [FN 17 excluded] (4) determining that significant judgments and conclusions on which the auditor’s report is based are appropriate and supported by sufficient appropriate audit evidence; [FN 18 excluded] and (5) determining that required communications under applicable professional and legal requirements have been made. [FN 19 excluded]

#### *Reasonable assurance*

We strongly support the Board’s proposal to retain the concept of reasonable assurance and the corresponding description from AS 1015 as a high level of assurance. However, we have concerns regarding the exclusion of the description of the limitations of an audit currently provided in AS 1015 paragraphs .10 through .13. Certain concepts discussed within these paragraphs have continued relevance and provide valuable context regarding the potential limitations of an auditor’s report and what investors and other stakeholders can expect of an auditor in the performance of an audit, specifically, that the auditor is not an insurer and the auditor’s report does not constitute a guarantee (as the Board has not indicated in the proposing release that it has changed its view on this topic). We believe this level of transparency is in the best interest of investors and other stakeholders and provides them with information that may be important to their capital allocation decisions.

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<sup>6</sup> Proposed AS 1000 release text, Page 22.





As such, we recommend the following revisions to paragraph .14 of proposed AS 1000 (language to be added is underlined):

.14 Reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence. [FN 25 excluded] The auditor is able to obtain reasonable, but not absolute, assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot, therefore, obtain absolute assurance that the financial statements are free from material misstatement, whether caused by error or fraud, or about whether any material weaknesses exist as of the date of management's assessment. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from the nature of financial reporting and the nature of audit procedures. Since the auditor's opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her report does not constitute a guarantee.

#### *Distinction Between Responsibilities of Auditor and Management*

The distinction between the responsibilities of the auditor and of management is important for users of financial statements to understand and for the efficient and effective functioning of the capital markets. As stated in the release text, “The proposed standard [further] retains the distinction between the responsibilities of the auditor and management and expands those responsibilities to include an audit of ICFR. We [the Board] are proposing to streamline the language from AS 1001 and describe the respective responsibilities by leveraging the language used to describe the responsibilities in the auditor’s reports on the audit of financial statements [FN 57 excluded] and the audit of ICFR. [FN 58 excluded] The phrase “the financial statements are management’s responsibility” encompasses the preparation of the financial statements by management, including adopting sound accounting policies and establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management’s assertions embodied in the financial statements.”<sup>7</sup>

Certain language from paragraphs .02 and .03 of AS 1001 that describes the distinction between the responsibilities of the auditor and management and explains the premise on which the audit is conducted is important to retain. One of the reasons for the success of the Sarbanes-Oxley Act is not just the elements that have enhanced audit quality, including the establishment of the Board, but the important elements that strengthened the quality of financial reporting, which is management’s responsibility. It is critically important for stakeholders to clearly understand this distinction.

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<sup>7</sup> Proposed AS 1000 release text, Page 26-27.



As such, we recommend the following revisions to paragraph .13 of proposed AS 1000 (language to be added is underlined):

.13 The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to:

a. Obtain reasonable assurance about whether:

(1) In an audit of financial statements, the financial statements are free of material misstatement, [FN 22 excluded] whether due to error or fraud; [FN 23 excluded]

(2) In an audit of internal control over financial reporting, material weaknesses exist as of the date specified in management’s assessment; and

b. Provide the auditor with a reasonable basis for forming an opinion. [FN 24 excluded]

Note: In an audit of financial statements, the financial statements are management’s responsibility and the auditor’s responsibility is to express an opinion on the financial statements. In an audit of internal control over financial reporting, management is responsible for establishing and maintaining effective internal control over financial reporting and for assessing the effectiveness of internal control over financial reporting, and the auditor’s responsibility is to express an opinion on the effectiveness of the company’s internal control over financial reporting. An audit is conducted on the premise that management has acknowledged and understands that they have responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of these matters and internal control is limited to that acquired through the audit. Thus, the fair presentation of financial statements in conformity with the applicable financial reporting framework is an implicit and integral part of management's responsibility.

### *Professional Skepticism*

As stated within the release text, “The proposed standard retains the concept of professional skepticism in substantially the same form as it is described in AS 1015. The proposed standard describes professional skepticism as an attitude that includes a questioning mind and a critical assessment of information related to the audit. In describing the concept, we propose to use ‘information related to the audit’ rather than ‘audit evidence’ (as described in AS 1015) to emphasize that application of professional skepticism extends beyond the information used as audit evidence in arriving at conclusions on which the auditor’s opinion is based. For example, by exercising professional skepticism in the preparation of Form AP, the



auditor may become aware of inconsistencies in total audit hours reported by another accounting firm participating in the audit and take corrective action.”<sup>8</sup>

While it is reasonable and practicable for an auditor to “... exercise due professional care in all matters related to the audit,” as required by proposed AS 1000.09, including in the preparation of Form AP and other reports to regulators, the extension of the concept of professional skepticism in proposed AS 1000.10 from the extant critical assessment of “audit evidence” to a critical assessment of “information related to the audit” is overly broad. There may be a significant amount of information related to the audit, and without a more specific definition, it is unclear what this requirement encompasses. Additionally, while AS 1105, *Audit Evidence*, provides a framework for the auditor to use in critically assessing audit evidence, it is unclear what framework the auditor would use to perform a critical assessment of information related to the audit that goes beyond audit evidence.

As such, we recommend the following revisions to paragraph .10 of proposed AS 1000, which would revert back to the language in extant AS 1015.07 (language to be deleted is ~~struck through~~; language to be added is underlined):

.10 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of ~~information related to the audit~~ evidence.

We offer our observations regarding the introduction of the concept of auditor bias in proposed AS 1000.11. As stated within the release text, “[In addition,] in exercising professional skepticism, the auditor would consider the impact of management bias and the auditor’s own bias that could affect the auditor’s own judgments. For example, the tendency to seek confirming information can lead the auditor to seek audit evidence that is only consistent with management’s explanations, or to favor conclusions that are consistent with the auditor’s initial beliefs. In exercising professional skepticism, the auditor could mitigate such bias by being aware of ‘confirmation bias,’ considering alternatives provided by others, and seeking contradictory information as evidence. [FN 47 excluded]”<sup>9</sup> While we acknowledge that an auditor, like any person, may be susceptible to bias, we believe that AS 1105, *Audit Evidence*, addresses the auditor’s requirements related to obtaining sufficient appropriate audit evidence, the assessment of which inherently encompasses consideration of auditor bias. The requirement to consider potential bias on the part of the auditor as currently proposed in AS 1000.11e is overly vague, is not accompanied by a framework with which to perform such an assessment, and may create an undue burden on the auditor to identify and document their consideration of any and all possible ways in which their judgments could be affected, as well as how such considerations have been addressed.

As such, we recommend the following revisions to paragraph .11 of proposed AS 1000 (language to be deleted is ~~struck through~~):

.11 The auditor’s exercise of professional skepticism includes:

<sup>8</sup> Proposed AS 1000 release text, Pages 23 – 24.

<sup>9</sup> Proposed AS 1000 release text, Page 24.



- a. Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management’s assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence; [FN 20 excluded]
- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not relying on evidence that is less than persuasive;
- d. Not assuming that management is honest or dishonest; and
- e. Consideration of potential bias on the part of management ~~and the auditor.~~

### *Professional Judgment*

We also have concerns regarding the definition of “professional judgment” in proposed AS 1000.12. The inclusion of the clause ‘such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements’ creates a strict liability requirement in PCAOB auditing standards. The inclusion also does not take into account the reasonableness of the auditor’s conclusions and could result in hindsight challenges of auditor’s judgments.

The definition suggests that, for one to conclude that professional judgment was exercised, the course of action that an auditor takes must not only be “appropriate in the circumstances” but also cause the audit to be performed “in accordance with applicable professional and legal requirements.” This definition may turn out to be, in many cases, a circular one in that the question of whether an auditor complied with professional and legal requirements will often depend on whether a particular decision was within the scope of their professional judgment. Additionally, the definition implies that, should the conclusion be reached that an applicable professional or legal requirement was violated, then by definition the auditor did not appropriately exercise professional judgment. This implication would be contrary to the established interpretation of an auditor’s responsibilities, which recognizes that reasonable observers may disagree regarding whether applicable standards were complied with while agreeing that the matter in question was within the purview of the auditors’ professional judgment.

As such, we recommend the following revisions to paragraph .12 of proposed AS 1000, which retains certain concepts from the existing definition of “professional judgment” in AS 1001.05, (language to be deleted is ~~struck through~~; language to be added is underlined):

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience in determining which auditing procedures are necessary in the circumstances to make informed decisions and reach well-reasoned conclusions and afford a reasonable basis for the issuance of the auditor’s report about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.



*Q9. 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?*

Relevant guidance such as PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB provide useful information that can be helpful to auditors in applying the requirements of the standards. With that said, we offer some observations regarding the challenges of complying with the proposed requirement in FN 26 of AS 1000.15 in a consistent manner as proposed.

As part of its standard-setting process, the Board may issue multiple documents, including concept and proposing releases, over a period of years setting out its intent in relation to proposed standards. To facilitate auditors' appropriate consideration, it would be helpful for the PCAOB to codify and clearly delineate what is relevant guidance in the accompanying release (for example, the Executive Summary, Background, Overview of Final Rules). We believe it would be appropriate for such accompanying release text of only the final standards to be authoritative, as previous discussions in proposals or concept releases may have been superseded as a result of cumulative changes made during the standard setting process. Further, information from economic analyses presumably would not be considered relevant guidance. Revising the manner in which relevant guidance is presented would also better afford stakeholders the opportunity to comment on this guidance during the rulemaking process. Additionally, we recommend that the Board clarify what is encompassed within "Board-issued guidance," as there is currently no category of guidance available on the PCAOB website with this heading or description.

As such, we recommend the following revisions to paragraph .15, FN 26 of proposed AS 1000 (language to be added is underlined):

.15 The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors.

Note: The auditor should take into account relevant guidance<sup>26</sup> applicable to the audit.

FN 26: Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the final standards and final rules of the Board.

The Board states in the release text that, "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."<sup>10</sup> While we agree with this statement, it may not capture the full extent of costs that will be incurred. Even when auditors have been taking such guidance into account – whether at the individual engagement team level or as part of a firm's guidance and methodology – it may not have been done in

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<sup>10</sup> Proposed AS 1000 release text, Page 48.



a consistent and formal manner. Additionally, without codification and clear delineation of what is relevant guidance, as described above, such costs will be even higher.

*Q10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not?*

As stated within the release text, “Our [the Board’s] proposed movement of requirements from AS 2815 into AS 2810 includes an important clarification of the auditor’s existing responsibilities. Specifically, the amendments would clarify that the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. U.S. federal securities laws prohibit the financial statements and company disclosures from being materially misleading, [FN 67 excluded] which is a broader concept than mere compliance with the applicable financial reporting framework. Presented fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework. However, the existing standards may not be sufficiently clear that the auditor’s obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework.”<sup>11</sup>

We do not agree that the auditor has an existing responsibility under the extant standards to evaluate the fairness of the financial statements beyond the evaluation of whether they are presented in conformity with the applicable financial reporting framework. Currently, AS 3101.08e (to which the Board has not proposed changes as part of this exposure draft) describes that the first section of the auditor’s report must include the following elements – “An opinion that the financial statements present fairly, in all material respects, the financial position of the company as of the balance sheet date and the results of its operations and its cash flows for the period then ended *in conformity with the applicable financial reporting framework*. [FN 16 excluded] The opinion should also include an identification of the *applicable financial reporting framework*.” (*emphasis added*). As directly referenced in the auditor’s report, the auditor’s responsibility is to evaluate whether the financial statements are presented in conformity with the applicable financial reporting framework. Additionally, as defined in section (a)(v) of PCAOB Rule 1001, Definitions of Terms Employed in Rules, “[t]he term ‘audit’ means an examination of the financial statements, reports, documents, procedures, controls, or notices of any issuer, broker, or dealer by an independent public accounting firm in accordance with the rules of the Board or the Commission, *for the purpose of expressing an opinion on the financial statements or providing an audit report*.” (*emphasis added*).

Further, it is not appropriate for the auditor to be required to make an evaluation of fairness that goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework – particularly as part of a proposal whose stated purpose is to modernize the Board’s standards and not “impose new requirements on auditors or significantly change the requirements of PCAOB standards.”<sup>12</sup> As currently stated in AS 2815.03, “The independent auditor’s judgment concerning the ‘fairness’ of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that framework, the auditor

<sup>11</sup>Proposed AS 1000 release text, Page 30.

<sup>12</sup> Proposed AS 1000 release text, Page 50.



would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements.”

The language in proposed AS 2810.30, FN 17A and AS 2810.30A not only imposes an inappropriate requirement for the auditor to make a judgment concerning the fairness of the overall presentation of the financial statements that goes beyond the applicable financial reporting framework, but also potentially requires auditors to make a legal judgment regarding certain disclosures that are not required by the applicable framework. In our view, the proposed requirement could lead to claims that the auditor would be essentially standing in the shoes of an issuer’s management and its disclosure counsel and assessing whether - notwithstanding the issuer’s compliance with the extensive information and disclosure obligations imposed by the applicable financial reporting framework and SEC requirements – the issuer’s financial statements should contain additional information in order not to be misleading. As discussed in our response to Q6, we do not believe the auditor is expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation, including the legal profession. Moreover, professional standards applicable to the audit profession do not articulate a standard against which the auditor is to make that determination. As such, it is not reasonable to expect an auditor to be able to make legal judgments in this area.

Further, in considering the language in proposed AS 2810.30A, we assume that the term “financial statements,” including the reference to “disclosures,” is intended to be defined in the same way that the term “financial statements” is defined in AS 3101.01 FN1 (both current and proposed).<sup>13</sup> To the extent the term “disclosures” as used in proposed AS 2810.30A is intended to include disclosures beyond the notes to the financial statements and related financial statement schedules, as defined in AS 3101.01 FN1, our concerns would be broader than those articulated above.

Additionally, we are concerned that the addition of FN 17A in proposed AS 2810.30 may even go so far as to imply that SEC Rule 12b-20 17, C.F.R. § 240.12b-20 is applicable to the auditor (i.e., that the auditor has the same legal responsibility under this rule as the issuer).<sup>14</sup> We acknowledge that the issuer’s requirement under this rule to disclose information as necessary to make the financial statements not misleading is something the auditor should keep in mind. However, it is not appropriate to indicate that

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<sup>13</sup> Proposed AS 3101.01 This standard establishes requirements regarding the content of the auditor’s written report when the auditor expresses an unqualified opinion on the financial statements<sup>1</sup> (the “auditor’s unqualified report”).

FN 1 This standard uses the term “financial statements” as used by the U.S. Securities and Exchange Commission (“SEC”) to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, Identifying and Assessing Risks of Material Misstatement.

<sup>14</sup> See Appendix 2 – Proposed Amendments to AS 2810; Recission of AS 2815, FN 17A, “For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose “in a statement or report ... such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”).”





this legal principle that is applicable to registrants' securities filings and disclosures more broadly be applied to the auditor – again, as part of a proposal where the cost/benefit analysis has been performed on the basis of not imposing new requirements on auditors.

We are also concerned with the proposed exclusion of the concept of “within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in the financial statements” included in existing AS 2815.04. The applicable financial reporting framework against which the auditor is assessing the conformity of the financial statements may allow for a range of acceptable alternatives. By eliminating this language, the proposed standard suggests that an auditor should make an independent assessment of the financial statements based on the auditor’s own judgment, as opposed to making an objective assessment of management’s application of the financial reporting framework, considering alternatives that are permissible under that framework.

Paragraph .06 of extant AS 2815 states that, “Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.” With regards to the language used in the Note within proposed AS 2810.31, which states, “The auditor should also evaluate whether the substance of transactions or events differs materially from their form,” the elimination of the reference to generally accepted accounting principles (or the applicable financial reporting framework) may imply that the auditor has a responsibility to assess the substance of a transaction beyond the applicable financial reporting framework. For the same reasons outlined within the paragraphs above with respect to the concept of “present fairly,” this would not be an appropriate requirement of an auditor.

As such, we strongly recommend the following revisions to paragraphs .30 and .30A of proposed AS 2810 as follows (language to be deleted is ~~struck through~~; language to be added is underlined):

.30 The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.<sup>17A</sup>

Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.<sup>17AB</sup>

~~<sup>17A</sup> For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose “in a statement or report ... such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”).~~

<sup>17AB</sup> AS 2820, Evaluating Consistency of Financial Statements, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.

.30A When evaluating whether the financial statements present fairly the financial position, results of operations, cash flows, and disclosures, in all material respects, in conformity with the applicable financial reporting framework, the auditor should evaluate whether:<sup>17B, 17C</sup>





- a. The information in the financial statements is presented and classified ~~appropriately and in a manner that would be informative and not misleading to a reasonable investor~~ in conformity with the applicable financial reporting framework and is informative of matters that may affect their use, understanding and interpretation;
- b. The accounting principles selected and applied by the company's management are in conformity with the applicable financial reporting framework and appropriate in the circumstances; and
- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements, and their substance does not differ materially from their form.

<sup>17B</sup> This standard uses the term "financial statements" as used by the U.S. Securities and Exchange Commission ("SEC") to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, Identifying and Assessing Risks of Material Misstatement.

<sup>17C</sup> The concept of materiality is inherent in the auditor's judgment. That concept involves qualitative as well as quantitative factors (see AS 2105, Consideration of Materiality in Planning and Performing an Audit).

.31 As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>18</sup> Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

~~Note: The auditor should also evaluate whether the substance of transactions or events differs materially from their form.~~

<sup>18</sup> See AS 3105.24-.27 for auditor reporting considerations related to inadequate disclosures.

*Q13. 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 Board's 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.



As acknowledged by the Board in their economic analysis, firms currently have varied archiving policies and practices, and some small firms still use paper-based workpapers. For certain firms, this proposed change will require changes to systems and technology, which will take time and impacts methodology, policies, practices and behaviors. It is important that firms have sufficient time to adopt this requirement. Refer to our response to Q25 for specific recommendations.

*Q25. 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 recommend that the effective date be tied to audits of fiscal years, as implementing the standard mid-year when audits are already in process would be challenging. This is especially important given the proposal changes not only the foundational standards, but also various performance standards.

As noted within our response to Q13, it is important that firms have sufficient time to adopt an amendment to accelerate the documentation completion date as proposed by the Board. Further, we believe that the need for firms to have sufficient time to adopt proposed AS 1000 and the related amendments is broader than just that matter.

With respect to proposed AS 1000, while the Board has indicated that “the proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards,”<sup>15</sup> as expressed throughout this letter, we are concerned that certain elements of the Board’s proposal expand the auditor’s responsibilities and will create confusion for investors and other users of auditor’s reports regarding the responsibility of the auditor. It will be necessary for firms to perform extensive analyses to evaluate how the final AS 1000 will impact engagement teams and how firm methodologies and guidance will need to be updated. Additionally, it will take time for firms to develop and deliver trainings, taking into account normal training cycles. In addition to proposed AS 1000, the Board has proposed changes to various performance standards which, similarly, will take time to analyze and to build into methodologies, guidance, and training. Further, the larger firms will need time to implement any necessary changes and trainings globally.

As such, assuming the SEC approves the final standard before the end of calendar year 2023, we recommend a final standard be effective no earlier than for audits of financial statements for periods beginning on or after December 15, 2024 to allow ample time for this transition. We also ask the Board to consider the other ongoing standard-setting projects and to bear in mind that auditors could be in a position where they are required to implement QC 1000, the Auditor’s Use of Confirmation standard, and AS 1000 (and related amendments) at the same time. With this pace of change, it is critical that auditors have sufficient time to thoroughly evaluate and effectively train their professionals on new and amended standards in order to avoid an unintended negative impact to audit quality.

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<sup>15</sup> Proposed AS 1000 release text, Page 50.

# CAQ

The CAQ appreciates the opportunity to comment on the Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, and we look forward to future engagement. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum ([vteitelbaum@thecaq.org](mailto:vteitelbaum@thecaq.org)) or Emily Lucas ([elucas@thecaq.org](mailto:elucas@thecaq.org)).

Sincerely,



Vanessa Teitelbaum, CPA  
Senior Director, Professional Practice  
Center for Audit Quality

cc:

**PCAOB**

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Duane M. DesParte, Board member  
Christina Ho, Board member  
Kara M. Stein, Board member  
Anthony C. Thompson, Board member  
Barbara Vanich, Chief Auditor

**SEC**

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July 20, 2023

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

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (“PCAOB” or the “Board”):

CFA Institute<sup>1</sup>, in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment and provide our perspectives on the [PCAOB Rulemaking Docket Matter No. 049: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, PCAOB Release no.2023-001](#) (the “Proposal”<sup>3</sup>).

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

We thank the Board for undertaking this project to replace and augment its interim standards. This was something CFA Institute recommended in our commentary to the Board in 2022 as the new Board was seated and we recognize the Board’s efforts in being responsive in this regard.

The interim standards were adopted from the audit profession twenty years ago. The PCAOB is not a self-regulatory organization and the proposed standards are better aligned with the Board’s statutory mandate to: *“oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public*

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<sup>1</sup> With offices in Charlottesville, VA; New York; Washington, DC; Brussels; Hong Kong SAR; Mumbai; Beijing; Abu Dhabi; and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program. For more information, visit [www.cfainstitute.org](http://www.cfainstitute.org) or follow us on [LinkedIn](#) and Twitter at [@CFAINstitute](#).

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

<sup>3</sup> We use the term “Proposal” to refer to the proposed rule as a whole and “proposed standard[s]” to specifically refer to the proposed standards contained in the Appendices to the Proposal.



*interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.”<sup>4</sup>*

The Proposal combines four interim standards<sup>5</sup> which establish the general principles and responsibilities of the auditor when conducting an audit into a new standard AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

Additionally, the Proposal amends several other standards including AS 2810, *Evaluating Audit Results*, AS 1215, *Audit Documentation*, and rescinds AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."*

Our comments are organized and presented in two sections which follow. The first is comprised of overarching considerations we noted in reviewing and considering the Proposal more broadly. The second section provides our responses to select questions posed by the Board.

## OVERARCHING CONSIDERATIONS

### 1. Fundamental Obligation to Investors

***Support Acknowledgement of Auditor’s Obligation to Investors*** – We commend the Board for adding Paragraphs .01 and .15 to AS 1000 that acknowledge and sets forth the auditor’s fundamental obligation to protect investors. The new language affirms what is already embodied in the requirement for the auditor’s report to be addressed to shareholders and evidenced by many facets of the relationship between investors and auditors, including<sup>6</sup>:

- Investors bear the risk of material misstatements of the financial statements and weaknesses in internal controls over financial reporting.<sup>7</sup>
- Investors rely on audited financial statements to make investment decisions. Management, apart from making investments in other issuers such as acquisitions, does not. Management has access to a broad range of internal financial information to make decisions.
- Shareholders, as owners of corporations, compensate auditors.
- Shareholders elect the members of the board including the audit committee which, by law, must maintain independence from the issuer and appoint and oversee the auditor.<sup>8</sup>

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<sup>4</sup> Sarbanes-Oxley Act of 2002, Section 101(a).

<sup>5</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*.

<sup>6</sup> AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, Paragraph .07.

<sup>7</sup> Karpoff, Jonathan M. and Lee, D. Scott and Martin, Gerald S. (2008); *The Cost to Firms of Cooking the Books*; Journal of Financial and Quantitative Analysis, 43, September 2008, 581-612., pg. 13. The mean and median cumulative abnormal stock returns for firms subject to federal enforcement actions for financial misrepresentation were -51% and -31%, respectively. Shareholders experienced total losses in 34% of the 585 firms subject to enforcement actions from 1978 to 2002.

<sup>8</sup> Sarbanes-Oxley Act of 2002, Section 301.



- Shareholders vote annually on whether to ratify the selection of independent auditors by most issuers' (over 90% of Russell 3000 constituents) audit committees.<sup>9</sup>

***Suggested Revisions:***

***Define “Investors” Consistent with US GAAP, Explain the Auditor’s Obligation and Remove Reference to “Client” When Referring to Entity Under Audit***

*Define Investors* – To strengthen Paragraphs .01 and .15 in AS 1000, we suggest the Board defines “investors,” clarifies and explains what duties the auditor has to investors to fulfill its fundamental obligation and removes the remaining instances of the word “client” from the Proposal when referring to the issuer under audit.

“Investors” include not only existing shareholders, to whom the auditor’s report is addressed, but potential shareholders as well as existing and potential debt investors. To more clearly identify to whom auditors owe their fundamental obligation, we recommend the Board adds a footnote to the first sentence of Paragraph .01 in AS 1000 with the following definition and description of “investors,” drawn from the Financial Accounting Standards Board’s (“FASB”) Concepts Statement No. 8, Conceptual Framework for Financial Reporting – Chapter 1, *The Objective of General Purpose Financial Reporting*.<sup>10</sup>

*Investors are existing and potential shareholders, lenders, and other creditors of an issuer. Investors rely on audited and reviewed financial information reported by issuers, among other sources, in making decisions to provide resources to them. Unlike management and regulators, investors cannot require issuers to provide them with information directly.*

Regardless of the specific language the Board chooses, we urge alignment between the FASB’s definition of primary users and the Board’s definition of investors because they should reflect a responsibility to the same group of individuals and institutions.

*Explain Auditors Obligation* – Paragraphs .01 and .15 of the proposed AS 1000 state and remind auditors of their fundamental obligation to protect investors. Page 16 of the Proposal speaks to the importance of “explicitly remind[ing] auditors of their obligation to protect investors.” While we agree in principle, we recommend the Board clarifies the auditor’s duties to investors by citing to the legal or regulatory requirements that the Board is seeking to remind auditors of in the final standard.

Such clarifications should provide more detail on whether the auditor’s obligation entails activities beyond conducting an audit in accordance with PCAOB standards, which we believe is unclear in the proposed AS 1000. It would also be helpful for the Board to explain how the auditor’s obligation to investors differs from its obligations to the issuer’s board of directors,

<sup>9</sup> Howard, J.K., Son, M. and Song, H. (2023); *Shareholders’ Perception of Auditor Type and Timing of Auditor Engagement: Evidence from Auditor Ratification*; Australian Accounting Review.

<sup>10</sup> [FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting - Chapter 1, The Objective of General Purpose Financial Reporting](#). See Paragraph OB5 as well as Paragraphs BC1-BC1.24 for why the FASB concluded that the primary users of financial reports are existing and potential investors, lenders, and other creditors.



audit committee, and management. At a minimum, we recommend including Footnote 21<sup>11</sup> from the Proposal that cites to *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) in the final standard.

*Remove Reference to Client* – Finally, we suggest the Board replace the remaining instances of the word “client” with “issuer,” “company,” or “company under audit” in the final standard.<sup>12</sup> We recognize that the existing interim standards use “client”, and the Board has removed several instances of it in the proposed standards, but the task is not yet complete. Identifying the issuer or its management as the “client” of the auditor mischaracterizes their relationship, placing the auditor in a subservient position. The auditor’s fundamental obligation is to investors.

## 2. Present Fairly

*What Changed?* – The text of the Proposal – which precedes and discusses the changes to the standards – states that the amendments to AS 2810, *Evaluating Audit Results*, and rescission of AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*, would “clarify that the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework” and, further, that “present fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework.”<sup>13</sup>

We have undertaken to map the changes from AS 2815 to the revised AS 2810 to ascertain if the changes in the standards accomplished this intended objective. We find that most provisions of AS 2815 have been incorporated into AS 2810 as follows with one key addition:

- **Paragraph .01** in AS 2815, which explains the purpose of the standard, maps to Paragraph .30 in AS 2810.
- **Paragraph .03** in AS 2815 explains the concept of fairness needs to be applied within the reporting framework and without it no uniform standard would exist for making a fairness judgement. The reporting framework is mentioned in Paragraph .30 and .30A of AS 2810, but the language “without it no uniform standard would exist for making a fairness judgement” is omitted from AS 2815.
- **Paragraph .04** in AS 2815, which explains the meaning of fairly presents, maps to Paragraph .30 in AS 2810, particularly Paragraphs .30 a, b, and c - though different language is used. It is not clear why different language was deemed necessary.
- **Footnote 1 to Paragraph .04** in AS 2815, which addresses materiality, maps to Footnote 17C of Paragraph .30A in AS 2810.
- **Paragraph .06** in AS 2815 dealing with the substance of a transaction is included in the note to Paragraph .31 in AS 2810.
- **Paragraph .08** in AS 2815 dealing with other regulatory agency reporting requirements does not appear to be carried forward in AS 2810.

<sup>11</sup> Footnote 21 states: *See United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (also noting that an “independent certified public accountant ... [b]y certifying the public reports that collectively depict a corporation’s financial status, ... assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to [the] investing public”) (emphasis in original).

<sup>12</sup> Specifically, we request the Board replaces instances of the word “client” in Paragraphs: .04 of AS 1000; .11 of AS 1215; .12 of AS 1220; .13 of AS 2505; .11 of AS 2610; .05 of AS 2710; and .29 of AT Section 701 which are among the standards amended by the Proposal.

<sup>13</sup> Proposal, Page 30.





- **Paragraphs .02, .05, .07 and .09** in AS 2815 had been deleted previously and were not carried forward to AS 2810.
- **Footnote 17A** of AS 2810 is an addition which references to SEC Rule 12b-20 requiring management to make additional disclosures beyond the required statements if necessary to make the required statements not misleading. This cross reference did not exist in AS 2815.
- **Footnote 17B** of AS 2810 simply cross references to AS 2820, *Evaluating Consistency of Financial Statements* which is not explicitly mentioned in AS 2815.

We see the net result as follows:

- If the language in AS 2815 was copied over word-for-word from AS 2815 to AS 2810, the only significant addition would be that of Footnote 17A which references to SEC Regulation S-K Rule 12b-20.
- The other changes amount to wording changes, the most substantive of which relate to the fairness references in Paragraph .03 and the narrative explanation of fairness in Paragraph .04 in AS 2815. The need to consider the substance of a transaction language in AS 2815 – the language which might likely be interpreted as related to overriding GAAP – carries over to AS 2810. This may likely stem from language on Page 30 of the Proposal.

***Differing Interpretations of Changes*** – We find there are widely different interpretations of these changes by the PCAOB’s stakeholders.

On one end of the spectrum, organizations indicate this is a fundamental change in auditors’ responsibilities and would result in auditors undertaking to override GAAP for public companies if they believe the underlying application of GAAP does not fairly present the substance of transactions.<sup>14</sup> On the other end of the spectrum, you have stakeholders interpreting that the language does not sufficiently explain that the responsibilities of auditors extend beyond mere compliance with GAAP.<sup>15</sup>

We are challenged to see how both interpretations can simultaneously be true. As such, we analyzed the differences which may result in these differing interpretations.

***The Areas Resulting in Varying Interpretations*** – As we analyzed these differing interpretations two items appear central to the differing views. We consider these below:

- ***Reference to the Reporting Framework*** – There is a view by some stakeholders that the reference to the reporting framework makes the interpretation of fairness too confined to the technical application, rather than the substance of GAAP. Those reaching that interpretation could only point to changes in language in Paragraph .03 and .04 of AS 2815 and how they have been incorporated into Paragraphs .30 and .30A of AS 2810 as a basis for their position that something is narrower than what was stated previously.
- ***Reference to SEC Regulation S-K, Rule 12b-20*** – Other stakeholders appear to view the reference to SEC Regulation S-K Rule 12b-20 (requiring management to make additional disclosures beyond the required statements if necessary to make the required statements not misleading) should not be included in an auditing standard because they believe this refers to

<sup>14</sup> Chamber of Commerce Comment Letter: [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/24\\_chamber.pdf?sfvrsn=3b71c437\\_4](https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/24_chamber.pdf?sfvrsn=3b71c437_4)

<sup>15</sup> PCAOB Investor Advisory Group Comment Letter: [Microsoft Word - AS1000 MIAG CommentLetter 05 16 2023.docx \(pcaobus.org\)](#)





other information outside of the financial statements. And, they highlight this is an obligation of management not the auditor. They believe this language addition extends the auditors scope significantly beyond the financial statements, as well as beyond present requirements to read the information outside the financial statements for inconsistencies as specified by AS 2710, *Other Information in Documents Containing Audited Financial Statements*. These stakeholders point to the language in the Proposal on Page 30 and to the statement of Board members in making this assertion.

***Our Consideration of the Changes*** – Our take on these interpretative issues is as follows:

- ***Reference to the Reporting Framework (Paragraph 30 of AS 2810)*** – We note the proposed AS 2810 does not explicitly state that the auditor’s evaluation of fairness goes beyond evaluating conformity with the applicable financial reporting framework.

In fact, AS 2810 retains the AS 2815 language “...*in conformity with the applicable financial reporting framework*” in AS 2810 Paragraphs .30, .30A, .30A(b), and .31.

What is unclear is precisely what language within Paragraph .30 are those who believe a narrower interpretation results than currently exists in AS 2815 looking to in reaching that conclusion.

The language in Paragraphs .03 and .04 of AS 2815 (excerpted below) might be interpreted by some as being a bit more helpful (specifically, the language bolded below) in understanding what fairness means than the revised language in Paragraph .30.

- .03 The independent auditor's judgment concerning the “fairness” of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. ***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.***
- .04 The auditor's opinion that financial statements present fairly an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles should be based on his or her judgment as to whether (a) the accounting principles selected and applied have general acceptance; (b) the accounting principles are appropriate in the circumstances; ***(c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation*** (see paragraph .31 of AS 2810, Evaluating Audit Results); (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed (see AS 2810.31); and ***(e) the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.***

The question is: should this exact language be moved from AS 2815 to AS 2810 to mitigate some of the noise around this change? The language in Paragraph .04 bolded above makes it fairly clear the PCAOB is requiring auditors to urge management to make additional disclosures when necessary to facilitate an understanding of the financial statements and ensuring they are “...*informative of matters that may affect their use, understanding, and interpretation.*”



In our view, the PCAOB needs to add clarifying language to AS 2810 to ensure there is clarity regarding their intent to ensure the auditors' obligation is broader than mere technical compliance with GAAP.

The language in Paragraph .06 of AS 2815 with respect to the need to consider the substance of the transaction is included in AS 2810 Paragraph .31 and makes it clear that the substance of the transaction is to be considered. When combined with Paragraphs .03 and .04 of AS 2815, it is clearer that disclosure – not overriding GAAP – is to be the tool used in ensuring fair presentation.

It is important to note that we have supported the incorporation of a disclosure objective in addition to disclosure requirements within GAAP such that companies and auditors have the flexibility to add clarifying disclosures when the specific disclosure requirements may not suffice to provide investors with a complete understanding or fair presentation of the substance of the transaction.

Additionally, we would add that we disagree with the Proposal's use of the phrase "mere technical compliance with the applicable financial reporting framework" in describing auditor's present responsibilities for evaluating fairness. US GAAP and IFRS afford management a wide degree of discretion; there are many conforming choices management can make in its accounting policies across virtually every financial statement account and the notes to financial statements.<sup>16</sup> It is the auditor's responsibility to judge whether management has made choices within the reporting framework that present the substance and economic reality of transactions, events, and conditions fairly in all material respects. It is also the auditor responsibility to evaluate whether the disclosures reflect and accurately explain those choices.

- Reference to SEC Regulation S-K, Rule 12b-20 (SEC's Requirement of Management) – Footnote 17A in Paragraph .30 of AS 2810 cites SEC Rule 12b-20 17, C.F.R. §240.12b-20 requiring **management** to make additional disclosures if necessary to make the required statements not misleading. We do not believe the PCAOB's proposed rule properly articulates the **auditor's** responsibilities.

Further, we believe the reference to the Regulation S-K rule – which generally deals with disclosures outside the financial statements (which are governed by Regulation S-X) – is creating the perception, but possibly not the intended reality, that the auditors' scope of responsibility is being expanded to disclosures outside the financial statements. SEC Regulation S-K Rule 12b-20 states the following:

*In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made **not misleading**.*

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<sup>16</sup> Important examples of areas of US GAAP and IFRS with wide management discretion that are material to investors include revenue and expense recognition, segment reporting, accounting for business combinations, computing the provision for income taxes, fair value measurement, contingencies, and the classification and measurement of financial instruments.



We would note that SEC Regulation S-K Rule 12b-20 indicates it requires management to consider additional disclosures – that can be included in financial statements (or reports, which may imply in annual report on Form 10-K and thereby be interpreted as also including information outside the financial statements) that are necessary to prevent the financial statements from being misleading. What lacks clarity is whether such additional information to prevent the financial statements from being misleading needs to be included inside the financial statements. One would presume that management would make these within the financial statements to ensure there is no question regarding them not being misleading, but this is not stated in SEC Regulation S-K Rule 12b-20.

We would note, however, the provisions of SEC Regulation S-X, Rule 4-01(a)(1) which states:

**§ 210.4-01 Form, order, and terminology.**

**(a) *Financial statements* should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.**

**(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.** This article and other articles of Regulation S-X provide clarification of certain disclosures which must be included in any event, in **financial statements** filed with the Commission.

This provision of Regulation S-X Rule 4-01(a)(1) makes it clear that management is responsible for filing financial statements with the SEC that are prepared in accordance with generally accepted accounting principles (and noting that footnotes or disclosures do not cure the failure to apply generally accepted accounting principles). Not doing so is presumed to mean the financial statements are misleading. The aforementioned language also makes it clear that additional disclosures are necessary to ensure the financial statements, under the principles they are made, are not misleading.<sup>17</sup> Because this is within Regulation S-X and relates to financial statements upon which the auditors are expressing an opinion, we believe it is clear this would also apply to auditors.

While we believe the Board sought to clarify rather than create a new responsibility, their citation of SEC Regulation S-K Rule 12b-20 appears to have muddled the issue of disclosures inside and outside the financial statements. In doing so, it has enabled those who disagree with this clarification to not only state that the Board is extending the auditors responsibility to include an evaluation of the completeness of an issuer's disclosures in their entirety (not only the financial statements and notes), which includes searching for omitted information.

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<sup>17</sup> SEC Rule S-X § 210.4-01(a)(1) states that “financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.”



Further, this cross referencing has allowed those who oppose the changes to extrapolate this belief into a view that they are enabling auditors to override GAAP. We do not believe that this reference to SEC Regulation S-K Rule 12b-20 (i.e., which deals with disclosures not accounting) nor any language which has been transitioned from AS 2815 or added to AS 2810, as we discuss in the previous bullet, would suggest management or the auditors have the ability to override GAAP as some suggest. We believe Regulation S-X Rule 4-01(a) makes this perfectly clear and is a reference the Board should consider as clarifying language.

With respect to information outside the financial statements, we note that AS 2710, *Other Information in Documents Containing Audited Financial Statements*, governs the auditor's responsibilities for other information besides the financial statements and notes included in, for example, an annual report filed on Form 10-K with the SEC. AS 2710 advises auditors (uses the language "should" throughout) to read the report, identify and seek correction of material inconsistencies and misstatements, and communicate or take action on inconsistencies and misstatements that management refuses to correct.<sup>18</sup> AS 2710 is silent on whether the auditor should identify omissions that make the financial statements and notes misleading or, more generally, evaluate the annual report for completeness. We note that AICPA auditing standards, which govern audits of non-public companies, explicitly state that "the auditor is not responsible for searching for omitted information or for the completeness of the other information."<sup>19</sup>

We would support a responsibility for auditors to evaluate the completeness, in all material respects, of an issuer's annual report beyond the financial statement and notes (i.e., an auditor responsibility that complements the responsibility of management required by SEC Rule 12b-20 17, C.F.R. § 240.12b-20). However, we believe such a responsibility should be established by an amendment to AS 2710 and include guidance on materiality, what basis auditors should use to evaluate completeness, and how the auditor should respond if it identifies omissions that make required disclosures misleading. For example, could some omissions in the annual report rise to the level of requiring the auditor to add an explanatory paragraph in their report?

*Our Suggested Revisions: We Support the Spirit of What the PCAOB Wants to Accomplish, But Improved Wording is Necessary to Clarify the Board's Intent and Eliminate Misinterpretations* – Because the proposed standard does not explicitly state that the auditor's evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework – in contrast to Page 30 of the Proposal which does state this – our suggested changes for the final standard include the following. We suggest the Board:

- Use the language in Paragraphs .03 and Paragraph .04 from AS 2815 in AS 2810 and explain, possibly through examples, how technical compliance with GAAP may require additional disclosures to improve investors' understanding of the financial statements. And

<sup>18</sup> AS 2710, *Other Information in Documents Containing Audited Financial Statements*, Paragraphs .04-.06.

<sup>19</sup> AU-C Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, Paragraph .18.



including further language explaining that such additional disclosures do not result in an override of GAAP but are meant to simply ensure that, as per AS 2815: “...*the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation.....and the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.*

- Remove the existing language on Page 30 in the Proposal and replace with language which mirrors the language in AS 2810 such that it is clear how the words in AS 2810 accomplish the PCAOB’s intent to ensure the financial statements are informative with respect to the matters that affect their use, understanding, and interpretation.
- Reference Rule 4-01(a)(1) which clarifies the Board recognizes that neither management nor auditors may override generally accepted accounting principles, and which highlights that additional disclosures may be necessary to ensure that the financial statements prepared and presented in accordance with generally accepted accounting principles are not misleading – a responsibility of both management and the auditor.
- Remove Footnote 17A to Paragraph .30 of AS 2815 that cites SEC Rule 12b-20 17, C.F.R. §240.12b-20 and add language – if they believe necessary in light of any addition of Rule 4-01(a)(1) – that provides greater clarity that this rule within Regulation S-K – which may result in additional disclosures by management inside the financial statements because it is meant to ensure that financial statements are not misleading is consistent with the spirit and intent of AS 2810’s requirement that auditors make a fair presentation assessment as financial statements cannot be considered fairly presented without a consideration of the need for disclosures that prevent the financial statements from being misleading.
- As it relates to the inclusion of other information outside of financial statements under SEC Rule 12b-20 17, C.F.R. §240.12b-20, commence a research project on AS 2710, *Other Information in Documents Containing Audited Financial Statements*. In addition to considering an auditor’s responsibility for evaluating the completeness of other information, we note that this standard is worthy of the Board’s attention because of investors’ regular use of other information in making investment decisions.

We believe the changes above would ensure the language in AS 2810 accomplishes the PCAOB’s intent with respect to the fair presentation of information within financial statements; ensures the discussion in the Proposal which supplements AS 2810 appropriately expresses the PCAOB’s intent and the actual wording in AS 2810 and provides a distinction between managements and the auditors responsibilities within and outside the financials. This should also quell any mistaken interpretation that the PCAOB supports overriding GAAP.





### 3. Critical Audit Matters

We are troubled by the lack and decreasing number of critical audit matters (CAMs) in audit reports as addressed at a [recent PCAOB Investor Advisory Group Meeting](#).<sup>20</sup>

A large number, and rising proportion, of audit reports contain only one CAM, including those for 7 of the 10 largest issuers on US stock exchanges by market capitalization and the financial institutions that failed or liquidated in the spring of 2023.<sup>21</sup>

This is especially troubling in comparison to audit reports in other jurisdictions like the UK, which tend to contain twice the number of KAMs and significantly more tailored disclosures.<sup>22</sup>

CAMs are an important communication by the auditor to investors. CAMs are an opportunity for auditors to “show their work,” and increase investors’ confidence in the quality of the audit and conclusions of the audit report. We are afraid that unless the Board acts, the audit profession will successfully achieve its desire not to communicate to investors via CAMs. We worry that this will perpetuate the belief amongst investors that audits are not fit for purpose or relevant.

As an initial step in preventing the lack of usefulness of CAMs’, we respectfully urge the Board to elevate CAMs (which are only mentioned in footnote 30 in the proposed standard) by moving Paragraph .11 from AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* to Paragraph .03 in AS 1000.

Additionally, we agree with the suggestion by the members of the PCAOB’s Investor Advisory Group to delete the term “especially,” given concerns that this term is used by auditors to avoid communicating critical audit matters.

Our recommended Paragraph .03 of AS 1000 is as follows (new language, ~~deleted language~~):<sup>23</sup>

#### *OBJECTIVES OF THE AUDITOR*

*.03 The objectives of the auditor are as follows:*

*a. In an audit of financial statements – To (1) obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud; and (2) issue an auditor’s report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework;*

*b. In an audit of internal control over financial reporting – To (1) obtain reasonable assurance about whether, material weaknesses exist as of the date specified in management’s assessment; and (2) issue an auditor’s report that expresses an opinion on the effectiveness of the company’s internal control over financial reporting;*  
~~and~~

<sup>20</sup> The average number of CAMs in audit reports of large, accelerated filers have decrease from 1.69 to 1.43 from fiscal years ending June 29, 2020 to May 31, 2022. (PCAOB Release No. 2022-007 Interim Analysis Report, Further Evidence on the Initial Impact of Critical Audit Matter Requirements. December 7, 2022.)

<sup>21</sup> Annual reports filed on Form 10-K for fiscal years ending in 2022 by Apple Inc., Alphabet Inc., Amazon.com Inc., Nvidia Corporation, Tesla, Inc., Taiwan Semiconductor Manufacturing Company Ltd., Visa Inc., First Republic Bank, SVB Financial Group, and Signature Bank. Silvergate Capital delayed its 2022 annual report filing and liquidated before it was filed, but the auditor report in its 2021 annual report communicated zero CAMs.

<sup>22</sup> Miguel Minutti-Meza (2021); *The Art of Conversation: The Expanded Audit Report*; Accounting and Business Research, 51:5, 548-581.

<sup>23</sup> Letter from Members of the PCAOB Investor Advisory Group (IAG) to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board. [Comment letters for Docket 049 \(May 16, 2023\)](#).



*c. Determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).; and*

*d. Communicate externally, as required by applicable professional and legal requirements.*

#### 4. Audit Documentation Completion Date

We support the Board's amendments to AS 1215, *Audit Documentation*, to accelerate the completion date for the assembly of a final set of audit documentation from 45 days to 14 days because it reduces the opportunity for "revisionist history" well after the audit is completed and should not impose significant costs on auditors given advancements in technology supporting the audit process. If this enables the Board to begin – and finish – its audit inspection process sooner, that would be an added, but not primary, benefit.

The Board's audit inspections are essential to improving audit quality and investor confidence in audited financial statements and the effectiveness of internal controls. However, the significant lag between the date of audit reports and inspection rate harms the relevance of the inspection process for investors and auditors. Inspection reports dated in the spring of 2023 refer to inspections of audits for fiscal years ending in 2020 or earlier. While we agree with the acceleration in the audit documentation timeline of 31 days, we ask the Board and staff to scrutinize the audit inspection process and identify what steps in the process could be accelerated, modified, or eliminated to more significantly reduce the overall timeline, i.e. by months or years, not days.

### RESPONSES TO SELECT QUESTIONS

We considered all 25 questions posed in the Proposal and chose to respond to a selection of the questions, on topics of interest to us, which are presented below by reference to the question number presented in the Proposal.

#### 5. **Ethics Requirements** – *Are the proposed requirements related to ethics clear and comprehensive? If not, why not?*

No. The proposed standard states that "*the auditor must comply with applicable ethics requirements, including the rules and standards of the PCAOB.*"<sup>24</sup> Such a meager statement does not reflect the importance of ethics nor acknowledge how a lack of ethical behavior is a principal driver of audit failures. Following the law and regulations is a minimum ethical standard.

We recommend the Board augment the proposed standard by requiring audit firms to create and maintain codes of ethics that embrace the principles proposed in EI 1000, *Integrity and Objectivity*,<sup>25</sup> as well as upholding the integrity of capital markets and auditor's fundamental

<sup>24</sup> Proposed AS 1000, Paragraph .06.

<sup>25</sup> PCAOB Release No. 2022-006.



obligation to investors, competence, independence, due professional care, professional skepticism and judgment, and encouraging others in the profession to practice ethically.

CFA Institute has a long history of ethics advocacy, enforcement, and education since the creation of its [Code of Ethics and Standards of Professional Conduct](#) in the 1960s. We welcome a broader discussion of ethical requirements in the audit profession.

**6. Auditor Competence** – *Are the proposed requirements related to the auditor’s competence clear and comprehensive? If not, why not?*

We agree with the members of the PCAOB Investment Advisory Group<sup>26</sup> that the professional development of auditors must include a focus on:

- (a) investors, because they are the primary beneficiary of the audit process and the perspective auditors are required to take by AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, to determine materiality; and
- (b) the business of the entities they are auditing and the industries to which they belong; because “it is axiomatic that an auditor cannot audit what the auditor does not understand.”<sup>27</sup>

Therefore, we recommend revising Paragraphs .07 and .08 of AS 1000 as follows (new language, ~~deleted language~~):

**COMPETENCE**

*.07 The audit must be performed by an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements. Competence consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm’s policies and procedures. The , of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time.*

*Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates. Knowledge of the business and industry of the company under audit, including its business model, strategy, risk factors, and competitive landscape is fundamental to appropriately planning and conducting the audit.*

*.08 The auditor should develop and maintain competence through an appropriate combination of:*

- a. Academic education;*
- b. Professional experience in accounting and auditing, with proper supervision; and*
- c. Training, including a focus on investors as the primary beneficiary of the audit and perspective through which materiality is determined, as well as accounting, auditing, independence, ethics, and other relevant continuing professional education.*

We cannot over emphasize the importance of training and professional education with respect to the perspective of investors. Such perspective should permeate auditors’ mindset when executing the audit.

<sup>26</sup> Letter from members of the PCAOB IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board. Comment letters for Docket 049 (May 16, 2023).

<sup>27</sup> Colonial BancGroup v. PricewaterhouseCoopers LLP, No. 2:11-cv-975-BJR, Order on the Liability Phase of the PWC Bench Trial, at 35, (M.D. Ala. Dec. 28, 2017), <https://www.dandodiarary.com/wp-content/uploads/sites/893/2019/03/pwc-liability-order.pdf>.





9. ***Consideration of Relevant Guidance*** – *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?*

Experienced auditors and audit firms have no problems navigating regulatory labyrinths, but the proposed requirement poses significant difficulty to those entering and new to the profession as well as to outsiders (e.g., investors). The Board’s standards, including the proposed AS 1000 which is the foundational and first standard, are already challenging to read because there are numerous cross-references to other standards and statements like “as required by applicable professional and legal requirements” that direct readers to other locations outside the PCAOB but without hyperlinks.

While we agree with the principle of requiring auditors to consider all authoritative materials, we recommend the Board take a “codification” approach and include all guidance, interpretations, releases, amendments, and rules in the same location as the applicable auditing. Staff notes directing users to what is current, controlling, and has been superseded would be most helpful.

11. ***Engagement Partner Responsibilities*** – *Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?*

Yes. We strongly support the amendments to AS 1201, *Supervision of the Audit Engagement*, and AS 2101, *Audit Planning*, which clarify that an engagement partner is not relieved of their responsibility for an engagement and its performance by seeking assistance from others.

We appreciate the fact that audits are done by teams, including the engagement partner, quality review and other partners, professional staff and staff support, specialists, and national office consultation staff. The same is true for preparation of financial statements and the related internal controls over financial reporting that support their creations. That too is a team effort by the CEO and CFO of a company and many professionals and staff supporting that important process. The Sarbanes-Oxley Act firmly establishes that it is the CEO and CFO who bear ultimate responsibility for the financial statements and internal controls, a responsibility they must attest to in every quarterly and annual report filed with the SEC. The CEO and CFO are responsible because they have personnel and supervisory decision-making power. They are well compensated for these responsibilities of leadership.

Engagement partners are leaders of audit engagements and leaders in their firms, which comes with decision-making power and commensurate levels of compensation. Engagement partners seeking assistance from others ultimately remain accountable for the entirety of the audit. It is why investors asked for the disclosures of the engagement partner name. We sought the behavioral accountability which ensues from such public disclosure. We see these revisions as a complement to that requirement and believe that the language included herein will ensure, just as it did for SOX, that the appropriate internal control and accountability and review processes are implemented within firms – not to unnecessarily seek enforcement against engagement partners, but to ensure they operate within the ecosystem of their respective firm that recognizes and supports partners with the appropriate staffing and specialized resources.



We also believe this language will facilitate a culture of accountability within the firms, reduce audit failures and protect investors. Investors want audits to be effective and audit partners to succeed and they are willing to compensate auditors fairly for their services.

*15. **Scalability of Audit Documentation** – Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required.*

– And –

*24. **Applicability and Impact on EGCs** – The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.*

We believe all companies that seek and receive financing from investors should prepare high-quality financial statements and be subject to high-quality audits. We oppose the “scaling” of any requirements for issuer, auditor, or audit engagement size, including the issuer’s status as an Emerging Growth Company.

Reducing requirements reduces investor’s confidence in the affected issuers audited financial statements and effectiveness of internal controls. While scaling requirements is a well-intentioned attempt to reduce costs for smaller companies, the result is simply a shift of costs from one form (regulatory) to another (market-imposed premiums to costs of capital and steep valuation discounts for issuers that must restate financials), both of which are born by investors.

Rather than scaling down requirements for smaller capitalization issuers, we believe there is a case for *stricter* requirements and stronger investor protections related to these issuers:

- Since 2005, the vast majority of restatements have been made by non-accelerated filer registrants, with these issuers accounting for 73% of restatements in 2021.<sup>28</sup>
- Small capitalization issuers have a far greater proportion of their equity owned by individual investors than large capitalization issuers.<sup>29</sup>
- Small capitalization issuers have far less coverage by sell-side analysts than larger capitalization issuers.<sup>30</sup>

If auditors are willing to assume the risks of auditing publicly traded firms and reap the consequent rewards, they should abide by a single set of high-quality rules and standards set by the PCAOB.

<sup>28</sup> Financial Restatements: A Twenty-One Year Review. Audit Analytics, May 2022.

[https://www.auditanalytics.com/doc/2021\\_Financial\\_Restatements\\_A\\_Twenty-One-Year\\_Review.pdf](https://www.auditanalytics.com/doc/2021_Financial_Restatements_A_Twenty-One-Year_Review.pdf)

<sup>29</sup> “Only small caps see minority of shares held by institutions, research shows.” IR Magazine. Jan 18, 2022.

<https://www.irmagazine.com/small-cap/only-small-caps-see-minority-shares-held-institutions-shows-research>

<sup>30</sup> Companies with a market cap of at least \$10B had, on average, current estimates from 19 analysts on FactSet compared to 4 and 1 analysts for companies with market caps less than \$5B and \$300M, respectively.



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Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more detail on our letter. If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org) and Matthew P. Winters at [matt.winters@cfainstitute.org](mailto:matt.winters@cfainstitute.org).

Sincerely,

*/s/ Sandra J. Peters*

Sandra J. Peters, CPA, CFA  
Senior Head, Global Financial Reporting Policy Advocacy  
CFA Institute

*/s/ Matthew P. Winters*

Matthew P. Winters, CPA, CFA  
Senior Director, Global Financial Reporting Policy Advocacy  
CFA Institute

**Rulemaking Docket Matter No. 049****Proposed AS 1000 -- General Responsibilities of the Auditor in Conducting an Audit  
Response to Request for Public Comment by Robert A. Conway, CPA****May 29, 2023**

I have read the public comment letter on the PCAOB website submitted by the Members of the Investor Advisory Group applicable to the general responsibilities of the auditor. I agree with the feedback and suggestions included in that letter. I have four additional observations described below that merit the PCAOB's consideration:

1. **Contradictory Evidence** -- The PCAOB standards have important reminders about the auditor's duty to consider contradictory evidence. However, I do not believe the auditing literature is sufficiently clear about the auditor's duty to conduct a reasonable search for contradictory evidence. Greater clarity as to the auditor's duty to identify contradictory evidence is important in light of the profession's ongoing struggle to demonstrate an appropriate level of professional skepticism. The IAG letter makes some related observations about the presumption that management is dishonest rather than assuming management is neither honest or dishonest. My suggestion takes this a little further by obligating the auditor to search for contradictory evidence.

The exhibit to this letter contains excerpts from the auditing standards that I considered while vetting this recommendation. Paragraph 11 of AS 2110 has "should consider" language. Here are some basic things I believe need to be in the "should" or "must do" category:

- a. Conduct a series of internet searches using the company name, the names of major products, and the names of officers. The absence of such a requirement in the existing standards is an example of the existing standards being out of date;
  - b. Listening to the earnings calls should be mandatory; and
  - c. Understanding the content of all public filings, including all 8-Ks, should be mandatory.
2. **Ethics and Integrity** - Below is an excerpt from my January 2020 public comment on possible revisions to the Quality Control standard. I repeated a similar comment in my public comment on the draft of the Quality Control standard in January 2023. This comment continues to be in need of attention by the PCAOB:

**22. PCAOB Question:** Is the approach to relevant ethical requirements appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

## Conway Public Comment Response

The AICPA's Integrity and Objectivity standards have always forbidden the subordination of judgment when differing views arise over a material issue. In other words, a subordinate with a differing view is obligated to speak up on material matters. This construct is critical to audit quality. The AICPA, recognizing that it is not easy for subordinates to challenge overbearing supervisors, added provisions (circa 2014) prohibiting supervisors (including audit partners) from exercising undue influence over subordinates. In other words, a partner should not apply undue influence to override a subordinate and bypass appropriate dispute resolution protocols. These enhancements to the AICPA standards were made by the AICPA after the PCAOB adopted the AICPA standards in 2003. **It is important that the PCAOB at least catch up to the AICPA in this regard so that subordinates know that their PCAOB professional standards fully support their responsibility to voice their concerns, even in the face of an over-bearing supervisor.**

3. **Professional Judgment** – The proposed draft of AS 1000 has one paragraph devoted to professional judgment that reads as follows:

### PROFESSIONAL JUDGMENT

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.<sup>21</sup>

<sup>21</sup> References to judgment of the auditor in other PCAOB standards have the same meaning as “professional judgment.” See, e.g., AS 1215.07, and paragraph .02 of AS 1220, *Engagement Quality Review*.

Poor professional judgment is intertwined with the lack of professional skepticism and independence and is frequently a root cause of audit failures. One would expect greater emphasis and definition of professional judgment than what we see above. Some have said it is not necessary for the PCAOB to publish a “professional judgment framework” because each of the audit firms have already published their own frameworks. Wouldn't the PCAOB have greater leverage from an inspection and enforcement perspective if there was a “PCAOB Framework on Professional Judgment”? Might the PCAOB be able to drive more improvements in audit quality if public company auditors were held to a suitably high standard for professional judgment? Yes, the auditing literature talks about considering contradictory evidence – but that is only a small part of the professional judgment frameworks developed by the largest audit firms. There is an abundance of good material about “professional judgment frameworks” in the public domain. It would not take much effort for the PCAOB to develop its own professional judgement framework for incorporation into the auditing standards.

- 4. Time Pressures and the Archiving Date** – Public company auditors are typically under great pressure to “sign-off” on earnings at an earnings release date which in many cases precedes the filing of the annual report on Form 10-K by a significant period of time. **The unwritten expectation is that the results will not change during the period between the earnings release date and the public filing of the 10-K. This is an unhealthy dynamic and needs to change.**

As part of the audit planning process, it is understandable that the auditor may have discussions with the issuer about when the issuer hopes to make an earnings release and the date the issuer hopes to file its 10-K. The “General Responsibilities of the Auditor in Conducting an Audit” should be clear that the auditor shall not make any firm commitment or make any promise as to when the audit will be completed. AS 1000 should remind the auditor that the date the audit opinion is signed and provided to the issuer shall be at the auditors’ sole discretion and judgment. If the audit engagement partner believes that additional time may be needed to complete the audit, the engagement partner should confer with the Engagement Quality Reviewer and the Audit Committee. Any effort by the issuer or the audit committee to apply pressure with respect to the completion of the audit should be evaluated to determine if the issuer or the audit committee has violated Section 303 or the Sarbanes-Oxley Act regarding “Improper Influence on Conduct of Audits.”

The auditor should be expected to have periodic discussions with the audit committee about the progress of the audit. The audit committee should periodically inquire about the progress of the audit and the issuer’s responsiveness to the auditors’ information requests. The audit committee should also specifically ask if the auditor needs or may need additional time to complete the audit.

The threat of time pressure to audit quality should also be addressed in any Professional Judgement Framework the PCAOB may develop in response to my comment # 3 above.

I hope the PCAOB finds my suggestions helpful. Please feel free to reach out to me if the PCAOB or its professional staff have any questions about my recommendations.

Sincerely,

*Robert A. Conway*

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### **About Robert Conway -- My 360° Perspective on the Auditing Profession**

I am a retired KPMG audit partner. I worked at KPMG for 26+ years, including 17 years as an audit partner. After retiring from KPMG, I joined the PCAOB where I worked from 2005 to

2014. During my last six years at the PCAOB, I was the Regional Associate Director with leadership responsibility for the PCAOB's Orange County and Los Angeles offices. Like virtually everyone else that joins the PCAOB, I was inspired by the PCAOB's important Mission to improve audit quality.

After leaving the PCAOB, I became the Professional Practice Director at CNM LLP, an 85-person regional CPA firm in Southern California that focuses exclusively on technical accounting consultations and SOX 404 outsourcing. My responsibilities put me in regular contact with Big Four audit partners, public company CFO's, Chief Accounting Officers, audit committees, and SOX Compliance Leaders. I worked at CNM for three years.

In 2019, I began serving as an expert witness in matters involving accounting, auditing, and internal controls over financial reporting.

In 2020, I published a book titled, "The Truth About Public Accounting – Understanding and Managing the Risks the Auditors Bring to the Audit."

My recommendation in 2007 to the US Treasury Department's Advisory Committee on the Auditing Profession (ACAP) was widely credited with providing the impetus for ACAP's final report recommendation that the PCAOB evaluate the feasibility and potential benefits of providing public transparency to audit firm input and output measures that may be indicators of audit quality (AQIs). The PCAOB ultimately published a Concept Release on Audit Quality Indicators in June 2015. A project to study "Engagement Performance Metrics" was added to the PCAOB's Research Agenda in 2022. That project recently moved to the PCAOB's Standard Setting Agenda.

**Exhibit****Existing Standards Considered in Developing  
My First Recommendation re Contradictory Evidence****AS 1105: Audit Evidence**

## Introduction

.01 This standard explains what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.

.02 Audit evidence is all the information, whether obtained from audit procedures or other sources, that is used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence consists of both information that supports and **corroborates** management's assertions regarding the financial statements or internal control over financial reporting and information that **contradicts** such assertions.

**PCAOB Release No. 2023-001, pages A1-4 to A1-5**

.11 The auditor's exercise of professional skepticism includes:

- a. Objective evaluation of evidence obtained in an audit (including information that supports and **corroborates** management's assertions regarding the financial statements or internal control over financial reporting and information that **contradicts** such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;
- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not relying on evidence that is less than persuasive;
- d. Not assuming that management is honest or dishonest; and
- e. Consideration of potential bias on the part of management and the auditor.



## AS 2101: Audit Planning

### Planning Activities

.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor's previous experience with the company, and changes in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, **the auditor should evaluate** whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures:

- Knowledge of the company's internal control over financial reporting obtained during other engagements performed by the auditor;
- Matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes;
- Matters relating to the company's business, including its organization, operating characteristics, and capital structure;
- The extent of recent changes, if any, in the company, its operations, or its internal control over financial reporting;
- The auditor's preliminary judgments about materiality,<sup>5</sup> risk, and, in integrated audits, other factors relating to the determination of material weaknesses;
- Control deficiencies previously communicated to the audit committee<sup>6</sup> or management;
- Legal or regulatory matters of which the company is aware;
- The type and extent of available evidence related to the effectiveness of the company's internal control over financial reporting;
- Preliminary judgments about the effectiveness of internal control over financial reporting;
- Public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the company's internal control over financial reporting;
- Knowledge about risks related to the company evaluated as part of the auditor's client acceptance and retention evaluation; and
- The relative complexity of the company's operations.

Note: Many smaller companies have less complex operations. Additionally, some larger, complex companies may have less complex units or processes. Factors that might indicate less complex operations include: fewer business lines; less complex business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management

in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control.

## AS 2110: Identifying and Assessing Risks of Material Misstatement

### Obtaining an Understanding of the Company and Its Environment

.07 The auditor should obtain an understanding of the company and its environment ("understanding of the company") to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement. Obtaining an understanding of the company includes understanding:

- a. Relevant industry, regulatory, and other external factors;
- b. The nature of the company;
- c. The company's selection and application of accounting principles, including related disclosures;
- d. The **company's objectives and strategies** and those related **business risks** that might reasonably be expected to result in risks of material misstatement; and
- e. The company's measurement and analysis of its financial performance.

.08 In obtaining an understanding of the company, the auditor should evaluate whether significant changes in the company from prior periods, including changes in its internal control over financial reporting, affect the risks of material misstatement.

### Industry, Regulatory, and Other External Factors

.09 Obtaining an understanding of relevant industry, regulatory, and other external factors encompasses industry factors, including the competitive environment and technological developments; the regulatory environment, including the applicable financial reporting framework<sup>6</sup> and the legal and political environment;<sup>7</sup> and external factors, including general economic conditions.

### Nature of the Company

.10 Obtaining an understanding of the nature of the company includes understanding:

- The company's organizational structure and management personnel;
- The sources of funding of the company's operations and investment activities, including the company's capital structure, noncapital funding (e.g., subordinated debt or dependencies on supplier financing), and other debt instruments;
- The company's significant investments, including equity method investments, joint ventures, and variable interest entities;
- The company's operating characteristics, including its size and complexity;

Note: The size and complexity of a company might affect the risks of misstatement and how the company addresses those risks.

- The sources of the company's earnings, including the relative profitability of key products and services; and
- Key supplier and customer relationships.

.10A To assist in obtaining information for identifying and assessing risks of material misstatement of the financial statements associated with a company's financial relationships and transactions with its **executive officers** (e.g., executive compensation, including perquisites, and any other arrangements), the auditor should perform procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers. The procedures should be designed to identify risks of material misstatement and should include, but not be limited to (1) reading the employment and compensation contracts between the company and its executive officers and (2) reading the proxy statements and other relevant company filings with the Securities and Exchange Commission and other regulatory agencies that relate to the company's financial relationships and transactions with its executive officers.

.11 As part of obtaining an understanding of the company as required by paragraph .07, the auditor **should consider performing the following procedures** and the extent to which the procedures should be performed:

- Reading public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and, in an integrated audit, the effectiveness of the company's internal control over financial reporting, e.g., company-issued press releases, company-prepared presentation materials for analysts or investor groups, and analyst reports;
- Observing or reading transcripts of earnings calls and, to the extent publicly available, other meetings with investors or rating agencies;
- Obtaining an understanding of compensation arrangements with senior management other than executive officers referred to in paragraph .10A, including incentive compensation arrangements, changes or adjustments to those arrangements, and special bonuses;
- Obtaining information about trading activity in the company's securities and holdings in the company's securities by significant holders to identify potentially significant unusual developments (e.g., from Forms 3, 4, 5, 13D, and 13G);
- Inquiring of the chair of the compensation committee, or the compensation committee's equivalent, and any compensation consultants engaged by either the compensation committee or the company regarding the structuring of the company's compensation for executive officers; and
- Obtaining an understanding of established policies and procedures regarding the authorization and approval of executive officer expense reimbursements.

**Public Comment by Robert A. Conway, CPA in Response to  
the PCAOB’s Proposed System of Quality Controls (Docket No. 046)  
January 4, 2023**

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**The Circumstances Warrant a Prescriptive Standard for  
Large Audit Firm Resource Management and Monitoring**

**The mismanagement of human capital by the largest audit firms is an age-old problem that undermines audit quality and threatens the long-term sustainability of the auditing profession.** Allowing the audit firms to each use their own risk-based approach to controls over the management and monitoring of their human capital will not drive serious change. Rather, it will allow the largest audit firms to perpetuate the status quo by enabling those firms to set a low bar on resource management and monitoring that the audit firms will satisfy despite the checkered realities of how the largest audit firms mismanage their human capital.

To achieve a suitable level of profitability in a commodity pricing environment, the audit firms have demanded high levels of productivity from their professionals. The heavy workloads cause high turnover that undermines experience levels and year-over-year engagement continuity – factors that academia have demonstrated are linked to audit quality. Heavy workloads at the partner and manager level (as evidenced by high ratios of staff to partners and managers) threaten the quality of supervision and review. **In summary, there is a heightened risk that inexperienced staff will be inadequately supervised. This staffing model is a complete mismatch with the complexity that auditors need to master in order to achieve a suitable level of audit quality.** A risk-based approach will simply provide cover for the existing flawed human resource model followed by the largest audit firms.

In the pages that follow, I will describe what a prescriptive approach to human resource management and monitoring would look like. But first, I want to be sure we are on the same page with respect to the current state of the audit firm staffing model and how the largest audit firms mismanage their human resources.

**Flashing Red Lights Point to Audit Firm Mismanagement of  
Human Capital as a Threat to Audit Quality and  
the Long-Term Sustainability of the Auditing Profession**

The PCAOB’s proposed QC standard leaves me wondering if this standard was crafted in a vacuum. I see no indication that the PCAOB considered the following flashing red lights:

- In April 2022, EY Germany “promised staff an improvement of working conditions after receiving the recommendations of an independent advisory commission tasked with

improving internal governance **in the wake of the Wirecard scandal**. In a briefing document for staff, which was seen by the FT, the firm said it would address “**permanent occupational stress and overburdening**” among its audit staff, in part by hiring more people and trying to limit after-hours work.<sup>1</sup>

- On June 28, 2022, an SEC Order fined Ernst & Young \$100 million for employee cheating on CPA Ethics exams. The order noted that, “Many professionals acknowledged during the firm’s investigation that they knew their conduct violated EY’s Code of Conduct, but **they cheated because of work commitments** or an inability to pass training exams after multiple attempts.”<sup>2</sup>
- The AICPA 2021 Trends Report<sup>3</sup> (“AICPA Trends Report”) published in 2022 monitors many things including trends in new CPA candidates and annual graduations with degrees in accounting. Here are two basic facts from the AICPA Trends Report that are alarming:
  - The number of new CPA candidates has declined from 48,004 candidates in 2016 to 36,670 candidates in 2019 (pre-pandemic).<sup>4</sup> This is a 24% decline.<sup>5</sup>
  - Total annual accounting degree completions have declined from 79,854 in the 2015-2016 academic year to 72,923 in the 2019-2020 academic year.<sup>6</sup> This is an 8.7% decline.

The AICPA has many good programs to try to draw more people into public accounting, but none of those programs deal with the central issue – the mismanagement of human capital by the largest CPA firms. Complaints about long hours in public accounting and the absence of work-life balance travel fast via social media from young audit professionals to those in the college ranks that are considering accounting majors. This messaging is driving college students away from careers in public accounting.

The audit firms will naturally pay higher salaries to get their share of a smaller a pool of future auditors. But higher salaries will not solve the root cause issue. The AICPA cannot be counted on to rectify this situation because of the influence the largest audit firms have over the AICPA. If the AICPA will not act, who will? **Spoiler alert: The PCAOB needs to step up. The shortage of qualified professionals is a serious threat to audit quality and investor protection.**

- A January 2018 article published by Reuters<sup>7</sup> about the FDIC’s claim against PwC in the Colonial Bank matter highlighted a quality control failure with respect to PwC’s human capital management as follows:

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<sup>1</sup> See Financial Times article at <https://www.ft.com/content/b4c603a9-d4f7-4f24-b27c-ad5f7f16a880>

<sup>2</sup> See paragraph 20 of the SEC Order at <https://www.sec.gov/litigation/admin/2022/34-95167.pdf>

<sup>3</sup> See [2021 Trends report | Professional Insights | AICPA](#)

<sup>4</sup> See page 52 of the AICPA 2021 Trends Report

<sup>5</sup> New CPA candidates subsequently declined to even lower levels of 30,385 candidates in 2020 and 32,186 candidates in 2021

<sup>6</sup> See page 15 of the AICPA 2021 Trends Report.

<sup>7</sup> See [At heart of FDIC’s win v. PwC, an unsettled theory | Reuters](#) by Alison Frankel.

*“Among PwC’s shortcomings, according to Judge Rothstein: The auditor relied on the chief architect of the fraud, Taylor Bean chair Lee Farkas, to verify key information about the collateral underlying a Colonial credit facility for Taylor Bean. PwC also signed off on Colonial’s audit without ever understanding the third and most complex iteration of the fraud, which involved a credit facility based on phantom mortgage securitizations. **After an auditor who was supposed to make sense of the transactions gave up, saying they were “above his pay grade,” PwC assigned a college-aged intern to evaluate the nearly \$600 million asset.***

*Judge Rothstein was distinctly harsh about PwC’s failings. Basing Colonial’s certification on Farkas’ account of Taylor Bean’s collateral was “quintessentially the same as asking the fox to report on the condition of the hen house,” she wrote. **And charging an intern to decipher a loan facility beyond the expertise of a senior auditor was a “truly astonishing” departure from PwC’s mandate, the judge wrote.***”

PwC settled the claim by the FDIC on the Colonial Bank matter for \$335 million. This was not PwC’s only settlement with respect to its audit of Colonial Bank.

- An academic study and survey titled “Auditor Perception of the Audit Workplace, Audit Quality, and the Auditing Profession”<sup>8</sup> sets off several alarms about the ill-effects on audit quality caused by the Big Four audit firm business model. The executive summary from that study is repeated below:

*“In this study, we use a survey instrument to obtain perspectives from over 700 auditors about present-day audit workloads and the relationship between audit workloads, audit quality, and job satisfaction. Our findings indicate that auditors are working, on average, five hours per week above the threshold at which they believe audit quality begins to deteriorate **and often 20 hours above this threshold at the peak of busy season.** Survey respondents perceive deadlines and staffing shortages as two of the primary reasons for high workloads and further believe **that high workloads result in decreased audit quality via compromised audit procedures (including taking shortcuts), impaired audit judgment (including reduced professional skepticism), and difficulty retaining staff with appropriate knowledge and skills.** We also find that **auditors’ job satisfaction and their excitement about auditing as a career are negatively impacted by high audit workload, particularly when the workload exceeds a threshold that is perceived to impair audit quality.** Overall, our findings provide support for the PCAOB’s recent concern that heavy workloads are continuing to threaten audit quality and suggest that the primary drivers of workload (i.e.,*

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<sup>8</sup> See <https://pdfs.semanticscholar.org/a029/ecca4757286cf68b3548a03244907354f24c.pdf> for “Auditor Perceptions of Audit Workloads, Audit Quality, and the Auditing Profession” by Persellin, Schmidt, and Wilkens; December 2014



*deadlines and staffing problems) might be the actual “root cause” of workload-related audit deficiencies.”*

While this study is admittedly eight years old, recent anecdotal evidence tells me that these findings are just as relevant today as they were eight years ago.

- Another relevant and more recent study published in 2019 is titled, “How Do Audit Team Workloads and Audit Team Staffing Affect Audit Outcomes?”<sup>9</sup> The executive summary from that study is repeated below:

*“Using U.S. data from a global accounting firm, we investigate whether two key elements of audit teams – team workloads and staffing continuity – affect audit outcomes. **We find that greater team workloads are associated with lower audit quality, particularly when team members spend more time on other concurrent clients, have lower performance ratings, and have total workloads that exceed the common industry benchmark. This detrimental effect is especially observable for senior and staff auditors. We also find that greater year-over-year team staffing continuity improves audit quality, efficiency, and profitability.** These effects are strongest when senior and staff auditor continuity is high, when returning team members are highly rated, and in smaller audit offices where quality typically is lowest. Our study provides important new evidence about audit teams and audit outcomes as called for by academics and audit regulators.”*

- **Do Not Be Deceived by the Inclusion of the Big Four in Fortune’s 100 Best Places to Work.** Yes, the Big Four are all in the top 50 of Fortune Magazine’s Best Places to Work. How could that be? Fortune Magazine explains that the “Best Places to Work” list is compiled by its research partner, a company called Great Places to Work. Survey data is compiled from five broad categories: 1) perks, 2) diversity, 3) paid time off, 4) compensation, and 5) applicants per opening. As best I can tell, work-life balance does not factor into the Fortune list.

Vault.com conducts an annual survey of accounting firms using criteria identified as important to job seekers. Those criteria, followed by their weighting in the survey results, are as follows: prestige (35%), firm culture (20%), job satisfaction (10%), compensation (10%), work-life balance (10%), business outlook (5%), formal training (5%), and informal training (5%). The Big Four do well in this survey [generally in the top four] because of the heavy weighting given to prestige. However, commentary from a recent survey reveals that, **“The Big Four ... regularly score much lower (usually in 20<sup>th</sup> place or below) along the dimensions that are most indicative of their desirability as places to work, most notably firm culture, work-life balance, and job satisfaction. ... It suggests that the Big Four may be more desirable as resume-building stopovers in a career path pointed elsewhere than as long-term destinations.”**<sup>10</sup>

<sup>9</sup> Christensen, Brant E. and Newton, Nathan J. and Wilkins, Michael S., How Do Audit Team Workloads and Audit Team Staffing Affect Audit Outcomes? Archival Evidence from U.S. Audits (July 11, 2019). Available at SSRN: <https://ssrn.com/abstract=3418533> or <http://dx.doi.org/10.2139/ssrn.3418533>

<sup>10</sup> See <https://www.thebalancecareers.com/best-accounting-firms-to-work-for-1286650>

- I don't believe it is well understood that corporate America is largely audited by non-CPAs with limited experience in the field of auditing. As I mentioned earlier, there is a heightened risk that inexperienced professionals will be inadequately supervised. To be sure everyone understands this reality, I compiled the table below using data from a 2018 Deloitte Audit Quality Report. The relevant assumptions underlying this data are summarized in the relevant footnotes at the bottom of this page.

| <u>Job Title</u>                | <u>Average Tenure at Deloitte after CPA Licensing (in years)</u> |   | <u>Engagement Level Data</u>                                      |   |            |
|---------------------------------|--|---|---|---|------------|
|                                 |  |   | <u>Author's Estimated Percentage of Chargeable Hours by Level</u> | <u>Tenure After CPA Licensing Weighted by Percentage of Chargeable Hrs.</u> |            |
| Partners and managing directors | 20.0 yrs.  | x | 10% <sup>11</sup>   | =   | 2.0        |
| Senior managers                 | 9.2  | x | 5%  | =   | 0.5        |
| Managers                        | 4.3  | x | 10%   | =   | 0.4        |
| Seniors                         | 1.4  | x | 25%   | =   | 0.3        |
| Staff                           | 0.0 <sup>12</sup>  | x | <u>50%</u>  | =   | <u>0.0</u> |
|                                 |  |   | <u>100%</u>   |   |            |

Est. Audit Team Weighted Ave. Years of Experience After CPA Licensing      **3.2 years**  
 The same statistic excluding the Partner and Managing Director experience      **1.3 years**

There are a few key takeaways from this data. First, you can see the “high leverage” in the large audit firm staffing . The true experts at the top of the organization account for only a small percentage of the hours expended on each audit. Second, a near majority of the audit hours come from professionals who are not yet licensed as CPAs. This distribution of audit hours accounts for common criticisms of from corporate controllers and CFOs about 1) being a training ground for young auditors, 2) being asked the same questions over and over, and 3) not seeing enough of the partner and manager assigned to the audit. Lastly, the weighted average experience of the team (excluding partner and managing director time) is only 1.3 years after certification. The reality is that corporate American is largely audited by a lot of young people just out of college.

If there is any remaining doubt about the staffing model issues I have described, please confer with the ex-Big Four professionals currently at the PCAOB. I am confident they will acknowledge that the staffing model and high demands for productivity are real problems in much need of attention.

<sup>11</sup> Deloitte reports a 1 to 8.0 headcount ratio of partners and managing directors to all other audit personnel. The percentage of partner and manager time to total time of 11.1%  $[(1/(1+8)) \times 100\%]$  was adjusted downward slightly to 10% since lower-level staff tend to have higher total chargeable hours.

<sup>12</sup> This data point from the 2018 Deloitte Audit Quality Report was 1.3 years of average experience before I subtracted the typical two-year time lag to become a licensed CPA. In other words, it would be rare to find anyone at the staff level with an active CPA license.



Lastly, I'll refer you to a recent Wall Street Journal article that is getting a lot of attention titled [“Why So Many Accountants Are Quitting -- Even Some Accounting Majors Don't Want Accounting Jobs.”](#)

### **What Would a Prescriptive Approach to Human Resource Management and Monitoring Look Like?**

This is not rocket science. It's actually quite simple. A prescriptive approach to the quality controls over human capital management and monitoring might look like the following:

- For each partner and manager, monitor all engagement assignments and time requirements at the office level to prevent excessive peak-period workloads that might undermine each professional's ability to provide appropriate supervision and review. Define parameters that would signal the need for remedial action to assure audit quality is not compromised.
- Monitor and manage audit staff utilization on a real time basis to prevent and remedy situations that threaten to undermine audit quality. Define parameters for staff utilization that would signal the need for remedial action to assure audit quality is not compromised.
- Monitor and identify engagements where the workloads, high turnover, low experience levels, and low year-over-year staff continuity, or insufficient industry expertise threaten to undermine audit quality. Define parameters that would signal the need for remedial action to assure audit quality is not compromised. Ideally, the parameters would be more stringent for engagements that are determined to be higher risk.
- Modify the Engagement Quality Review standard (which is essentially a quality control activity) to give the Engagement Quality Reviewer (EQR) visibility as to how the audit firm's human capital was deployed on the engagement under review. The EQR partner should understand whether the audit under review was conducted under conditions conducive to audit quality or was conducted under conditions that threaten to undermine audit quality. If the circumstances threaten audit quality, the EQR needs to be satisfied that appropriate remedial action was undertaken by the engagement team to assure audit quality was not compromised due to the audit firm's mismanagement of its human capital.
- In certain cases where the EQR partner is not satisfied that appropriate remedial action has been undertaken, the EQR partner should withhold his or her signoff until appropriate remedial action can be undertaken. Under these circumstances, the audit firm may need to advise the issuer that the audit cannot be completed within the specified time frame. As it stands currently, some audits move down the conveyer belt and are signed off on,

not because a suitable level of quality has been achieved, but because the auditor has simply run out of time. We know from the post-mortem on many failed audits that time pressures and client pressures can undermine good judgment. Giving the EQR expanded responsibilities can help to mitigate the risks associated with time pressures and over-bearing clients.

The metrics I favor for monitoring are easy to calculate and supported by academia as being relevant to audit quality:

- **Staff and Manager Workload Metric**  
Average audit staff and manager chargeable hours in excess of 40 hours per week as a percentage of total hours per week.
- **Partner Workload/Capacity**  
Total partner hours managed across all of the partner's engagements according to the workload system (actual year-to-date plus projected).
- **Supervision**  
Partner, Managing Director, and EQR hours as a percentage of total hours.
- **Engagement Team Continuity Metric**  
Engagement team continuity year-over-year (all prior year personnel returning = 100%).
- **Experience Metric**  
Weighted average years of experience post-CPA certification.

Reporting to the audit committee of these metrics should identify any instances where the metrics fall outside of predetermined parameters. If such instances occur, there should be an explanation of the steps taken by the engagement team to assure that audit quality was not compromised. The audit firm should be encouraged to supplement the reported data with its own discussion and analysis of the information presented.

### **Letting the Audit Firms Define How They Evaluate Themselves? Really?**

The draft QC standard gives the audit firms the latitude to conduct their own risk assessment and design their own control structure to manage the assessed risk. As it relates to the "Resources" component (the human capital component), my risk assessment says there is a heightened risk that the largest firms will set the bar abysmally low. How else can the largest audit firms give themselves a passing grade in resource management? The PCAOB's proposed quality control standard reads like a return to the pre-SOX days of self-regulation which was a complete failure.

## Evaluating the Cost-Benefit of the Proposed QC Standard

The PCAOB should look at the baseline of where the Big Four are at today in terms of their quality controls and judge whether the proposed QC standard will materially improve audit quality at the Big Four. In general, the Big Four process are mature for all components of quality control covered by the PCAOB's proposed standard – with the notable exception of human resource management where they fail miserably. I am concerned that the largest audit firms will set a low bar for compliance on human resource management and remediation because of the potential adverse effect on firm profitability. **The audit firms will assert that the completion of supervisory review by the senior accountant, the manager, the partner, and the EQR are sufficient evidence that the engagement was completed in conformance with PCAOB standards and GAAP (irrespective of whether human resource management on the engagement was chaotic as evidenced by high turnover, low year-over-year continuity, low experience levels, and high partner and manager workloads that threaten to undermine appropriate supervision and review).**

This is precisely why the monitoring and remediation of how human capital is deployed at the Big Four is so important. **Absent incorporating prescriptive requirements into the QC standard for the monitoring and remediation of human resources, I doubt that very little improvement in Big Four audit quality will result from the PCAOB's proposed standard.**

It is important to bear in mind that the audit firm's profitability is the highest when the audit ranks are understaffed. There is a financial incentive to operate lean that undermines audit quality. The use of metrics regarding the management of human capital creates the opportunity for those tasked with managing human resources to be held to account when audit operations evidence mismanagement of human resources.

## The Utility of a Firmwide Focus on Audit Quality Versus an Engagement Level Focus?

Businesses like Hilton Hotels, Hertz, or even McDonalds are able to achieve a uniform level of quality across locations. In the auditing profession, however, audit quality varies considerably from audit to audit (even within the same firm and within the same office). I know this to be true from my personal experience, but it is also evident in the PCAOB inspection results of each of the largest audit firms. Some inspected audits have no part 1 deficiencies while other audits have multiple deficiencies. Some audits become audit failures resulting in restatements while others do not.

Each issuer audit presents a unique set of challenges that contribute to the variability of audit quality. Each company under audit has challenges that are driven by economic issues, industry challenges, competitive challenges, the adequacy of financing to operate as a going concern, complex business transactions, asset impairment issues, etc. Yes, no two audits are alike.

Another source of variability comes from the individual skill levels of audit team members, the year-over-year continuity of engagement team members, industry expertise needs when relevant, and the capacity of each auditor to focus on the task at hand without being distracted by competing priorities. The level of supervision and review will also depend on the skill level of the reviewers and their ability to focus on the task at hand without interference from competing priorities.

Individual audits are not staffed with uniform levels of industry experience, year-over-year engagement continuity, or professionals with equally balanced workloads. A whole host of factors drive this type of variability. One significant factor might be the actual or perceived pressure to produce profits at the local office level. The thirst for profits can affect just how lean the audit ranks are staffed going into each busy season. Each audit in an office may be affected differently by unpredictable factors such as 1) staff turnover, 2) a sudden increase in new work as a result of proposal win or 3) the acquisition of a business in the local area by a firm client located elsewhere.

The PCAOB's draft QC standard is built around a risk-based approach that yields a firmwide report on audit quality to the PCAOB. **How much utility does such a report have for each individual audit committee? I would argue very little. Wouldn't there be more interest in understanding the level of audit quality delivered by the audit firm to produce each audit overseen by each audit committee?** This gets to the heart of the PCAOB's Mission to protect the investors – not collectively, but one audit at a time.

Each audit committee needs to understand whether the quality of their audit was threatened by human resource issues, and if so, what did the audit firm do to assure that audit quality was not compromised.

### **The Decoupling of the QC Standard from the Engagement Performance Metrics Initiative**

As it stands currently, the quality control standard is progressing toward becoming a reality while Engagement Performance Metrics initiative is in a holding pattern on the PCAOB's Research Agenda. This is unfortunate because the Quality Control Standard and Engagement Performance Metrics are very much interrelated (as I will explain below).

For the sake of discussion, think of Engagement Performance Metrics as a large coin. One side of the coin is inward facing for the benefit of audit operations management. The Engagement Performance Metrics are used to monitor audit operations so that situations where audit quality might be compromised get identified and remediated (i.e., audits with excessive turnover, low experience levels, excessive workloads, inadequate industry experience, insufficient specialist involvement, and inadequate supervision and review).

The other side of the Engagement Performance Metrics coin is outward facing for the benefit of each audit committee so they can understand whether audit quality on their audit was potentially compromised; and if so, what did the audit firm do to assure audit quality was not compromised?

Instead of an integrated approach between QC standards and Engagement Performance Metrics, the PCAOB is positioning them to be non-integrated. In my mind, this is akin to an IT strategy that fails to migrate to a point in the future where the company's hardware and software systems operate in harmony. There is an opportunity to realize synergy between the Engagement Performance Metrics and the Quality Control Standard – but that is not the path that the PCAOB is on.

PCAOB's Standards and Emerging Issues Advisory Group (SEIAG) and Investor Advisory Group (IAG) each convened twice in 2022 to discuss Engagement Performance Metrics (formerly referred to as Audit Quality Indicators). The webcasts of those meetings reflect resounding support for Engagement Performance Metrics as a mechanism to drive improvements in audit quality. The PCAOB needs to reconsider its non-integrated approach to Quality Controls and Engagement Performance Metrics. If there was ever a time for these two initiatives to be integrated, this is it.

If the PCAOB does not integrate these two initiatives, the PCAOB needs to explain why a non-integrated approach benefits investors more than an integrated approach.

### **A Troubling Passage in the Draft QC Standard Warrants Discussion**

Repeated below is paragraph .44 of the proposed standard discussing controls over resources:

#### *Resources Quality Objectives*

*.44 The quality objectives established by the firm with respect to the firm's resources should include the following:*

- a. Firm personnel are hired, developed, and retained who have the competence to perform activities and carry out responsibilities for the operation of the firm's QC system and the performance of the firm's engagements in accordance with applicable professional and legal requirements and the firm's policies and procedures.*

*Note: Competence consists of having the knowledge, skill, and ability that enable individuals to act in accordance with applicable professional and legal requirements and the firm's policies and procedures. **The measure of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained by firm personnel over time.***

The passage in bold strikes me as very prescriptive in what the PCAOB has otherwise characterized as a risk-based approach. I realize that this wording is a carryover from the existing Quality Control Standard 40. I do not understand why the PCAOB chose to carry this wording forward. It seems to preclude the use of metrics that could be instrumental in any monitoring activity over the deployment of human resources in audit operations. For example, an audit firm can have very competent professionals, but if those professionals are over-worked or inadequately supervised, the benefits of a high level of competence are severely diminished.

We know that the large audit firms all have a performance evaluation process that is geared toward giving people more responsibility as they demonstrate success at the current responsibilities. That is an important quality control process. But it should not be the only control process. That process needs to be supplemented by monitoring processes using data points on workloads (at the staff, partner, and manager levels), team experience levels, year-over-year engagement continuity, industry experience when relevant, and the capacity of managers and partners to provide appropriate supervision and review.

The bottom line is that a meaningful quality control system needs to evaluate far more than just competence. If a new quality control standard is somehow limited to qualitative aspects of competence, I fear that the PCAOB will have merely paved the cow path with no benefit to investors.

### **Keeping Pace with the AICPA on Integrity and Objectivity**

The AICPA's Integrity and Objectivity standards have always forbidden the subordination of judgment when differing views arise among AICPA members over a material issue. In other words, a subordinate with a differing view is obligated to speak up on material matters. This construct is critical to audit quality. **The AICPA, recognizing that it is not easy for subordinates to challenge overbearing supervisors, added provisions to its Integrity and Objectivity Standards in 2013 prohibiting supervisors (including audit partners) from exercising undue influence over subordinates. In other words, a partner should not apply undue influence to override a subordinate and bypass appropriate dispute resolution protocols.** These enhancements to the AICPA standards were made by the AICPA after the PCAOB adopted the AICPA standards in 2003. It is important that the PCAOB at least catch up to the AICPA in this regard so that subordinates auditing public companies know that their PCAOB professional standards fully support their responsibility to voice their concerns, **especially in the face of an over-bearing supervisor.** This is the same recommendation I made in my public comment in response to the PCAOB's December 2019 Concept Release on Potential Changes to the QC Standard.

### **Other Advances by the AICPA that Should Be Considered by the PCAOB**

After the PCAOB adopted the AICPA standards in 2003, the AICPA made some useful amendments to their QC standards that were never adopted by the PCAOB. Specifically, the AICPA modified its QC Standard in 2007 to "strongly emphasize the responsibility of audit firm leadership to set the proper "tone at the top." ... Each audit firm is required to design and implement quality control procedures that support that message and promote a quality-oriented culture." **The AICPA policy requires that the audit firm "assign management responsibilities so that commercial considerations do not override the quality of the work performed." ... Perhaps most importantly, QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.**<sup>13</sup>

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<sup>13</sup> Comments are from "Audit Watch" dated July 28, 2008

## The 100 Issuer Audit Threshold

I appreciate that “100 issuer audits in total” is the threshold the PCAOB uses to determine whether an audit firm is inspected annually versus triennially. I have often thought that the criteria for annual inspection should consider the market capitalization of individual issuers and issuers in the aggregate. A small audit firm auditing a company with a large market capitalization should not be able to fly under the radar because that audit firm simply has a small number of clients. Think for a moment about the small audit firms that audited Madoff or FTX. Philosophically, I think the highest responsibilities associated with any comprehensive reporting on quality controls should be based on a measure like market capitalization audited (individually and/or in the aggregate) rather than the number of issuers audited.

## Closing Thought

I will close by repeating a thought I shared when I responded to the PCAOB’s request for comment on its December 2019 Concept Release regarding potential changes to the quality control standards. At the time, I said:

I like the risk assessment approach. However, I think it is important for the PCAOB to be very prescriptive about the expectations for the management of human capital given 1) the poor past performance of large firms managing human capital and 2) the potential benefits to audit quality that can be achieved from improved management of human capital.

My responses to the 93 questions the PCAOB is seeking input on are attached to this document.

Respectfully submitted,

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## About the Author -- My 360° Perspective on the Auditing Profession

I am a retired KPMG audit partner. I worked at KPMG for 26+ years, including 17 years as an audit partner. After retiring from KPMG, I joined the PCAOB where I worked from 2005 to 2014. During my last six years at the PCAOB, I was the Regional Associate Director with leadership responsibility for the PCAOB’s Orange County and Los Angeles offices. Like virtually everyone else that joins the PCAOB, I was inspired by the PCAOB’s important Mission to improve audit quality.

After leaving the PCAOB, I became the Professional Practice Director at CNM LLP, an 85-person regional CPA firm in Southern California that focuses exclusively on technical accounting consultations and SOX 404 outsourcing. My responsibilities put me in regular contact with Big

Four audit partners, public company CFO's, Chief Accounting Officers, audit committees, and SOX Compliance Leaders. I worked at CNM for three years.

In 2019, I started serving as an expert witness in matters involving accounting, auditing, and internal controls over financial reporting.

In 2020, I published a book titled, "The Truth About Public Accounting – Understanding and Managing the Risks the Auditors Bring to the Audit."

My recommendation in 2007 to the US Treasury Department's Advisory Committee on the Auditing Profession (ACAP) was widely credited with providing the impetus for ACAP's final report recommendation that the PCAOB evaluate the feasibility and potential benefits of providing public transparency to audit firm input and output measures that may be indicators of audit quality (AQIs). The PCAOB ultimately published a Concept Release on Audit Quality Indicators in June 2015. A project to study "Engagement Performance Metrics" was added to the PCAOB's Research Agenda in 2022.



## Robert Conway Responses to Specific Questions Posed by the PCAOB

1. Is the proposed definition of “applicable professional and legal requirements” appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?

I think the definition is reasonable.

2. Is the proposed definition of “engagement” clear and appropriate? If not, why not? Should the definition be narrower (e.g., limited to engagements required to be performed under PCAOB standards) or broader? If so, how?

I think the definition is reasonable.

3. Are the proposed definitions of “firm personnel,” “other participants,” and “third-party providers” sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.

I think the definitions are reasonable.

4. Is the other terminology used in QC 1000 clear and appropriate? Are there other terms that should be defined?

I think it would help to define the components referred to as “Resources” and “Engagement Performance” in the definitions section. I eventually understood the distinction as I read on, but it would help to make the distinction clear in the definitions section.

5. Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.

The criteria for the application of this standard should be based on the whether the engagements individually or in the aggregate involve a material amount of market capitalization. If the firm does not plan to perform engagements pursuant to PCAOB standards, the firm should not be required to comply.

6. Is the proposed distinction between the obligation to design a QC system and the obligation to implement and operate a QC system appropriate? Is the proposed threshold for full applicability of QC 1000—having obligations under applicable professional and legal requirements with respect to a firm engagement—appropriate?

I understand the distinction. I think it would be simpler to say that, if a firm is going to conduct an issuer audit above a certain market cap threshold, the firm needs to have the QC system designed and operating before such services are rendered. The requirement to operate the QC system could be optional for registered firms auditing smaller market cap companies below a specified threshold. You may want to consider an aggregate market cap threshold for all issuer audits done by one firm if the aggregate market cap of all issuer audits exceeds a specified aggregate threshold.

For firms conducting audits of smaller market cap companies, I think it is reasonable for them to demonstrate how the quality control concepts described herein were incorporated into the design of the audit firm's processes, applying the scalable and risk-based concepts described in your proposed standard.

I don't believe an audit firm that does not intend to conduct PCAOB audits should be required to do anything.

7. Is it clear how a firm's responsibilities under QC 1000 may change depending on the extent of "applicable professional and legal requirements" to which the firm is subject at a particular time? Please explain what additional direction may be necessary.

I think it is clear.

8. Are there other provisions of QC 1000 that should apply to all firms? If so, which other provisions should we consider?

See above.

9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?

See page 11 of my response where I suggest an alternative to the "100 Issuer" threshold that I think better focuses the effort in proportion to the market cap at risk.

10. Is the reasonable assurance objective described in the proposed standard appropriate? If not, why not? Are there additional objectives that a QC system should achieve? If so, what are they?

I think the "reasonable assurance" terminology is appropriate.

11. Are the proposed requirements regarding design of the QC system appropriate? Are there other aspects of QC 1000 that should be required as part of the design of the QC system? If so, what are they?

**I feel strongly that the QC requirements pertaining to “Monitoring and Remediation” of “Resources” should be prescriptive and reported on at the engagement level.** I am fine with the other components being risk-based and scalable with the focus at the firm-wide level. Please see my specific comments on pages 1 through 10.

12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?

In 2007, the AICPA introduced into their QC standard the concept that “QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.” See my detailed commentary at the bottom of page 11.

13. Would firms have difficulty filling the specified roles in light of the proposed requirements?

I don’t believe this should be a problem.

14. Are the proposed definitions of “quality risks,” “quality objectives,” and “quality responses” sufficiently clear and comprehensive? If not, why not?

I understood them.

15. Is the threshold of “adversely affecting” set out in the proposed definition of quality risk clear, or would more guidance and examples be helpful?

More examples serve as helpful interpretive guidance to those tasked with implementing any new standard.

16. Should the proposed definition of “quality risks” explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?

Nothing specific to add here.

17. In the proposed definition of “quality risks” should the threshold of “reasonable possibility of occurring” also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?

No specific comment.

18. Are the proposed requirements for the firm’s risk assessment process appropriate? Are changes to the requirements necessary for this process? If so, what changes?

The risks specific to the “Monitoring and Remediation” of “Resources” are so great that I believe a very prescriptive approach is warranted. Otherwise, I doubt that the new QC standard will drive any meaningful improvement in audit quality. I have commented on this at length on pages one through nine of my public comment.

19. Are the proposed requirements sufficient to prompt firms to appropriately identify, assess, and respond to quality risks, or is supplemental direction needed? If supplemental direction is needed, what would assist firms in identifying, assessing, and responding to quality risks?

**I strongly believe the requirements need to be prescriptive as it relates to “Monitoring and Remediation” of Resources (as described in my public comments on pages one through ten herein).**

20. Are the specific examples included in Appendix B helpful in assisting the firm in identifying and assessing quality risks? Should additional examples or guidance be provided? If so, what additional examples or guidance would be helpful?

Appendix B is helpful.

In 2007, the AICPA introduced into their QC standard the concept that “QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.” Something like this needs to be incorporated into the new QC standard if it is not already there. See my detailed commentary on page 11.

21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Refer to my response to the preceding question (#20).

22. For the proposed specified quality response related to the firm’s governance structure, is the threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, what is an appropriate threshold?

I can appreciate that the “100 issuer” threshold is well understood, but I think a threshold that is based on market capitalization would be a better risk-based manner for establishing a threshold. See my comments on page 11 of my public comment.

23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?

I support the concept of independent oversight for the audit practice. I can appreciate that the “100 issuer” threshold is well understood, but I think a threshold that is based on market capitalization would be a better risk-based manner for establishing a threshold. See my comments on page 11 of my public comment.

24. Is the proposed specified quality response related to the firm's policies and procedures on receiving and investigating complaints and allegations appropriate? Are there any other specified quality responses in this area that we should consider, and if so, what are they?

The AICPA made specific changes to its Integrity and Objectivity standards in 2013 that should be incorporated into the PCAOB’s standards. The specific standard I am referring to prohibits supervisory personnel from applying undue influence over subordinates who express a contrary view. See page 10 of my public comment letter for further details.

25. Are there any other specified quality responses for the governance and leadership component that we should consider? If so, what are they?

In 2007, the AICPA introduced into their QC standard the concept that “QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.” Something like this needs to be incorporated into the new QC standard if it is not already there. See my detailed commentary at the bottom of page 11.

26. Are the proposed quality objectives for ethics and independence requirements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

The AICPA made specific changes to its Integrity and Objectivity standards in 2013 that should be incorporated into the PCAOB’s standards. The specific standard I am referring to prohibits supervisory personnel from applying undue influence over subordinates who express a contrary view. See page 10 of my public comment letter for further details.

27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?

Refer to my response to the preceding question (#26)

28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?

No specific comment.

29. Is the proposed specified quality response related to communication of changes to the list of restricted entities at least monthly (and more frequently, if appropriate) to firm personnel and others performing work on behalf of the firm who are subject to independence requirements appropriate? Could communication to a more limited group accomplish the goal of alerting all individuals whose actions and relationships are relevant to independence? If so, to whom should changes be communicated?

No specific comment.

30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?

Annual affirmation is always a good. Most public companies already do something like this.

31. Are the proposed quality objectives for acceptance and continuance of client relationships and specific engagements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

In addition to considering whether the firm has or can obtain the necessary resources to service new work, consideration should be given to the availability of industry specific resources at the partner and manager level and whether the incremental work might adversely affect the firm's ability to provide quality services to existing clients.

I think specific circumstances should be identified that require an immediate reconsideration of client continuance. Such circumstances could include newly discovered facts that call into question the integrity and honesty of management. Such facts would include illegal acts, fraud, material omissions of fact, and false representations provided by management.

32. Are the proposed specified quality responses for acceptance and continuance of client relationships and specific engagements appropriate? If not, what changes to the specified quality responses are necessary for this component?

See above response to question #31.

33. Are the proposed quality objectives for engagement performance appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Policies should be adopted that identify situations where national office consultation is required.

34. Should we include specified quality responses for the engagement performance component? If so, what should they be?

See above response to question #33.

35. We are proposing to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. Should the standard include specified quality responses explicitly directed to non-U.S. firms that audit issuers? If so, what are they?

This is another situation where I think the requirements should be more prescriptive because the risks are generally very high.

36. Are the proposed quality objectives for resources appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

**I feel very strongly that the risks associated with the “resources” component (including the related monitoring and remediation) are so great that a prescriptive approach is warranted. I have explained the basis for this view at length in my public comment letter (pages one through ten).**

37. Does the proposed quality objective and specified quality response related to technological resources provide sufficient direction to enable the appropriate use of emerging technologies? If not, what additional direction is necessary?

No specific comment.

38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?

See my response to question #36.

39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm’s clients? If yes, what should the requirement be?

No specific comment.

40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

As noted earlier, I strongly favor monitoring of resources as each audit progresses so that timely corrective action can be undertaken to assure audit quality is not compromised. In order for this to happen, there needs to be adequate information and communication to occur to enable timely monitoring and remediation.

41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?

The objectives are quite broad and may be reasonable for situations where the expectations are also broad (in other words, not prescriptive). As I have already indicated, the circumstances favor more prescriptive requirements for monitoring and remediation of the human resources component at the engagement level. This would require more prescriptive requirements for communications. The PCAOB also needs to be mindful of trying to achieve a degree of comparability across the largest audit firms. If the metrics lack comparability, there should be adequate disclosure as to how and why certain disclosures deviate from prescribed measures and the effect on comparability of the metrics to those used by other firms.

42. Are the proposed quality objective and specified quality response addressing information and communication related to other participants appropriate? If not, why not, and what changes are necessary?

Same response as above to question #41.

43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.

The audit firms monitor the quality of member firms but have typically been reluctant to share negative information about a member firm. Requiring transparency to such information would be beneficial to all constituents over the longer term.

44. Are the proposed specified quality responses for information and communication appropriate? If not, what changes to the specified quality responses are necessary for this component?

Same response as provided above to question #41.



45. Are the proposed requirements for the monitoring and remediation process appropriate? Are changes to the requirements necessary for this process? If so, what changes should be made and why?

As I have already mentioned, the monitoring and remediation process should be prescriptive **at the engagement level** and should make use of basic engagement performance metrics. The metrics I favor are easy to calculate and supported by academia as being relevant to audit quality:

- **Staff and Manager Workload Metric**  
Average audit staff and manager chargeable hours in excess of 40 hours per week as a percentage of total hours per week
- **Partner Workload/Capacity**  
Total partner hours managed across all engagements according to the workload system (actual year-to-date plus projected).
- **Supervision**  
Partner, Managing Director, and EQR hours as a percentage of total hours
- **Engagement Team Continuity Metric**  
Engagement team continuity year-over-year (all prior year personnel returning = 100%)
- **Experience Metric**  
Weighted average years of experience post-CPA certification

Reporting to the audit committee of these metrics should identify any instances where the metrics fall outside of predetermined parameters. If such instances occur, there should be an explanation of the steps taken by the engagement team to assure that audit quality was not compromised. The audit firm should be encouraged to supplement the reported data with its own discussion and analysis of the information presented.

46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?

This requirement is reasonable.

47. Is it appropriate to require monitoring of in-process engagements by firms that issue audit reports with respect to more than 100 issuers during a calendar year? If not, is there a more appropriate threshold?

I have suggested that a market capitalization threshold would more appropriately match the effort to the amount of market capitalization at risk (see page 11 of comment letter). I appreciate the desire for a scalable standard, but the PCAOB should not let scalability concerns or costs to small firms get in the way of producing a standard that meaningfully drives change and improvement in audit quality **among the largest audit firms**. That is where

the risk is.

Yes, it is good to have all of the audit firms working to improve their quality controls. But please don't let smaller firm considerations get in the way of doing the right thing for the largest audit firms. I continue to believe that monitoring and remediation as it relates to the deployment of human capital is the biggest opportunity for the PCAOB to make a difference.

48. Are the purposes of in-process monitoring (as proposed within this standard) clear and appropriate, including how in-process monitoring differs from the requirements of engagement quality reviews under AS 1220? If not, what additional direction is needed?

See my response to question #50.

49. Is it appropriate to require firms to consider performing monitoring activities on work they perform on other firms' engagements? If not, why not?

Yes, if the threshold is met for a substantial role under the PCAOB definitions, the monitoring activities should apply. There is often a heightened risk that referred work gets the last call on resources. This risk makes monitoring all the more important.

50. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which engagements to select, appropriate? If not, what other factors should be specified?

I am concerned that there is some blurring between quality controls, engagement monitoring, engagement performance, and engagement inspection. Here is my view of how this would play out:

**Firmwide Resources and Methodologies** -- From a big picture perspective, the largest audit firms have mature audit methodologies and tools, performance evaluation processes, well defined policies, processes to assign professionals to individual audit engagements and monitor workloads, consultation protocols, national office resources, engagement quality reviews, client continuance processes, independence functions, internal inspections, etc. These activities are the equivalent of creating an environment that enable auditors to be successful. They don't guarantee success, but they provide the fundamentals to be successful.

With the exception of the process to assign professionals to individual engagements and monitor workloads, these activities (the non-human resource activities) generally operate with a degree of regularity. From a QC perspective, the focus would be on making sure that these processes evolve in response to new accounting and auditing standards, that these functions are appropriately staffed and that any policy or audit methodology changes are approved and rolled out effectively to the field. From a quality control perspective, it would be important to know that these activities exist, they are appropriately designed, and they operate effectively.

**Human Capital Management** – My risk assessment says this is where most of the problems lie (apart from all the issues that stem from the auditor being hired and paid by the entity they are passing judgment on, i.e., the core auditor independence problem). This is where the in-process monitoring needs to be prescriptive. This is where audit committees need to understand that, if human resources have been mismanaged, what did the audit firm do to assure audit quality was not compromised?

**Engagement Performance Activities** -- Apart from all of the above, there are the engagement performance activities. These activities involve supervision and review to assure audits are conducted in accordance with firm methodology and policy and in accordance with professional standards. They also involve the Engagement Quality Reviewer. Except in specific situations I'll discuss in a moment, I believe the audit firms would find it cost prohibitive to build in "in process" controls that would be akin to doing an inspection of an audit in process. I say, "except in specific situations" because there may be a new standard or a new tool where additional quality controls are necessary to assure engagement teams are contemporaneously doing the right thing and coming to the right conclusions.

**Internal Inspections** -- Internal inspections are important to make sure audit teams are compliant with firm methodologies and professional standards. These are cost-effectively done on sampling basis and can provide important feedback on common mistakes made by engagement teams that may mean changes need to be made to training, tools, or methodologies.

**From a time-phased perspective**, I see the quality control work rolling out for one cycle as follows (subject to change if specific risks are identified):

**Firmwide Resources and Methodologies** – Tested throughout the year to assure these activities are appropriately designed and operate effectively. This may involve a combination of testing at the national level and at a sample of audit engagements for specific attributes (i.e., Were the current tools and approved methodologies applied? Did audit professionals comply with training requirements?).

**Human Capital Management** – As described on pages 6 and 7 of my comment letter, monitoring of human resource management should be conducted for **all public company engagements above a specific market capitalization**. The monitoring would use metrics such as staff workload utilization, year-over-year engagement continuity, experience levels, use of professionals with relevant industry experience when relevant, partner and manager workloads, staff to partner leverage ratios, etc.) If the metrics suggest an unacceptable risk that audit quality may have been compromised, remedial procedures would be deployed to assure audit quality was not compromised. Reporting would follow to audit committees of such "reportable events" in a format that could be tallied and reported firmwide.

**Engagement Performance While in Progress** – I would expect that the efforts here

would be limited to those instances where the firm felt that supplemental reviews or QC procedures were necessary to assure proper compliance with new tools, new auditing or accounting standards, or challenging emerging issues.

**Internal Inspections** – These inspections would be conducted during the spring, summer, and fall of audits of companies with year-ends falling during the preceding year. The results of these inspections would inform audit committees and investors as to the quality of the audit firm’s **Engagement Performance Activities**.

**Reporting** -- This would lead to firmwide reporting by April 1 of the succeeding year – in time for consideration during the April/May proxy season.

51. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of QC system-level monitoring activities appropriate? If not, what other factors should be specified?

Please refer to my description in the preceding question about the timing and nature of the QC activities, including monitoring activities.

52. Are the proposed requirements for firms that belong to a network that performs monitoring activities appropriate? If not, what changes should be made?

No comment.

53. Are the proposed definitions for “engagement deficiency,” “QC finding,” and “QC deficiency” sufficiently clear and appropriate? If not, what changes should be made and why?

No comment at this time.

54. What, if any, additional direction is needed regarding:

- a. Evaluating information to determine whether QC findings exist;
- b. Evaluating QC findings to determine whether QC deficiencies exist; or
- c. Responding to engagement and QC deficiencies?

No comment at this time.

55. Should firm personnel be allowed to inspect engagements or QC activities in which they are involved? If so, please explain why and provide examples of mechanisms that could reduce to an appropriate level the risk that noncompliance with PCAOB standards or the firm's policies and procedures would not be detected.

The testing of QC should not involve anyone testing their own work or the work of an engagement team they were part of.

56. Are the proposed requirements related to monitoring and remediation sufficiently scalable for smaller firms? Are there aspects of the proposed requirements that could be further scaled?

I appreciate the desire for a scalable standard, but the PCAOB should not let scalability concerns or costs to small firms get in the way of producing a standard that meaningfully drives change and improvement in audit quality **among the largest audit firms**. That is where the market cap risk is.

Yes, it is good to have all of the audit firms working to improve their quality controls. But please don't let smaller firm considerations get in the way of doing the right thing for the largest audit firms. I continue to believe that monitoring and remediation as it relates to the deployment of human capital is the biggest opportunity for the PCAOB to make a difference.

Yes, these things are scalable. Just don't let scalability get in the way of doing what is needed for the largest firms – such as a more prescriptive approach to monitoring the management (or mismanagement) of human capital.

57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?

No. See the time frame I outlined my response to question #50.

58. Is the proposed definition of “major QC deficiency” clear and appropriate? If not, what changes should be made and why?

No comment at this time.

59. Is it appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist? Are the circumstances described in the proposed definition appropriate? Should there be other circumstances that give rise to such a presumption? If so, what are they?

No comment at this time.

60. Are the proposed factors for determining whether an un-remediated QC deficiency is a major QC deficiency appropriate? If not, what other factors should be specified?

No comment at this time.

61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

I see some merit in reporting to the PCAOB. I might be hesitant to report such results publicly until experience showed there was a reasonable degree of comparability and integrity across the largest firms. Please consider that we are asking the audit firms to police themselves. Absent a suitable degree of comparability, I could see the reporting as potentially problematic and misleading.

I will separately express my views about reporting on **Human Capital Management** matters. As I described in my comment letter, monitoring of human resource management should be conducted for **all public company engagements above a specific market capitalization**. The monitoring would use metrics such as staff workload utilization, year-over-year engagement continuity, experience levels, use of professionals with relevant industry experience when relevant, partner and manager workloads, staff to partner leverage ratios, etc.) If the metrics suggest an unacceptable risk that audit quality may have been compromised, remedial procedures would be deployed to assure audit quality was not compromised. Reporting would follow to audit committees of such “reportable events” in a format that could be tallied and reported firmwide.

62. Should we require individual certifications of the evaluation of the QC system? Is the language in Appendix 2 regarding the certifications appropriate? If not, why not?

No specific comment at this time.

63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?

My recommendation on the timing of procedures and reporting is described in my answer to question #50.

64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?

I mentioned earlier in my response to question #50 that the reporting should be in advance of the April / May proxy season. Reports could be submitted by April 1 perhaps using an “as of date” of February 28.

65. Is the information required on proposed Form QC in Appendix 2 appropriate? Why or why not?

No comment.

66. Are proposed Rule 2203A, *Report on the Evaluation of the Firm's System of Quality Control*, and the proposed Form QC instructions included in Appendix 2, clear and appropriate? If not, why not?

No comment.

67. Are there any non-U.S. laws that would prohibit reporting the information required about the firm's QC system to the PCAOB on Form QC?

None that I am aware of.

68. Some of the PCAOB's reporting forms are permitted to be filed in XML format. Should we permit proposed Form QC to be filed in XML or another machine-readable format? Why or why not?

No comment.

69. In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?

Reporting to audit committees currently requires the auditor to report on whether the audit firm executed the audit in accordance with its plan and whether any particular problems were encountered during the conduct of the audit. The reporting I envision with respect human capital management fits squarely within existing requirements for the auditor to report to the audit committee.

70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?

The auditor should report relevant human resource metrics to the audit committee and should explain what the audit firm did to assure audit quality was not compromised in instances where the metrics raised concern that audit quality may have been compromised.

71. Are the proposed documentation requirements appropriate? If not, what changes should be made?

No comment.

72. Is the "experienced auditor QC threshold" set out in the in the proposed documentation requirement appropriate? If not, what threshold is appropriate?

Seems reasonable.

73. Are there additional specific matters that the firm should be required to document about its QC system? If so, what are they?

As I have mentioned already, I think it is very important for the PCAOB to set forth prescriptive requirements for reporting to audit committee on human resource mismanagement issues and what the auditor did to assure audit quality was not compromised.

74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?

No basis to comment at this time.

75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported? If not, why not?

I think the existing guidance in this area is sufficient.

76. Is the proposal to rescind ET 102 and replace it with EI 1000 appropriate in light of the changes proposed in QC 1000 and developments since 2003? If not, why not?

### Keeping Pace with the AICPA on Integrity and Objectivity

The AICPA's Integrity and Objectivity standards have always forbidden the subordination of judgment when differing views arise among AICPA members over a material issue. In other words, a subordinate with a differing view is obligated to speak up on material matters. This construct is critical to audit quality. **The AICPA, recognizing that it is not easy for subordinates to challenge overbearing supervisors, added provisions to its Integrity and Objectivity Standards in 2013 prohibiting supervisors (including audit partners) from exercising undue influence over subordinates. In other words, a partner should not apply undue influence to override a subordinate and bypass appropriate dispute resolution protocols.** These enhancements to the AICPA standards were made by the AICPA after the PCAOB adopted the AICPA standards in 2003. It is important that the PCAOB at least catch up to the AICPA in this regard so that subordinates auditing public companies know that their PCAOB professional standards fully support their responsibility to voice their concerns, **especially in the face of an over-bearing supervisor.**

This is the same recommendation I made in my public comment in response to the PCAOB's December 2019 Concept Release on Potential Changes to the Quality Control Standards.

77. Are the terms used in EI 1000 clear? Should additional terms be defined or additional guidance provided?

No specific observations.



78. Is the proposal to amend ET 191, including the proposed rescission of certain paragraphs, appropriate? Should any of the proposed interpretations be retained in our standards?

No comment.

79. Are the proposed amendments to other PCAOB standards and rules appropriate? If not, why not? Are there additional amendments to other PCAOB standards or rules that the Board should consider?

### Other Advances by the AICPA that Should Be Considered by the PCAOB

After the PCAOB adopted the AICPA standards in 2003, the AICPA made some useful amendments to their QC standards that were never adopted by the PCAOB. Specifically, the AICPA modified its QC Standard in 2007 to “strongly emphasize the responsibility of audit firm leadership to set the proper “tone at the top.” ... Each audit firm is required to design and implement quality control procedures that support that message and promote a quality-oriented culture.” **The AICPA policy requires that the audit firm “assign management responsibilities so that commercial considerations do not override the quality of the work performed.” ... Perhaps most importantly, QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.**<sup>14</sup>

80. Are the proposed amendments to Form 1 and Form 2 in Appendix 5 appropriate? If not, why not?

No comments at this time.

81. Are there additional academic studies or data related to the baseline for measuring the potential impacts of the proposed requirements? If so, what are they?

The footnotes to my public comment letter refer to various academic studies that support the need for prescriptive reporting on human capital mismanagement issues.

82. Are there additional academic studies or data available related to the resources employed by NAFs or foreign affiliates of GNFs in the design, implementation, and operation of their QC systems? If so, what are they?

None that I am aware of.

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<sup>14</sup> Comments are from “Audit Watch” dated July 28, 2008

83. Are there additional academic studies or data available that could help us approximate the number of firms that will be implementing ISQM 1 or SQMS 1? If so, what are they?

No comment.

84. Should we consider any additional academic studies or data related to the need for standard setting?

Please refer to the academic studies cited and footnoted in my public comment letter.

85. Does our analysis appropriately capture the potential benefits of the proposal? If not, please explain.

The PCAOB should look at the baseline of the where the Big Four are at today in terms of their quality controls and judge whether the proposed QC standard would materially improve audit quality at the Big Four. I am concerned that much of the improvement in audit quality will not occur at the Big Four, but more likely at the smaller and regional firms.

This is precisely why I believe the monitoring and remediation of how human capital is deployed at the Big Four is so important. Absent incorporating such requirements into the QC standard, I doubt that very little improvement in Big Four audit quality will result from the PCAOB's proposed standard.

86. Are there additional potential benefits that should be considered? If so, what are they?

The use of metrics regarding the management or mismanagement of human capital creates the opportunity for those tasked with managing human resources to help to account is audit operations frequently occur outside of predetermined thresholds.

It is important to understand that the audit firm's profitability is the highest when the audit ranks are understaffed. There is a financial incentive to operate too lean that undermines audit quality.

87. Does our analysis appropriately capture the potential costs of the proposal? If not, please explain.

I did not see a detailed quantification of the costs, but I expect they will be considerable. Considering that this will be a costly undertaking, it is incumbent upon the PCAOB to demonstrate that there will be appropriate benefits. If the PCAOB is not prescriptive about how the largest audit firms should monitor and remediate instances of human capital mismanagement, I believe the costs to implement the QC standard will far outweigh the potential benefits, particularly as it relates to the largest audit firms that audit the lion's share of the large cap issuers.

88. Are there additional potential costs that should be considered? If so, what are they?

No specific comment at this time.

89. Are there additional academic studies or data related to the potential benefits and costs of the proposed requirements? If so, what are they?

Not that I am aware of.

90. Are there other potential unintended consequences of the proposal that we have not identified? If so, what are they?

No comment at this time.

91. Are any alternative approaches to addressing the need for standard setting preferable to the proposed approach? If so, why?

Please refer to the comments in my public comment letter about the importance of monitoring and reporting at the engagement level of metrics relevant to human resource management.

92. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

No comment at this time.

93. Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

No comment at this time.



Via Email

May 18, 2023

Ms. Phoebe W. Brown  
Office of Secretary  
Public Company Accounting Oversight Board  
1616 K Street, NW  
Washington, DC 20006-2803

*Re: PCAOB Rulemaking Docket No. 049: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards<sup>1</sup>*

Dear Secretary Brown:

The Council of Institutional Investors (CII) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (PCAOB or Board) Release 2023-001, Proposed Auditing Standard – *General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (Proposal).<sup>2</sup>

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.<sup>3</sup>

## **CII Policies**

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making

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<sup>1</sup> Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, PCAOB Release No. 2023-001 (Mar. 28, 2023), [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/pcaob-release-no.-2023-001-as-1000---proposed.pdf?sfvrsn=28304d26\\_4](https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/pcaob-release-no.-2023-001-as-1000---proposed.pdf?sfvrsn=28304d26_4).

<sup>2</sup> *Id.*

<sup>3</sup> For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

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informed decisions, and vital to the overall well-being of our capital markets.<sup>4</sup> That belief is reflected in the following CII membership-approved policy on the **Independence of Accounting and Auditing Standard Setters**:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.<sup>5</sup>

This policy on **Independence of Accounting and Auditing Standard Setters** also importantly establishes the principle that “investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs.”<sup>6</sup> Our membership reaffirmed that principle in our policy on **Auditor Independence**.<sup>7</sup> That policy includes the following additional provisions that we believe may be relevant to issues raised by the Proposal:

**Audit Committee Responsibilities Regarding Independent Auditors:** The audit committee should fully exercise its authority to hire, compensate, oversee and, if necessary, terminate the company’s independent auditor. In doing so, the committee should take proactive steps to promote auditor independence and audit quality. Even in the absence of egregious reasons, the committee should consider the appropriateness of periodically changing the auditor, bearing in mind factors that include, but are not limited to:

....

- the clarity, utility and insights provided in the auditor’s report and the auditor’s letter to management in relation to the audit
- the level of transparency and robustness of the audit firm with the audit committee and investors, including with respect to audit quality indicators, governance practices and underlying principles, and the financial stability of the audit firm

....

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<sup>4</sup> CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), [http://www.cii.org/policies\\_other\\_issues#indep\\_acct\\_audit\\_standards](http://www.cii.org/policies_other_issues#indep_acct_audit_standards).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> CII, Policies on Corporate Governance, § 2.13 Auditor Independence (updated Mar. 6, 2023), [https://www.cii.org/corp\\_gov\\_policies](https://www.cii.org/corp_gov_policies).

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Investors are the “customers” and end users of financial statements and disclosures in the public capital markets. Both the audit committee and the auditor should recognize this principle.<sup>8</sup>

CII also has a long-standing membership-approved policy on **Financial Gatekeepers**.<sup>9</sup> That policy explicitly identifies auditors as “financial gatekeepers.”<sup>10</sup> The policy indicates that it is imperative that auditors be subject to “[r]obust oversight and [have] genuine accountability to investors. . . .”<sup>11</sup> The policy also states that “[c]ontinued reforms are needed to ensure that the pillars of transparency, independence, oversight and accountability are solidly in place.”<sup>12</sup>

## The Proposal

In CII’s September 2020 letter in response to the Request for Public Comment, *Draft 2022-2026 PCAOB Strategic Plan*,<sup>13</sup> we requested that the Board prioritize “as requested by [Securities and Exchange Commission] Chair Gensler, the Board’s standard setting project on ‘Interim Standards’”(September Letter).<sup>14</sup> Our prioritization of the interim standards was based, in part, on our policy on the **Independence of Accounting and Auditing Standard Setters** that reflects the view that auditing standards should be the product of an independent standard setting process that focuses on investors’ information needs.<sup>15</sup>

As described by PCAOB Chair Erica Y. Williams, the Proposal:

[W]ould replace a group of standards originally developed by the American Institute of Certified Public Accountants (AICPA) and adopted on an interim basis by the PCAOB in 2003. Those standards address reasonable assurance, due professional care, professional skepticism, independence, competence, and

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<sup>8</sup> § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.

<sup>9</sup> CII, Policies on Other Issues, Financial Gatekeepers (adopted Apr. 13, 2010), [https://www.cii.org/policies\\_other\\_issues#fin\\_gatekeepers](https://www.cii.org/policies_other_issues#fin_gatekeepers).

<sup>10</sup> *See id.* (“Auditors, financial analysts, credit rating agencies and other financial ‘gatekeepers’ play a vital role in ensuring the integrity and stability of the capital markets.”).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Request for Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/defaultsource/about/administration/documents/strategic\\_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a\\_4](https://pcaob-assets.azureedge.net/pcaob-dev/docs/defaultsource/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4); PCAOB, Strategic Plan, 2022-2026, Draft for Comment (Aug. 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db\\_4/%20Draft-2022-2026-Strategic-Plan.pdf](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db_4/%20Draft-2022-2026-Strategic-Plan.pdf).

<sup>14</sup> Letter from Jeffrey P. Mahoney, General Counsel, CII to Office of the Secretary, PCAOB 5 (Sept. 15, 2022), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20(final).pdf).

<sup>15</sup> *Id.* at 4 (referencing our policy on Independence of Accounting and Auditing Standard Setters in support for Securities and Exchange Commission Chair Gary Gensler’s statement regarding the need for the Public Company Accounting Oversight Board to update the “interim standards”).

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professional judgment—collectively, what we refer to as the “foundational standards.”<sup>16</sup>

We generally agree with Chair Williams that by “[m]erging these foundational standards into one standard, [it] would reaffirm the general principles and responsibilities of the auditor and solidify the foundation of every audit; leading to investor protection and informative, accurate, and independent audit reports.”<sup>17</sup> And by issuing the Proposal, we believe the Board is appropriately continuing to prioritize standard setting that replaces the interim standards and thereby is responsive to the recommendation in the September Letter.<sup>18</sup>

## Responses to Select Questions

The following includes CII’s responses to select questions raised in the Proposal.

**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?**<sup>19</sup>

CII generally believes the general principles and responsibilities described in the Proposal are appropriate for audits performed under PCAOB standards. And, generally consistent with language in our policies on **Independence of Accounting and Auditing Standard Setters** regarding the importance of the quality and credibility of audited financial information, we strongly agree with Board Member Kara M. Stein that those principles and responsibilities should be “anchor[ed] [on the auditor’s] obligation to protect investors.”<sup>20</sup> In that regard, we would support the inclusion of additional language to the “INTRODUCTION”<sup>21</sup> and “CONDUCTING AN AUDIT”<sup>22</sup> provisions of Proposed Auditing Standard AS 1000, *General*

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<sup>16</sup> Chair Erica Y. Williams, Statement on Proposal to Modernize PCAOB Standards Addressing Core Auditing Principles and Responsibilities, PCAOB Open Board Meeting (Mar. 28, 2023), <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposal-to-modernize-pcaob-standards-addressing-core-auditing-principles-and-responsibilities>.

<sup>17</sup> *Id.*

<sup>18</sup> *Cf.* Letter from Jeffrey P. Mahoney, General Counsel, CII to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 3 (Feb. 15, 2023), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2023/February%2016%202023%20CII%20PCAOB%20Letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2023/February%2016%202023%20CII%20PCAOB%20Letter%20(final).pdf) (“We applaud the Board for issuing the Proposal because it would replace interim standard AS 2310, The Auditor’s Use of Confirmation (AS 2310) [and] [b]y replacing AS 2310, we believe the Proposal would generally be responsive to the recommendation in our September Letter.”).

<sup>19</sup> PCAOB Release No. 2023-001 at 55 (emphasis added).

<sup>20</sup> Board Member, Kara M. Stein, A Return to Roots: General Responsibilities of the Auditor in Conducting an Audit, PCAOB Open Board Meeting (Mar. 28, 2023), <https://pcaobus.org/news-events/speeches/speech-detail/a-return-to-roots-general-responsibilities-of-the-auditor-in-conducting-an-audit>.

<sup>21</sup> PCAOB Release No. 2023-001 at A1-1.

<sup>22</sup> *Id.* at A1-5.



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*Responsibilities of the Auditor in Conducting an Audit* (AS 1000)<sup>23</sup> designed to further clarify the obligation to, and role of, auditors to their key customer—investors.

More specifically, we would generally support revisions to paragraphs .01<sup>24</sup> and .15<sup>25</sup> of AS 1000 to reflect the auditor’s obligation to, and role in, protecting investors as described in the seminal U.S. Supreme Court decision of *United States v. Arthur Young & Co.*<sup>26</sup> The opinion, delivered for a unanimous court by Chief Justice Warren E. Burger states:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times, and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.<sup>27</sup>

We agree with Members of the Investor Advisory Group (MIAG) that: “Given the significance of this opinion to the responsibilities and obligations of independent auditors, inserting it into a final standard would certainly enhance the standard.”<sup>28</sup>

For similar reasons, and consistent with the investor as customer language in our policies on **Independence of Accounting and Auditing Standard Setters** and **Auditor Independence** we generally support the inclusion of additional language to the “PROFESSIONAL QUALIFICATIONS OF THE AUDITOR” provisions of AS 1000.<sup>29</sup> We generally agree with the MIAG “that the training of auditors should be required to include a focus on users of financial information, including investors, as the primary beneficiary of the audit process.”<sup>30</sup>

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<sup>23</sup> PCAOB Release No. 2023-001 at A1-1.

<sup>24</sup> *Id.* (“01 Auditors have a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports, and that obligation governs the auditor’s work under the standards of the PCAOB.”).

<sup>25</sup> *Id.* at A1-6 (“15 The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors.”).

<sup>26</sup> *United States v. Arthur Young & Co.*, 465 U.S. 805, 818-19 (1984), *available at* <https://supreme.justia.com/cases/federal/us/465/805/>.

<sup>27</sup> *Id.*

<sup>28</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 2 (May 16, 2023) (on file with CII).

<sup>29</sup> PCAOB Release No. 2023-001 at Page A1-1.

<sup>30</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 6.



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More specifically, we would generally support amending paragraph .08(c) of AS 1000 as follows:

08. The auditor should develop and maintain competence through an appropriate combination of:
- ...
- c. Training, including a focus on investors as the key customer of the audit, and how audits can be more responsive to investor needs, as well as accounting, auditing, independence, ethics, and other relevant continuing professional education.<sup>31</sup>

We note that the Board proposes a number of amendments to AS 3101: *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (AS 3101).<sup>32</sup> Generally consistent with the audit report language in our **Auditor Independence** policy, we respectfully recommend the Board consider additional amendments to AS 3101 as part of this Proposal. In our view, two additional amendments are necessary to address (1) the declining number of critical audit matters (CAMs) disclosed<sup>33</sup> and (2) the failure of the disclosure to include the permitted information requested by CII and many investors regarding the outcomes and key observations of the related audit procedures performed.<sup>34</sup>

<sup>31</sup> See PCAOB Release No. 2023-001 at A1-3; cf. Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 6 (“We would suggest that paragraph .08(c) be revised along these lines: “Training, including a focus on investors as the primary beneficiary of the audit process, and how audits can be made more transparent and responsive to investor needs, as well as accounting, auditing, independence, ethics, materiality and other relevant continuing professional education.”).

<sup>32</sup> See PCAOB Release No. 2023-001 at A4-22 & A4-23; see also AS 3101: *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (last visited May 17, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS3101>.

<sup>33</sup> See Interim Analysis Report, Further Evidence on the Initial Impact of Critical Audit Matter Requirements, PCAOB Release No. 2022-007 at 3 (Dec. 7, 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/pir/documents/cam-interim-analysis-report.pdf?sfvrsn=1c9f4f13\\_2&utm\\_source=PCAOB+Email+Subscriptions&utm\\_campaign=bec22ed4ac-EMAIL\\_CAMPAIGN\\_2019--forums2019\\_COPY\\_01&utm\\_medium=email&utm\\_term=0\\_c97e2ba223-bec22ed4ac](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/pir/documents/cam-interim-analysis-report.pdf?sfvrsn=1c9f4f13_2&utm_source=PCAOB+Email+Subscriptions&utm_campaign=bec22ed4ac-EMAIL_CAMPAIGN_2019--forums2019_COPY_01&utm_medium=email&utm_term=0_c97e2ba223-bec22ed4ac) (“The average number of CAMs per audit report has declined over time, and the proportion of audit reports that communicate a single CAM has increased”); [Jian Zhang, PhD](#) and [Kurt Pany, PhD](#), *Critical Audit Matter Reporting, A Comparison of Years 1 through 3* (Mar. 2023), <https://www.cpajournal.com/2023/03/22/critical-audit-matter-reporting/> (“The average number of CAMs included in audit reports was 1.64 and 1.45 for 2020 and 2021, respectively.”); Kate Suslava et al., *Disappearing Audit Disclosure: Changes in the Reporting of Critical Audit Matters 25* (2023) (on file with CII) (“Our tests show that auditors are decreasing not only the number of CAMs, but also the number of procedures mentioned in the audit report . . . .”); see also Jean Eaglesham, *Auditors Didn't Flag Risks Building Up in Banks*, *Wall St. J.*, Apr. 10, 2023, <https://www.wsj.com/articles/auditors-didnt-flag-risks-building-up-in-banks-6506585c> (quoting Martin Baumann, a former chief auditor at the PCAOB: “I’m not the auditor of the bank and I don’t know if this [bonds issue] should have been included in the auditor’s report,” . . . “[b]ut as the lead author of the standard, this certainly is the kind of item that we had in mind for critical audit matters.”).

<sup>34</sup> See [Jian Zhang, PhD & Kurt Pany, PhD](#), *Critical Audit Matter Reporting, A Comparison of Years 1 through 3* (“As was the case in 2019, none of the CAMs analyzed in the latter two years included an explicit description of the outcomes of the related audit procedures performed”); see also [Karla M. Zehms et al.](#), *Old Institutions, New Report:*

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More specifically, our proposed amendments to paragraphs .11 and .14 follow:

*Determination of Critical Audit Matters*

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved **especially** challenging, subjective, or complex auditor judgment. Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

....

.14 For each critical audit matter communicated in the auditor's report the auditor must:

....

- c. Describe how the critical audit matter was addressed in the audit; ~~and,~~ including:

~~Note: In describing how the critical audit matter was addressed in the audit, the auditor may describe:~~ (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the audit procedures performed; (3) an indication of the outcome of the audit procedures; and (4) key observations with respect to the matter; ~~or some combination of these elements; and~~

....

We generally agree with the MIAG that the amendment to paragraph .11 to delete the word “especially” addresses “a concern this term is being used to avoid reporting of a critical audit matter.”<sup>35</sup> The amendment to paragraph .14 requires disclosure of how the critical audit matter

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Auditors' Experiences Implementing Critical Audit Matter Reporting 36 (2023) (on file with CII) (“Our results illustrate the real-world effects of the political nature of audit standard setting by showing how the PCAOB’s narrowing of the circumstances under which auditors would report original information in CAMs translated in practice into a prohibition against doing so.”).

<sup>35</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 6 (May 16, 2023) (on file with CII); *see* Karla M. Zehms et al., When Auditors Provide Both Key Audit Matter and Critical Audit Matter Disclosures for the Same Client 22 (May 2023) (on file with CII) (Finding that Key Audit Matters seem to cover a wider array of topics and thus tend to be greater in number than Critical Audit Matters, in part, because CAMs are limited by definition to matters “that involve especially challenging, subjective, or complex auditor judgment.”); *see also* [Soyoung Ho](#), PCAOB Advisers Say Auditors May not be Fully Complying with Expanded Reporting Rule, Thomson Reuters (Apr. 7, 2023),

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was addressed in a manner that many investors believe would provide more useful information for decision making.<sup>36</sup>

**10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not?**<sup>37</sup>

CII generally supports the proposed amendments to clarify the meaning of “present fairly.” The meaning of present fairly in the Proposal is generally consistent with the quality and reliability language in our policy on **Independence of Accounting and Auditing Standard Setters** because it provides that the auditor’s obligation to investors “extends beyond compliance with the applicable financial reporting framework.”<sup>38</sup> We strongly agree with the MIAG that “[a]udit firms should ensure that auditors focus on whether the financials are a fair presentation of the company’s position rather than narrowly focusing on whether the company is following U.S. GAAP.”<sup>39</sup>

The proposed amendments would, in our view, appropriately rescind existing AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*<sup>40</sup> and incorporate its requirements into proposed AS 2810, *Evaluating Audit Results (AS 2810)*.<sup>41</sup> We generally agree with the Board that the result provides “for a more logical presentation of requirements regarding whether the financial statements are presented fairly in conformity with the applicable financial reporting framework.”<sup>42</sup> We, however, would generally support the Board providing some additional language or guidance in AS 2810 on how auditors would be expected to meet their “present fairly” responsibility.

As one example, the Board might consider including in the Note to paragraph .31 of AS 2810<sup>43</sup> the following language from paragraph .06 of AS 2815: “Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their

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<https://tax.thomsonreuters.com/news/pcaob-advisers-say-auditors-may-not-be-fully-complying-with-expanded-reporting-rule/> (“Dane Mott, an accounting analyst with Capital Group Companies, believes that analysts should not have to go to two different filings to get information [and] [i]f KAMs have lower threshold, he said the PCAOB should consider lowering the threshold for CAMs because more information is helpful to investors.”).

<sup>36</sup> See, e.g., PCAOB Release No. 2022-007 at 4 (“Several investors said that they would like auditors to use more specific, rather than generic, language in communicating CAMs and to include in CAMs a discussion of the outcome of audit procedures.”).

<sup>37</sup> PCAOB Release No. 2023-001 at 55 (emphasis added).

<sup>38</sup> *Id.* at 30.

<sup>39</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 4 (emphasis omitted).

<sup>40</sup> AS 2815: The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”, PCAOB (last visited May 15, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2815>.

<sup>41</sup> PCAOB Release No. 2023-001 at A2-1.

<sup>42</sup> *Id.* at 30.

<sup>43</sup> See *id.* at A2-1 & A2-2.

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substance.”<sup>44</sup> We agree with the MIAG that “it is important to [include this language] . . . in AS 2810.”<sup>45</sup>

The Board might also consider including in the Note to proposed paragraph .30 of AS 2810 the following additional guidance:

The auditor should also carefully review the significant judgments made by the client that ties to the underlying business model; understand how the crucial elements of the business model interplay with accounting estimates; evaluate the range of estimates the auditor views as appropriate in their assessment of fairly presents; consider incentives/opportunities for management bias in their assessment of fairly presents; and consider uncorrected estimates. The auditor must exercise professional judgment to determine what additional steps should be taken to evaluate the audit evidence in the context of evaluating whether the financial statements are presented fairly.

**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?**<sup>46</sup>

CII generally supports 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.<sup>47</sup> We, however, would revise the proposed amendment by replacing 14 days with two days. Generally consistent with the “timely” language in our policy on **Independence of Accounting and Auditing Standard Setters**, we agree with the Board that:

[A] shorter period of time may provide better protection for investors than a longer period: it could permit acceleration of PCAOB inspections and provide the strongest incentives for firms to implement operating efficiencies. Thus, in principle, the shortest feasible documentation completion date could achieve more benefits than a longer period.<sup>48</sup>

Similarly, we note that Chair Williams stated: “[i]t is critical that the documentation is completed as close in time as possible to the completion of the audit.”<sup>49</sup>

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<sup>44</sup> *Id.* at A2-4 (language unstruck).

<sup>45</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 5.

<sup>46</sup> PCAOB Release No. 2023-001 at 56 (emphasis added).

<sup>47</sup> *See id.* at A3-5.

<sup>48</sup> *Id.* at 52.

<sup>49</sup> Chair Erica Y. Williams, Statement on Proposal to Modernize PCAOB Standards Addressing Core Auditing Principles and Responsibilities, PCAOB Open Board Meeting.

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Based on the information provided in the Proposal, we believe the shortest feasible documentation completion date appears to be two days.<sup>50</sup> We note our view is consistent with the following view of the MIAG:

The Proposal makes a good argument for why the completion period should be shorter in an age of instant documentation and communication but it fails to make convincing argument for why 14 days is better than any other shortened period. . . . We . . . believe that the shorter period would allow the PCAOB to schedule its inspections more efficiently, providing additional benefits to investors.<sup>51</sup>

**24. The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of [Emerging Growth Companies] EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.<sup>52</sup>**

CII believes the Proposal should apply to audits of EGCs. Generally consistent with the quality and reliability language in our policy on **Independence of Accounting and Auditing Standard Setters** and our prior views on EGC and PCAOB proposals,<sup>53</sup> we generally agree with the following conclusion of the Board:

We expect [the Proposal's] . . . benefits to be greater on EGC audits than non-EGC audits because EGCs are more likely to be audited by [U.S. non-affiliate firms] NAFs; however, costs of implementation may also be incrementally higher for audits of EGCs. On a net basis, we expect that the overall impact of the proposed amendment on EGC audits would not be disproportionate to the impact on non-EGC audits.

Accordingly, and for the reasons explained . . . , the Board anticipates that, if it adopts the proposed standard and related amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote

<sup>50</sup> See PCAOB Release No. 2023-001 at 37 (“Examples observed through the PCAOB’s 2022 inspections include non-U.S. affiliates that have local policies specifying completion of documentation by deadlines such as 2 days, 7 days, 10 days, 14 days, and 30 days after the report release date.”).

<sup>51</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 9.

<sup>52</sup> PCAOB Release No. 2022-009 at 57 (emphasis added).

<sup>53</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 2 (Oct. 28, 2021), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket042/1\\_cii.pdf?sfvrsn=f15ad4b2\\_6](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket042/1_cii.pdf?sfvrsn=f15ad4b2_6) (“In response to this question, CII shares the PCAOB’s view that “if [the Board] . . . adopts the proposed amendments, it will request that the [U.S. Securities and Exchange] Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the amendments to audits of EGCs.”).

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efficiency, competition, and capital formation, to apply the proposed standard and related amendments to audits of EGCs.<sup>54</sup>

We note our view is also shared by the MIAG which concluded: “Based on the experience of all our members, we believe the analysis of the impact of the Proposal on EGC’s is reasonably accurate [and] [w]e support the Proposal’s conclusion that the standard should apply equally to audits of EGCs.”<sup>55</sup>

\*\*\*\*

We appreciate the opportunity to provide CII’s investor-focused perspective on the Proposal. Please let me know if you have any questions about the content of this letter.

Sincerely,

A handwritten signature in blue ink that reads "Jeff Mahoney". The signature is written in a cursive, flowing style.

Jeffrey P. Mahoney  
General Counsel

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<sup>54</sup> PCAOB Release No. 2022-009 at 54.

<sup>55</sup> Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 11.



Crowe LLP  
Independent Member Crowe Global

May 30, 2023

By email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Ms. Phoebe W. Brown  
Office of the Secretary  
PCAOB  
1666 K Street NW  
Washington, DC 20006-2803

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

Dear Ms. Brown:

Crowe LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or "the Board") proposed auditing standard, Auditing Standard (AS) 1000, *General Responsibilities of the Auditor in Conducting an Audit*, (AS 1000) and other proposed amendments ("the proposal").

### **General Observations**

Reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment ("the general principles and responsibilities") are foundational to the audit and support high-quality audits. We support the stated objectives of the proposal to streamline and clarify the general principles and responsibilities of auditors and to provide a more logical presentation in order to enhance the useability of the standards by making them easier to read, understand, and apply.

We also agree that the general principles and responsibilities are currently generally understood by auditors and investors. We are concerned, however, that certain proposed changes eliminate important information about the role and responsibilities of the auditor. These changes may, over time, erode that understanding of the general principles and responsibilities. Without this vital information in the standards, investors and other stakeholders will have less transparency about the role and responsibilities of the auditor, such that the proposed standards may exacerbate the audit expectations gap.

Additionally, we are concerned that certain proposed changes that are intended to clarify the requirements may inappropriately expand the auditor's role and responsibilities, leading to confusion about the scope of the audit. Auditors play a vital role in the financial reporting ecosystem by providing investors and other financial statement users an independent opinion on a company's financial statements and, if applicable, internal control over financial reporting. Other parties, however, play equally important roles in financial reporting, including management, the audit committee, and regulators. It is important that the PCAOB does not, through a project to clarify and streamline existing responsibilities, expand the role and responsibility of the auditor in a manner that may obscure the responsibilities of other parties in the financial reporting ecosystem.





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Included below are comments on specific aspects of the proposal.

## **Specific Areas of Comment**

### General Principles and Responsibilities

We believe it is in the best interest of investors and other stakeholders that the auditing standards are clear and understandable regarding the responsibilities of the auditor and the level of assurance provided by an auditor's report, including the potential limitations of an auditor's report. While we support the Board's objective of clarifying the existing standards and using plain language in the proposed standards, the proposed elimination of certain language from the existing standards may have the effect of reducing the level of transparency about the role and responsibilities of the auditor.

Specifically, our concerns relate to the proposed changes regarding reasonable assurance and due professional care.

#### *Reasonable assurance*

We support the Board's proposal to retain the description of reasonable assurance from AS 1015 as a high level of assurance and the statement that the auditor is able to obtain reasonable, but not absolute, assurance. These concepts are vital to understanding reasonable assurance, the role of the auditor, and the scope of the auditor's report.

We have concerns, however, regarding the elimination of some of the descriptive language currently provided in AS 1015 paragraphs .10 through .13. Those paragraphs provide critical information to investors and others about the scope of an audit and potential limitations of an auditor's report. The removal of this language may also reinforce and exacerbate the audit expectation gap. In particular, we strongly encourage the Board to retain the following existing statements:

- "...an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements." (AS 1015.10)
- "The nature of most evidence derives, in part, from the concept of selective testing of the data being audited, which involves judgment regarding both the areas to be tested and the nature, timing, and extent of the tests to be performed. In addition, judgment is required in interpreting the results of audit testing and evaluating audit evidence. Even with good faith and integrity, mistakes and errors in judgment can be made. Furthermore, many accounting presentations contain accounting estimates, the measurement of which is inherently uncertain and depends on the outcome of future events. The auditor exercises professional judgment in evaluating the reasonableness of accounting estimates in significant accounts and disclosures based on information that could reasonably be expected to be available through the date of the auditor's report. As a result of these factors, in the great majority of cases, the auditor has to rely on evidence that is persuasive rather than convincing." (AS 1015.11)





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- “Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement. Characteristics of fraud include (a) concealment through collusion among management, employees, or third parties; (b) withheld, misrepresented, or falsified documentation; and (c) the ability of management to override or instruct others to override what otherwise appears to be effective controls...Collusion may cause the auditor who has properly performed the audit to conclude that evidence provided is persuasive when it is, in fact, false...an auditor may not discover the existence of a modification of documentation through a side agreement that management or a third party has not disclosed. Finally, management has the ability to directly or indirectly manipulate accounting records and present fraudulent financial information by overriding controls in unpredictable ways.” (AS 1015.12)
- “Since the auditor's opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the Public Company Accounting Oversight Board (United States).” (AS 1015.13)

Retaining this language will benefit investors and other stakeholders by making the standard more transparent about the role and responsibilities of the auditor, including certain inherent limitations of an audit. It can help reduce information asymmetry by providing all parties a clear understanding of what reasonable assurance means in the context of the audit and the auditor's report. As such, we recommend that the Board retain the statements identified above in a final AS 1000.

#### *Due professional care*

The concept of due professional care is described in AS No. 1015, *Due Professional Care in the Performance of Work*, (AS 1015) through reference to a 1932 legal treatise, *Cooley on Torts*. We understand the Board's intention is to clearly and concisely describe the concept of due professional care. We believe, however, that certain information in the reference to *Cooley on Torts* provides valuable context regarding what investors and other stakeholders can expect of an auditor in the performance of an audit, which is good faith and integrity but not infallibility. This additional description provides investors and other stakeholders with information that may be important to their understanding of the role of the auditor. As such, we recommend the Board retain this information in the description of due professional care in a final standard.



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### Proposed Introduction to AS 1000

A high-quality audit benefits investors, who may rely on the objective and independent opinions on the company's financial statements and, if applicable, internal control over financial reporting (ICFR), in making investment decisions. As noted in the release accompanying the proposal, "A properly conducted audit and related auditor's report enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, ICFR." We take our responsibility to the investing public seriously. We are committed to the highest standards of audit quality to support the integrity of the capital markets and work to enhance audit quality for the benefit of investors.

Investor protection, however, can include many elements beyond the audit, and investors may have differing views on what should be done to protect their interests. Accurate financial reporting, high-quality audits, and effective regulation all play an important part in investor protection. While the auditor plays a critical role, other parties – such as management, the audit committee, and capital market regulators – are also vitally important to investor protection. As such, it is important that the auditing standards appropriately communicate the auditor's specific role. As currently drafted, paragraph .01 of proposed AS 1000 is not sufficiently transparent about the auditor's role in investor protection. We recommend the Board refine paragraph .01 to reflect the role of the auditor in the capital markets more appropriately:

Auditors have a fundamental obligation to ~~protect investors through the preparation and issuance of~~ prepare and issue informative, accurate, and independent auditor's reports, ~~and that obligation governs the auditor's work under~~ in accordance with the standards of the PCAOB. An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company's financial statements are presented fairly and, if applicable, on the effectiveness of the company's internal control over financial reporting. A properly conducted audit and the related auditor's report enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, internal control over financial reporting.

### Proposed Amendments to AS 2810

In the release, the Board indicates that they are incorporating requirements from AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles,"* (AS 2815) into AS 2810, *Evaluating Audit Results,* (AS 2810) "for a more logical presentation of requirements" that include "an important clarification of the auditor's existing responsibilities." The Board does not give an indication of an intent to change the requirements in the release; however, Proposed AS 2810.30A, along with the related statements in the release accompanying the proposal, specifies that the auditor's judgments concerning the fair presentation of the financial statements go beyond conformity with the applicable financial reporting framework. We do not agree with the statement in the release that this is a clarification of the auditor's existing responsibilities; rather, this appears to be an expansion of the auditor's role. We are concerned that these proposed changes inappropriately expand the auditor's responsibilities, as well as introduce potential inconsistency.



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Currently, AS 2815.03 states, “The independent auditor’s judgment concerning the ‘fairness’ of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. *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*” (emphasis added). The auditor’s judgment of the “fairness” of the presentation of the financial statements must be in the context of the applicable financial reporting framework. Without that context, there will be a lack of consistency in how auditors evaluate the presentation of financial statements and correspondingly, a lack of clarity for investors and other users about each individual auditor’s judgments.

Additionally, if the auditor’s evaluation of fair presentation is not grounded in the applicable financial reporting framework, the roles of management and the auditor may become obscured. If the auditor applies his or her own, unique perspective of what is necessary to achieve fair presentation, the auditor may be determining the presentation of the financial statements and identifying disclosures – in effect, the auditor may be preparing aspects of the financial reporting. In those instances, the auditor will not be able to apply impartial or objective judgments. The link to the applicable financial reporting framework is necessary to guide the auditor’s judgments and evaluations – as well as establish requirements for management – so that the auditor is able to provide an independent opinion.

We recommend that the PCAOB base the auditor’s responsibilities for evaluating the fair presentation of the financial statements in the applicable financial reporting framework and retain the important language from AS 2815.03. This will provide necessary guidance for auditors in exercising their responsibilities under the standards as well as context for investors and others in understanding how the auditor conducted the work.

#### Information Related to the Audit

While proposed AS 1000 retains the concept of professional skepticism largely in the same form as it is described in AS 1015, the PCAOB proposed to replace the term “audit evidence” with “information related to the audit” such that professional skepticism would include:

“...a critical assessment of information related to the audit.”

We have concerns about this proposed change, and recommend the Board use the term “audit evidence” in a final standard. While the term “audit evidence” is well defined, the phrase “information related to the audit” does not have a clear or developed definition. As a result, there will likely be confusion or inconsistency in what information is considered related to the audit. Additionally, the proposed standard is not clear as to what a “critical assessment of information related to the audit” would entail. AS 1105, *Audit Evidence*, guides the auditor’s assessment of audit evidence such that the auditor’s assessment will encompass the relevance and reliability of the audit evidence. There is no corresponding existing framework to assess information related to the audit. Without a framework or standard to guide the auditor’s assessment of information related to the audit, there is likely to be inconsistency in the auditor’s assessment and a resulting lack of transparency for users of the auditor’s report.



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### Relevant Guidance

The note to paragraph .15 in the proposed standard directs the auditor to take into account relevant guidance applicable to the audit, which includes auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the Board. While we agree that the auditor should take into account relevant guidance applicable to the audit, we have concerns about the proposal to include the releases that accompany Board standards and rules in this requirement.

The Board's releases often contain a significant amount of information that can be useful in understanding the requirements of a standard or a Board rule. That information, however, is not organized or presented in a manner that would allow the auditor to identify the applicable guidance. Given the current form of the Board's releases, we have concerns about the practicality for auditors to consistently identify all relevant guidance for each Board standard and rule. Additionally, as there can be multiple releases related to a single standard and not all information is included in subsequent releases, auditors will need to evaluate each release related to a particular standard in order to identify the related guidance. This evaluation will be a significant undertaking for each firm that maintains its own methodology. While the Board's economic analysis acknowledges that firms will incur costs related to updating their methodologies and conducting training, we emphasize that it will be a substantial effort for firms to review and analyze the releases that accompany 20 years of standard-setting and rule-making activities.

We recommend that the Board revise its releases to clearly identify the information that is considered authoritative to facilitate consistent application of that guidance by auditors, including identifying such information from releases previously adopted by the Board.

### Engagement Partner's Responsibility to Exercise Due Professional Care

Proposed AS 1000 would make the engagement partner's responsibility to exercise due professional care more specific. Among the clarifications, the proposed standard directs engagement partners to determine "that significant judgments and conclusions...are appropriate..." The release states that the proposed clarifications leverage existing requirements for planning and performing an audit and references AS 1220, *Engagement Quality Review*, when discussing the requirements related to significant judgments and conclusions. To improve the clarity of the standard and drive consistency in its application, we recommend including a footnote to AS 1220 in proposed AS 1000.09.

### Competence

The note to paragraph .07 of proposed AS 1000 states:

Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

While we agree that the auditor should possess special skill in auditing and accounting, we have concerns with the expectation that the auditor is also an expert in SEC rules and regulations and the issuer's relevant industry. Given that auditors are not securities attorneys or industry experts, it may be



Crowe LLP  
Independent Member Crowe Global

difficult to comply with this note without adding certain specialists or experts to the engagement team. We would expect, however, the auditor to have a sufficient understanding of SEC rules and regulations and the industry in which the company being audited operates. We encourage the PCAOB to revise this note to reflect that competence includes "...knowledge of relevant SEC rules and regulations and the issuer's industry."

#### Effective Date

We noted the PCAOB's proposed effective date of June 30<sup>th</sup> of the year after SEC approval. As this could be as little as six months, we are concerned about the ability to implement the changes in proposed AS 1000 and other proposed amendments. Certain changes will take a significant amount of time to implement. For example, if the Board does not make any changes to clarify or refine the proposed requirement that Board-issued releases are authoritative, firms will need to review 20 years of standard-setting and rule-making releases to identify guidance to incorporate in their respective methodologies and conduct training on those changes. As another example, in order to comply with a reduced timeframe to complete all documentation, firms will need sufficient time to modify their technologies. Firms may also need to revise their staffing models to allow engagement teams time to finalize any documentation in a shorter timeframe. In order to allow sufficient time to implement the new standard thoroughly and thoughtfully, we encourage the PCAOB to allow for at least 12 months for implementation.

In addition to allowing firms sufficient time to conduct the implementation activities, we recommend the PCAOB set an effective date that would correspond with the beginning of an audit period (e.g., effective for audits of financial statements for fiscal years ending on or after December 15). It is not practical to implement certain changes – such as the requirement to demonstrate who performed and reviewed work or the requirement to consider Board releases as guidance – in the middle of an audit. By setting the implementation date as of the beginning of an audit period, it will be clear which principles and responsibilities apply for that particular audit.

\* \* \* \* \*

We appreciate the opportunity to share our perspectives on the Board's proposed auditing standard and proposed amendments. We would be pleased to discuss our comments with the Board or its staff. If you have any questions, please contact Matthew Schell or Kyle Owens.

Sincerely,

A handwritten signature in black ink that reads "Crowe LLP".

Crowe LLP



**Deloitte & Touche LLP**

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USA

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May 30, 2023

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

Re: PCAOB Rulemaking Docket Matter No. 049

Deloitte & Touche LLP (“D&T”) appreciates the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on PCAOB Release No. 2023-001, *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (the “proposed standard”, “proposed AS 1000”, or “the Release”).

### *Overview*

We recognize and appreciate our responsibilities under the Sarbanes-Oxley Act to protect investors and further the public interest together with other stakeholders in the financial reporting ecosystem, including management, audit committees and regulatory bodies. We support the Board’s ongoing efforts to modernize and clarify its standards. We also support the combination of the general principles and responsibilities into one standard (proposed AS 1000) and the proposed acceleration of the documentation completion date to reduce the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days.

While the Board has indicated that it intends to modernize the foundational standards rather than impose new requirements on auditors or significantly change the existing requirements of PCAOB standards, certain proposals and the removal of existing language, taken together, may suggest a change in the existing auditing standards. In certain cases, the PCAOB may need to undertake additional auditing standard-setting projects which we stand ready to participate in and work together with other stakeholders to advance. These projects will also enable the opportunity for further public comment and input.

As proposed, public accounting firms will need time to sufficiently implement a final standard, including to make necessary changes to audit policies, procedures, trainings and technology. As such, we suggest the Board consider an effective date no sooner than two years after the approval by the U.S. Securities and Exchange Commission and based on a financial statement year-end (e.g., for audits of financial statements for fiscal years ending on or after December 15).

In the remainder of this letter, we offer constructive suggestions about certain proposed changes.

### *Elimination of Existing Clarifying Language*

The updates to the general principles and responsibilities that involve the removal of explanatory or contextual language may result in less clarity than that provided by the existing standards about the role and responsibilities of auditors, including as they relate to important fundamental concepts that are crucial for users of the financial statements to understand. As a result, inconsistency in implementation may ensue.

### Reasonable Assurance

The auditor's report highlights the requirement that "the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud." While proposed AS 1000.14 retains a brief discussion of the meaning of "reasonable assurance," without the additional context provided by the existing explanatory language in current paragraphs AS 1015.10 - .13, we believe that proposed AS 1000.14 could create confusion for users of the financial statements. The proposed elimination of the existing clarifying language could also result in ambiguity as to whether a new level of assurance, beyond reasonable assurance but less than absolute assurance, is expected.

We therefore suggest that the Board retain the following within proposed AS 1000:

1. The language in AS 1015 that explains that absolute assurance is not attainable and why a properly planned and performed audit may still not detect a material misstatement, including, in particular, the language in AS 1015.10 that states "Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud."
2. The language in AS 1015.13 that states that "the auditor . . . not [being] an insurer and . . . [the] . . . report [not constituting] a guarantee," as well as the language that notes that "the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the Public Company Accounting Oversight Board (United States)."
3. The language in AS 1001.02 that states "The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected."

### Role of the Auditor in the Financial Reporting Ecosystem

In streamlining the foundational standards, we note the proposed standard eliminates most of the discussion of management's role in financial reporting. We believe it is important to describe the auditor's role and responsibilities in context of the financial reporting ecosystem as a whole; therefore, we suggest that the substance of the text of current AS 1001.02 and .03 relating to the respective responsibilities of management and the auditor (applicable to both a financial statement audit and an ICFR audit) be retained



and included in the proposed standard. However, we agree with the Board’s observation on pages 13 and 14 of the Release that the reference in AS 1001.03 to the auditor drafting financial statements should not be included in any new standard, given that it is inconsistent with auditor independence requirements.

### *Auditor’s Responsibility to Evaluate Whether the Financial Statements Are “Presented Fairly”*

The proposed standard appears to extend the requirements related to the auditor’s responsibility to evaluate whether the financial statements are fairly presented. Currently the auditor’s conclusion about fair presentation is made based on the financial reporting framework, in the context of materiality.

#### Misleading to a Reasonable Investor

Both US GAAP and IFRS are fair presentation frameworks which permit additional disclosures that depart from the requirements of the applicable financial reporting frameworks when compliance with an accounting principle would result in misleading financial statements. While departures are permitted, material departures only occur in extremely rare circumstances and would result in a qualified opinion in accordance with AS 3105 *Departures from Unqualified Opinions and Other Reporting Circumstances*.

The addition of footnote 17A to proposed AS 2810.30 and proposed AS 2810.30A may suggest the need for a framework beyond the financial reporting framework for the auditor to conclude whether the financial statements are “misleading to a reasonable investor”. These additions are linked to an existing registrant’s requirement to consider the requirements of SEC Rule 12b-20 when preparing the annual report. In extending SEC Rule 12b-20 as an auditor responsibility, the proposed standard suggests that the auditor is required to make a legal judgment which is outside of the applicable financial reporting framework.

The proposal does not specify the nature or content of a framework beyond the financial reporting framework to be used by the auditor to evaluate what is “misleading to a reasonable investor”. Without such a framework, there may be inconsistent application. If the Board determines additional guidance with respect to “fair presentation” is warranted, we recommend that the Board initiate a new project to develop a framework in collaboration with other stakeholders, including the SEC, FASB, IASB and IAASB, and the project would provide an opportunity for public comment.

#### Disclosures

AS 2815.01 currently requires that the auditor’s report contain an opinion as to whether the registrant’s financial statements present fairly, in all material respects, “an entity’s financial position, results of operations, and cash flows.” Proposed paragraph 2810.30A, when discussing the auditor’s evaluation of fair presentation, would add the registrant’s “disclosures” to this list. We agree that the auditor’s evaluation of fair presentation should include the financial statement accompanying notes, however we assume the release is not intending to expand the auditor’s responsibilities beyond the financial statements and accompanying notes to all other information, including MD&A disclosures, in the annual report. This would be inconsistent with AS 2710.04, which states “The auditor’s responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document.” Therefore, we suggest that the Board clarify that the term “disclosures,” in this context,



is intended to address only disclosures contained in the footnotes included in the registrant's financial statements.

If a broader formulation of "disclosure" is intended, we believe the prior "other information" project should be added back to the Board's standard-setting agenda and any potential expansion of the auditor's obligations be considered as part of that project.

#### Removal of "Range of Acceptable Alternatives"

AS 2815.04 currently states that the auditor's opinion on whether the financial statements are presented fairly should be based on the determination of, among other matters, whether the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows, stated "within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements." Eliminating this language in the proposed standard may suggest that the auditor, in evaluating whether the financial statements are fairly presented, is no longer able to take into consideration that there may be a range of acceptable alternatives, including when the financial reporting framework (e.g., US GAAP) may allow accounting alternatives. We therefore suggest that the Board retain the concept of a range of "acceptable alternatives" in proposed AS 2810.30A.

#### Note to Proposed AS 2810.31

On page 30 of the Release, the Board states "We are not proposing to retain the remaining paragraphs in AS 2815 because the paragraphs contain no requirements and are explanatory in nature." The proposed standard therefore does not include the first sentence of AS 2815.06: "Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance." We believe this language provides important context for the requirement in the note to proposed AS 2810.31 for the auditor to evaluate whether the substance of transactions or events differs materially from their form, and therefore that it should be included in proposed AS 2810. The proposed standard also changes the auditor's responsibilities from what is currently required in AS 2815.06 by replacing "consider" with "evaluate" and, similar to our prior point regarding proposed 2810.30A(a), a framework is not provided for the auditor to use in performing this evaluation. We believe "consider" should be retained in preference to "evaluate." We also suggest that the note (together with the additional clarifying language and amendments) be relocated to proposed AS 2810.30A to provide better context.

#### *Professional Judgment*

AS 1001.05 currently states that the "independent auditor must exercise his judgment in determining which auditing procedures are necessary in the circumstances to afford a reasonable basis for his opinion . . . His judgment is required to be the informed judgment of a qualified professional person." The proposed standard eliminates this language and changes the definition of professional judgment to "applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements." The inclusion of the clause "such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal

requirements” could be interpreted as creating a strict liability requirement in PCAOB auditing standards without the necessary consideration of the reasonableness of the auditor’s consideration when exercising their professional judgment in conducting the audit. We recommend that the existing (and longstanding) definition of “professional judgment” in AS 1001.05 be retained and the reference to “applicable professional and legal requirements” be removed from the definition of professional judgment.

### *Professional Skepticism*

We strongly agree that professional skepticism is an important part of exercising due professional care in conducting an audit and, accordingly, remains essential to the performance of high-quality audits. The existing definition of professional skepticism is grounded in the critical assessment of audit evidence. We are concerned that the expansion of the concept to “information related to the audit” rather than “audit evidence” introduces uncertainty, including as to how the auditor would be expected to apply the requirements in the sub-points to the overall requirement in proposed AS 1000.11. “Information related to the audit” is not used elsewhere in the PCAOB auditing standards, nor is there a framework available to auditors to determine what would be considered “information related to the audit” and therefore within the scope of this requirement. AS 1105 defines audit evidence as “all the information, whether obtained from audit procedures or other sources, that is used by the auditor in arriving at the conclusions on which the auditor's opinion is based.” PCAOB AS 1105 therefore only provides requirements and guidance related to audit evidence and does not include the concept of “information related to the audit.” Expanding the application of that term beyond audit evidence may therefore expand the obligations of the auditor in a way that would create inconsistency in practice. We recommend that the Board revert this requirement from “information related to the audit” to “audit evidence.”

In addition, while current AS 1015.09 states that “[t]he auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest,” the Board intends to replace that language with the requirement that professional skepticism includes “not relying on evidence that is less than persuasive.” This requirement is a change from existing standards from “not being satisfied” to “not rely” and appears to be more restrictive in that it would preclude the auditor from placing any reliance on anything less than completely persuasive evidence, even in combination with other, persuasive evidence. In practice (and consistent with the requirements of existing PCAOB auditing standards), an auditor does not often rely on a single piece of audit evidence but rather objectively evaluates the culmination of audit evidence, and whether it supports or contradicts management’s assertions, to reach a conclusion as to whether the related risk is reduced to an acceptably low level. For example, inquiry is an important audit procedure to obtain audit evidence that, by itself, would not provide sufficient appropriate audit evidence. However, when coupled with evidence obtained from other audit procedures such as inspection and confirmation, it could produce audit evidence that, collectively, is sufficiently persuasive. This proposed change therefore represents a potentially significant change to the existing standards. We suggest that the Board align more closely to the original language of current PCAOB auditing standards to emphasize that the concept of professional skepticism has not changed fundamentally.

### *Board-Issued Guidance and Rulemaking Releases*

Footnote 26 of the proposed standard defines “applicable professional and legal requirements” as being inclusive of “Board-issued guidance and releases that accompany the rules and standards of the Board.”

The proposed standard is not sufficiently clear as to what would be considered “Board-issued guidance and releases” in the context of the associated requirement in the note to paragraph 15 of proposed AS 1000 to take into account relevant guidance applicable to the audit. Further clarification is necessary to determine which releases the auditor “take[s] into account” (e.g., only the final adopting releases for prospectively adopted auditing standards and rules of the Board) and what would constitute Board-issued guidance (e.g., whether staff guidance would be included in this category).

Before implementing this requirement, we recommend the Board take up a new project to define more clearly “Board-issued guidance and releases that accompany the rules and standards of the Board,” including, as necessary, the codification of prior releases, to clarify what the Board intends by this language. Such a project should include an opportunity for public comment, consistent with the Board’s standard-setting process.

#### *Audit Documentation*

The expected extent of audit documentation related to certain areas of the proposed standard is ambiguous, and as a result could lead to inconsistency in practice. For example, paragraph AS 1000.11e indicates that the auditor’s exercise of professional skepticism includes consideration of potential bias on the part of the auditor. The proposed standard does not provide guidance related to the nature and extent of expected audit documentation related the auditor’s consideration of its own bias, if any. As another example, it is not clear if additional documentation related to assessment of competency for each member of the engagement team in correlation to assigned work is expected, or if the existing documentation captured and retained as part of the system of quality control (e.g., learning courses taken, independence) is sufficient.

#### *Applicable Professional and Legal Requirements*

Consistent with our feedback provided on proposed QC 1000, *A Firm’s System of Quality Control*, the definition of “applicable professional and legal requirements” includes the phrase “other applicable statutory, regulatory, and other legal requirements,” which should be clarified. As currently drafted, this phrase could be read broadly as a wide range of laws and regulations that do not directly bear on the conduct of audit engagements (e.g., Occupational Safety and Health Administration laws), and, thus, would be inconsistent with the focused statutory mission of the PCAOB to oversee the audits of public companies and broker-dealers for the protection of investors.

#### *Effective Date*

We ask the Board to consider an effective date “for audits of financial statements for fiscal years ending on or after December 15” no sooner than two years after the approval by the U.S. Securities and Exchange Commission, instead of the proposed effective date of June 30 in the year after approval by the SEC, to provide firms with sufficient time to:

- Implement technology enhancements or solutions for the change in archive timing from 45 days to 14 days. While we fully support this change, we acknowledge that, as noted in the Board’s economic analysis, there is diversity across global networks in the systems used to archive audit documentation, and insufficient time to deploy enhanced systems may lead to an unsuccessful implementation.

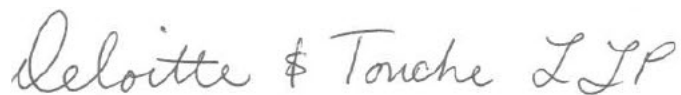
- Address changes arising from the requirement, if retained as proposed, for the auditor to “take into account” the “Board-issued guidance and releases that accompany the rules and standards of the Board.” Public accounting firms would need sufficient time to fully incorporate the “Board-issued guidance and releases that accompany the rules and standards of the Board” within audit methodologies. Public accounting firms would also need time to develop guidance and train personnel on how to demonstrate compliance with the new requirement.
- Implement the enhanced requirements for documentation and supervisory and review responsibilities. In addition, our proposed effective date aligns with the approach taken by the PCAOB for other recently issued auditing standards. As currently proposed, audits of financial statements with fiscal years ending around June 30 in the year after approval by the SEC may have difficulty in effectively implementing certain requirements, and public accounting firms may not have sufficient time to train personnel on the enhanced requirements.

While we are supportive of the interconnectivity between proposed QC 1000 and proposed AS 1000, given the number of conforming amendments within proposed AS 1000 with proposed QC 1000, we recommend that the PCAOB consider an effective date for proposed AS 1000 that does not precede the implementation date of proposed QC 1000.

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We appreciate the opportunity to provide our perspectives on these important topics. While the potential benefits of the proposed standard are significant, careful consideration of the matters and concerns raised in our comments is necessary, as these are complex and challenging topics. We look forward to engaging constructively with the Board and other stakeholders to provide our perspectives and experiences to facilitate the issuance of final PCAOB auditing standards that will enhance audit quality. If you have any questions or would like to discuss these issues further, please contact Christine Davine at (202) 879-4905, Jennifer Haskell at (203) 761-3394, or Emily Fitts at (203) 423-4455.

Yours sincerely,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Deloitte & Touche LLP



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<https://www.deloitte.com>

January 31, 2023

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

Re: PCAOB Rulemaking Docket Matter No. 046

Deloitte & Touche LLP (“Deloitte” or “we”) appreciates the opportunity to provide comments on *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (“the proposal”) issued by the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”), including the proposed QC 1000, *A Firm’s System of Quality Control* (“the proposed standard” or “QC 1000”).

We are pleased to see the PCAOB’s thoughtful consideration of International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Review of Financial Statements, or Other Assurance or Related Services Engagements* (“ISQM1”) issued by the International Auditing and Assurance Standards Board, and the Statement on Quality Management Standards No. 1, *A Firm’s System of Quality Management* issued by the American Institute of Certified Public Accountants (“AICPA”).

We commend the Board for recognizing the need for, and the benefits of, alignment with these standards – benefits which include, but extend beyond, implementation cost considerations. Having a common base structure through use of identical components (e.g., Governance and Leadership, Engagement Performance, Information and Communication) and establishing the same risk-based framework of quality objectives and their relationship to quality risks and quality responses are critical factors supporting a firm’s ability to operate a single, consistent Quality Control system (“QC system”), especially when that firm is subject to the standards of different standard-setting bodies, oversight by multiple regulators, or when operating in a network of firms. Adding incremental provisions to that common base - provisions that are specifically relevant to the US environment (i.e., tailoring to the US regulatory environment) - provides a structure to operationalize the proposed standard in an effective manner.

We are also supportive of the following provisions in particular, some of which extend beyond ISQM1:

- **Independent oversight role** – involving someone with an objective lens, and in a manner appropriate to a firm’s nature and circumstances, enables firms to address this requirement so as to provide more diverse insights on the operation of the QC system
- **In-process monitoring** – providing real-time feedback to engagement teams enhances the quality of audit execution
- **Annual written certification by firm personnel regarding familiarity and compliance with ethics requirements and the firm’s ethics policies and procedures** – focuses on the importance of ethics and confirming firm personnel’s understanding of such responsibilities



- **Monitoring work performed by firm personnel below the “substantial role” threshold as an “other auditor”** – inclusive scoping of referred work based on a judgmental determination of risk and complexity is important
- **Annual evaluation of the effectiveness of the firm’s QC system** – having a formal process will introduce additional rigor and enhance the focus on driving development of continuous improvement actions
- **Annual reporting to the PCAOB** – will provide a channel for confidentially sharing information with the PCAOB, to update their understanding of a firm’s QC system and inform the scope of the PCAOB’s future oversight activities

Notwithstanding our overall support and the positive elements of the proposal noted above, we do have concerns with the following aspects of the proposal and other observations on which we have provided more detail below:

- Differing conclusions on, and communication of, the effectiveness of a firm’s QC system
- Specified annual evaluation date of November 30
- Operationalization of the proposed standard in firms of different sizes and structures
- Inclusion of “other participants” as part of the firm’s QC system
- Alignment of liability and scope of laws with existing standards and rules
- Threshold for consideration of “intentional misconduct” within the definition of quality risk
- Ethics and independence matters
- External communication of performance metrics

### **Differing Conclusions on, and Communication of, the Effectiveness of a Firm’s QC System**

We believe that the difference in the nature of the conclusions on a firm’s QC system between QC 1000 and ISQM1 will result in confusion for various stakeholders, including audit committees. The risk of misunderstanding is particularly acute in the “effective, except for” conclusion where, in reaching its conclusion, a firm will have to consider two different deficiency populations (i.e., all unremediated deficiencies under QC 1000 versus “severe but not pervasive” deficiencies under ISQM 1). As a result, it is possible that two different conclusions may be reached and need to be communicated simultaneously, for example to an audit committee of a dual registrant (e.g., the firm may report to the audit committee that its QC system is “effective” under ISQM 1 but “effective, except for” under QC 1000). Using a consistent evaluation framework would alleviate confusion and inconsistency in these situations and therefore would enhance comparability.

In addition, while we are supportive of communicating the conclusion of the firm’s most recent annual evaluation of its QC system to audit committees, we are concerned that the additional requirement to discuss a “brief overview of remedial actions taken and to be taken” could be difficult, if not impossible, to address without disclosing to the audit committee confidential information about unremediated deficiencies that would be protected by the provisions of the Sarbanes-Oxley Act (“SOX” or “the Act”), (Section 105(b)(5)(A)). For example, in communicating remedial actions to be taken, firms may interpret the proposed standard as requiring the sharing of information about PCAOB Part II inspection comments (and related remediation) prior to the 12 months provided by SOX for addressing them before the possibility of public



disclosure, which would negate the protections afforded by law. We therefore recommend limiting the required audit committee communication to the conclusion on the firm’s QC system.

*Further Considerations in Arriving at the Conclusion on the Effectiveness of a Firm’s QC System*

In arriving at the conclusion on the effectiveness of the QC system, we are concerned that the difference in the definitions between QC 1000 and ISQM1 may also create inconsistencies. For example, the proposal indicates a presumption that every engagement deficiency is to be considered a quality control finding (“QC finding”). We believe an engagement deficiency could be an isolated instance (e.g., human error) which does not extend to the QC system as a whole. Paragraph 71 of the proposed standard already requires that firms evaluate information from engagement monitoring in determining whether QC findings exist. We believe that the firm should make a judgment based on the engagement deficiency evaluation based on facts and circumstances as to whether a QC finding exists, and therefore recommend that the proposal enable that judgment by removing the phrase “engagement deficiencies are QC findings” from the definition of QC finding.

In addition, we are concerned that the presumption implicit in the examples of major quality control deficiencies in the proposal overrides a risk-based approach and the principles-based nature of the PCAOB standards. This removes the application of judgment when evaluating the severity and pervasiveness of a quality control deficiency (“QC deficiency”). To enable firms to exercise professional judgment, similar to material weakness judgments by companies under SOX, we recommend that the circumstances included as examples be recast as ‘indicators’ of whether a major QC deficiency, individually or in the aggregate, might exist.

**Specified Annual Evaluation Date of November 30**

We are supportive of the requirement for firms to perform an annual evaluation of their QC system’s effectiveness; however, we have concerns about the proposal for a prescribed evaluation date for all firms and selection of November 30 as that date. In addition to these concerns, we have a suggestion to extend the documentation completion date.

*Prescribed Evaluation Date for All Firms*

We believe it is essential to allow firms to select an evaluation date that aligns with their own cycle of operations, which is analogous to the SEC allowing issuers to select a year-end (or related management certification date for internal control over financial reporting) that aligns with their business cycle. During the implementation of ISQM1 by audit firms of the global Deloitte network (“the network”), the network carefully considered various evaluation date options and concluded that a date that approximates the end of each firm’s fiscal year (Saturday nearest to May 31) was the most appropriate date for all audit firms in the network, considering network firms’ cycle of quality control operations (including performance evaluations, budgeting, and senior leadership changes), monitoring and remediation cycle (including root cause analysis, development and testing of remedial actions implemented), as well as required or expected timing of transparency reporting in non-US jurisdictions.

*November 30 as the Evaluation Date*

If the PCAOB decides to select November 30 as the evaluation date for all firms, global network firms will be put in a position of performing two separate evaluations every year, having already selected a date for ISQM1. In addition to the incremental cost of two duplicative evaluations, there is a likely risk of confusion in



the marketplace arising from (1) providing differing information to external parties (through communications with audit committees - both for ISQM1 and QC 1000 - and within transparency and other reporting), and (2) situations in which different conclusions are reached under the different standards, as we described in the comment above. We do not believe this outcome would be in the public interest.

Importantly, we are also concerned about capacity of firm personnel during the months of November through February, as many with roles within the QC system also either directly perform or support audit and assurance engagements during busy season. This includes both firm personnel who are responsible for operation of quality responses within a component of a firm's QC system (e.g., Firm's Risk Assessment Process, Resources) as well as those involved in the monitoring and remediation process, who would be responsible for performing much of the work in support of the annual evaluation and reporting.

#### Documentation Completion Date

We recommend that the documentation completion date be no later than 45 days after the report date, instead of the same day Form QC is submitted to the PCAOB, to allow a reasonable, but not excessively long period of time after the report date for firms to assemble the required documentation .

#### **Operationalization of the Proposed Standard in Firms of Different Sizes and Structures**

We have considered the proposal in relation to the Deloitte network of member firms, which comprises individual audit firms of diverse sizes and engagement portfolios, all of which are subject to ISQM 1. In certain cases, different structures have been used to maximize sharing of quality control resources through "clustering" certain quality control roles or processes across a number of smaller firms within a geographic region. We believe these structures can enhance consistent high-quality audit execution, broadly and at the engagement level. For example, a geographical region composed of different firms that are separate legal entities in a small number of different countries may combine their activities related to independence monitoring. Having one dedicated individual with a supporting team focused on this topic might be more effective than having three separate individuals and teams spending 30 percent of their time on this topic. As written, the proposal does not seem to recognize these types of arrangements as it requires specific roles and responsibilities to be filled by "firm personnel." In our example, this would preclude anyone from outside a specific registered firm from fulfilling a key quality control role for the firm. We therefore suggest that the proposed standard acknowledge that, in addressing the most effective way of executing quality control roles and activities, different structures may exist in the operation of the QC system, and that individuals with qualified expertise necessary to fulfill quality control roles may come from outside a registered firm in certain circumstances.

#### **Inclusion of Other Participants as Part of the Firm's QC System**

We are concerned about having "other participants" form part of the firm's QC system, as stated in the objective in paragraph 5.a, and similarly referenced in other sections of the proposed standard (e.g., paragraphs 44c, 47 and 55). As defined, "other participants" include internal auditors and external specialists. Internal auditors and external specialists are not directly subject to the firm's quality control policies and procedures, and therefore the firm cannot impose responsibilities that are part of the firm's QC system. For example, paragraph 47 indicates that the firm is required to establish quality control policies and procedures related to other participants' "maintain[ing] their competence." As internal auditors and external specialists are not part of the firm, the firm would not be in a position to impose specific learning requirements on these individuals. Further, we believe that describing "other participants" as being part of





the firm’s QC system may create cross-jurisdictional legal issues – for example, a requirement to obtain and evaluate information relating to the personnel of an entity located outside the US may not be possible if employment information is protected by local privacy laws. We believe other PCAOB standards sufficiently address “using the work of others” (AS 1205, *Part of the Audit Performed by Other Independent Auditors*, AS 1210, *Using the Work of an Auditor-Engaged Specialist*, AS 2605, *Consideration of the Internal Audit Function*) and include requirements to consider the competence, objectivity, and time to fulfill their responsibilities when deciding whether to use the work of others, and as a result “other participants” should be removed from the paragraphs noted above, and elsewhere in the proposal as appropriate.

## **Alignment of Liability and Scope of Laws with Existing Standards and Rules**

### Certifications

Through the certifications by senior leaders of the firm included in Form QC regarding the design and effectiveness of the QC system, it appears that the Board intends to establish a requirement that parallels the SOX certification requirement for senior executives of public companies. We acknowledge this new requirement emphasizes the importance of accountability within and for a firm’s QC system overall. However, the Board’s proposal does not specify the standard against which an individual could be held liable for making a certification on Form QC that is later determined to be inaccurate. It is our understanding that, for certification by senior executives under SOX, courts have decided that a SOX Section 302 certifier can be held personally liable for an inaccurate statement in a certification only if they made the statement knowing it was false or recklessly not knowing it was false.<sup>1</sup> We believe it would be appropriate for the Board to clarify that the same standard applies to certifications made on Form QC.

### Confidentiality

The PCAOB recognizes that, to the extent that the matters discussed in Form QC touch on the inspection process, certain information in the Form QC will likely receive the protections of Section 105(b)(5)(A) of the Act, which provides that “all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents,” in connection with an inspection or investigation, “shall be confidential and privileged as an evidentiary matter.”<sup>2</sup> However, the Board also recognizes that the certification portions of Form QC “are not subject to privilege under Section 105(b)(5),” which creates a risk of unwarranted legal exposure for registered firms, particularly where the interconnected nature of documents and information prepared or reviewed in connection with inspections and investigations will overlap in numerous ways with documents and information prepared for and relevant to the Form QC report. Given the inextricable overlaps in information and given that the Form QC will form supplemental information for the inspection process, we encourage the Board to clarify and determine that Form QC falls within the bounds of the Board’s inspection authority. We believe that the legal exposure risk posed by QC 1000’s required annual evaluation and reporting justifies an arrangement that permits Section 105(b)(5)(A) of the Act to apply.

In addition, the proposed standard does not appear to recognize that certain information relevant to the description of a QC deficiency might be restricted from disclosure by the operation of legal requirements such as data protection laws or blocking statutes. This would be applicable for US-based firms in situations in which a QC deficiency is identified relating to its supervision of audit work by non-US “other participants” that is subject to data privacy regulations or for firms outside of the US that may not be able to disclose

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<sup>1</sup> SEC v. Miller, 2:17-cv-897-CBM, 2019 WL 1460615 (C.D. Cal. Feb. 6, 2019)

<sup>2</sup> (15 U.S.C. § 7215(b)(5)(A))



details of unremediated QC deficiencies altogether due to such regulations. We recommend that the Board clarify how firms should address a situation in which the Board’s expectation concerning the thoroughness of a firm’s quality control reporting might risk a firm’s compliance with other laws to which it, or the information it might disclose, is subject – as well as consider the inclusion of exemptions set forth in other PCAOB forms to acknowledge that disclosure of certain information by non-US firms may not be permitted.

### **Threshold for Consideration of “Intentional Misconduct” within the Definition of Quality Risk**

We understand the PCAOB’s rationale for the specific inclusion of “intentional misconduct” within the definition of “quality risk,” as we believe it is an important consideration of “what could go wrong” when identifying and assessing potential quality risks. However, we believe that it is appropriate for the definition to also address the “possibility of occurrence” of intentional misconduct when identifying and assessing quality risks. We note that the PCAOB suggests that “limiting risks of intentional misconduct to only those that have a reasonable possibility of adversely affecting the achievement of the firm’s quality objectives would result in the firm concentrating its efforts on more pervasive and larger risks and not on every conceivable act of misconduct.” However, we believe it is not feasible to design and implement quality responses to address every risk that has only a remote likelihood of occurring, particularly in the context of a system where the objective is to provide reasonable and not absolute assurance of achieving its stated quality objectives. Focusing on “every conceivable act of misconduct” would result in a misallocation of time and resources compared to true risk. Accordingly, we recommend revisions to the definition of quality risks as noted below.

*.A12 Quality risks – Risks that, whether due to unintentional acts or intentional acts by firm personnel or other participants to deceive or to violate applicable professional and legal requirements, individually or in combination with other risks, have a reasonable possibility of adversely affecting the firm’s achievement of one or more quality objectives if the risks were to occur, and are either:*

- (1) ~~Risks that have a reasonable possibility of occurring; or~~*
- (2) ~~Risks of intentional acts by firm personnel and other participants to deceive or to violate applicable professional and legal requirements.~~*

### **Ethics and Independence Matters**

#### Operational Responsibility

The proposal appears to indicate that only one individual should be assigned to the roles of both ethics and independence so that operational responsibility is not inappropriately delegated. In our experience, the scope of both roles may be too great for only one person and may detract from focus on the discrete and important, but different, goals of an ethics oversight program (that firm personnel understand and act consistent with applicable ethical rules, policies, and procedures) and an independence oversight program (that firm personnel and the firm itself remain independent of their audit clients consistent with a highly complex set of rules governing relationships with those clients and their employees). We therefore suggest that the Board clarify that the final standard does not preclude a firm from assigning one person to each of the ethics and independence operational roles, both of whom should have “a direct line of communication” to the principal executive officer and be identified on Form QC.

#### Monthly Communication of Changes to Restricted Entities

The proposal includes detailed specified quality responses related to (1) the firm updating and communicating changes to the list of restricted entities at least monthly, and (2) firm personnel reviewing the list of restricted entities changes after they are communicated by the firm or upon the occurrence of a



qualifying event. The requirements as written may drive responses that would not be as effective as automated processes already in place at larger firms. Such automated processes more precisely address the risks by updating restricted entity information in real-time with open access by firm personnel at all times, and especially for larger firms, are likely to be far more effective than monthly communications.

We recommend that instead of prescribed quality responses, a quality objective regarding “awareness of changes in restricted entities” should be established, which would allow firms to design their quality responses in line with the technology and processes already in place.

#### Obtaining Independence Certifications Upon Change in Personal Circumstances

We recommend that the PCAOB remove the specified quality response to “obtain additional certifications upon changes in personal circumstances” (especially related to changes in marital status – which employers may not be permitted to require employees to disclose). Rather, the proposal should emphasize that a firm’s independence certification processes and other procedures should consider timeliness in addressing the quality objective, and instead encourage firms to consider the appropriateness of obtaining periodic certifications throughout the year.

#### **External Communication of Performance Metrics**

We recommend that performance metrics subject to the quality objective in paragraph 53(e) be clarified to indicate that the metrics in scope are those related to the effectiveness of the firm’s QC system or audit quality, as these align with the PCAOB’s rules and standards. In addition, we suggest that “external communications” are clarified to indicate “formal” external reporting (e.g., Audit Quality Reports, Transparency Reports, communications with audit committees, and other published reports) so as to better enable effective operation of this requirement.

#### **Other Observations**

##### Cycle for Selecting Partners for Inspection

We recommend allowing firms to use a risk-based approach for each firm to determine an appropriate cycle for partner and engagement selection. Further, as each Deloitte registered firm operates one QC system for all engagements within that firm (as recognized in the Release to be the most efficient and effective approach for all firms), we believe this judgment should include consideration of all engagements in a partner’s portfolio.

##### Definition of “Applicable Professional and Legal Requirements”

The definition of “applicable professional and legal requirements” includes the phrase “other applicable statutory, regulatory, and other legal requirements” which could be read broadly as a wide range of laws and regulations that do not directly bear on the conduct of audit engagements (e.g., OSHA laws), and thus would be inconsistent with the focused statutory mission of the PCAOB to oversee the audits of public companies and broker-dealers for the protection of investors. As a result, we propose that “applicable professional and legal requirements” be clarified to mean only legal requirements that directly relate to the performance of engagements under PCAOB standards or that there be reference to specific relevant legal requirements that are intended to be brought within the ambit of the rule, such as PCAOB form reporting requirements and Securities Exchange Act Section 10A.



Amendments to Form QC

Similar to management's report and our opinion on internal control over financial reporting, we recommend that revisions to Form QC not be required for inconsequential matters (e.g., new unremediated deficiencies or changes to existing ones that would not change the conclusion reached on the effectiveness of the QC system).

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We would welcome the opportunity to engage with the Board in dialogue about these issues to provide deeper context about impacts and implications. If you have any questions, please contact Jen Haskell at 203-761-3394 or Julie Vichot at 415-783-4627.

Yours sincerely,

A handwritten signature in black ink that reads "Deloitte &amp; Touche LLP". The signature is written in a cursive, flowing style.

Deloitte & Touche LLP



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Ms. Phoebe W. Brown, Secretary  
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30 May 2023

**Re: PCAOB Rulemaking Docket Matter No. 049 – Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards**

Dear Ms. Brown:

Ernst & Young LLP (EY) is pleased to submit comments to the Public Company Accounting Oversight Board (PCAOB or Board) on the proposed standard on the general responsibilities of the auditor in conducting an audit and related proposed amendments (PCAOB Release No. 2023-001).

**General support and observations**

We support the Board's efforts to modernize a group of foundational standards that were originally developed by the American Institute of Certified Public Accountants (AICPA) and adopted on an interim basis by the PCAOB in 2003. We believe the efforts to streamline and clarify general principles and the responsibilities of auditors can enhance the consistency in interpreting and applying the PCAOB's standards.

We are supportive of the Board's reaffirmation of the general principles and responsibilities, which we believe remain appropriate considering the changes in the financial reporting and auditing environment. These general principles and responsibilities are foundational for conducting high-quality audits that provide reliable and independent audit opinions and informative communications that serve the public interest.

While we recognize that the Board does not intend to impose new requirements on auditors or significantly change existing requirements,<sup>1</sup> we believe that stakeholder input obtained during the rulemaking process is critical to confirm the achievement of the proposal's objectives since there are elements of the proposal that could unintendedly contribute to the expectations gap related to the auditor's responsibility.

The attachment to this letter contains our responses to the questions the PCAOB posed in the proposal.

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<sup>1</sup> The PCAOB release states on page 50 that "[t]he proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards."



Ms. Phoebe W. Brown,  
Public Company Accounting Oversight Board  
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We thank the Board and its staff for their consideration of this letter. We would be pleased to discuss our comments with members of the PCAOB or its staff at their convenience.

Very truly yours,

*Ernst & Young LLP*

**Q1.** 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?

The preparation and issuance of informative, accurate and independent auditor's reports are important roles that auditors have in the financial reporting ecosystem. We fully embrace our responsibility to perform high-quality audits that promote trust in the capital markets and investor confidence.

To further the proposal's goal of clarifying the auditor's responsibilities, we suggest certain changes to paragraph .01 in proposed Auditing Standard (AS) 1000.<sup>2</sup> Specifically, we believe that auditors and investors may interpret and understand differently the reference to a "fundamental obligation to protect investors" and "governs the auditor's work." We believe this language could create a misimpression that auditors are permitted and expected to diverge from following auditing standards in situations where they feel it would be warranted to further investors' interests.<sup>3</sup> Our suggested changes are also consistent with the Board's stated intent to avoid significant changes or new requirements.

*.01 A properly conducted audit and the related auditor's report benefit investors and other market participants by enhancing confidence in the company's financial statements and, if applicable, internal control over financial reporting. Auditors have responsibilities that include the preparation and issuance of informative, accurate, and independent auditor's reports, and that obligation governs the auditor's work under the standards of the PCAOB. An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company's financial statements, taken as a whole, are presented fairly in all material respects and, if applicable, on the effectiveness of the company's internal control over financial reporting. A properly conducted audit and the related auditor's report enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, internal control over financial reporting.*

**Q2.** Is the approach to reorganize and consolidate the general principles and responsibilities appropriate? If not, why not?

As mentioned in our cover letter, we are supportive of the Board's approach to reorganize and consolidate the general principles and responsibilities, which should drive enhanced usability and consistent application of the standards.

<sup>2</sup> We generally believe the general principle that investors benefit from properly conducted audits and related audit reports is foundational and should be stated similarly as our recommendation in Q1 in proposed AS 1000.15. The sentence "In fulfilling these requirements, the auditor should keep in mind their role in protecting investors" could be unclear for determining measures for complying with such a requirement.

<sup>3</sup> The PCAOB release states on page 42 that "[i]nvestors form expectations from a number of sources, including potentially the language of the standards themselves, but also from third parties (e.g., media) who may write about PCAOB standards."

**Q3.** Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?

We believe that the objectives of the auditor in proposed AS 1000.03 would be appropriate.

**Q7.** 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?

We believe the proposed requirements and related descriptions of the general principles are clear and comprehensive. However, we believe the reference to "information related to the audit" when describing where professional skepticism applies would be too broad and would result in the risk of capturing information that is never presented to the auditor for assessment but is "related to the audit." We believe that the Board should make the following revisions to proposed AS 1000.10:

.10 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of ***audit evidence and other information obtained to comply with the Rules of the Board-information related to the audit.***

These revisions would retain the general concept of audit evidence that is defined in AS 1105 in the foundational standard while also specifying that other information obtained by the auditor for compliance with the Board's rules should be critically assessed.

We also discuss potential unintended consequences of the proposal in our response to Q21 below.

**Q9.** 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?

We believe that it would be appropriate 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. Relevant guidance accompanying the standards helps promote the consistent application of the requirements by auditors.

However, we recommend that the Board include in the final standard guidance addressing how firms should demonstrate as part of their system of quality control that they "took into account" relevant guidance of existing standards, amendments and rules of the PCAOB during implementation to comply with the proposed requirement.

Finally, to avoid confusion on what types of supplemental publications are deemed to be authoritative and taken into account by auditors, we recommend the Board revise footnote 26 as follows:

26 Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and ***final rulemaking*** releases accompanying the standards and rules of the Board.



Otherwise, it could be interpreted that prior proposals, including concept releases, should be taken into account, which we do not believe is the Board's intention and would not be practical or cost-effective to implement. Additionally, there would be aspects of prior proposals that would not be relevant and would be superseded by changes made during the standard-setting process.

**Q10.** Are the proposed amendments to clarify the meaning of "present fairly" appropriate? If not, why not?

We believe that certain proposed amendments to clarify the meaning of "present fairly" would extend the auditor's obligation beyond what is expressed in an auditor's report. The auditor's report references that the auditor's responsibility is to evaluate and conclude whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

We recommend that the Board remove footnote 17A in paragraph AS 2810.30, which introduces SEC Rule 12b-20 17 C.F.R. § 240.12b-20 for additional considerations regarding the fairness of presentation of financial statements. This requirement is a legal responsibility of registrants, and its inclusion in AS 2810 could imply that it would be applicable for auditors and, therefore, extend the auditor's responsibilities.

We also encourage the Board to provide guidance to auditors to promote the consistent application of AS 2810.30A(a) because the term "informative" could be widely interpreted and applied in practice.

**Q11.** Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?

We believe that the proposed clarifying amendments related to engagement partner responsibilities would be appropriate.

**Q12.** Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?

We believe that the proposed clarifying amendments related to audit documentation would be appropriate.

**Q13.** 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?

The proposed amendment to reduce the maximum period of time to assemble a complete and final set of audit documentation for retention would be appropriate.

**Q14.** Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?

We would not have difficulty complying with the requirements of AS 1215.16; however, we expect to incur incremental costs (e.g., effort to change processes, administrative burden) that are not explicitly indicated by the Board in the economic analysis.

**Q16.** Are the amendments to the general principles and responsibilities described in the PCAOB's attestation standards appropriate? Should other relevant amendments be made to the PCAOB's attestation standards? If so, what are they?

We believe that the amendments to the general principles and responsibilities described in the PCAOB's attestation standards are appropriate, and no other relevant amendments would be necessary.

**Q17.** Are the amendments to the general principles and responsibilities described in AS 4105, *Reviews of Interim Financial Information*, appropriate? Should other relevant amendments be made to AS 4105? If so, what are they?

We believe that the amendments to the general principles and responsibilities described in AS 4105, *Reviews of Interim Financial Information*, are appropriate, and no other relevant amendments would be necessary.

**Q21.** We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?

We support the Board's proposed retention of the general principle of reasonable assurance and its reaffirmation through the definition in proposed AS 1000.14. However, we believe the proposal could inadvertently reduce transparency and contribute to an expectation gap regarding the nature of reasonable assurance.<sup>4</sup>

While we appreciate the Board's efforts to streamline the general principles and responsibilities, we believe there is a risk that the proposal could contribute to an expectation gap when it comes to investor understanding of an auditor's general responsibilities. We believe this risk may be exacerbated by omitting certain concepts related to reasonable assurance. For example, the context included in extant

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<sup>4</sup> In addition to retaining certain language from the current standards, the Board could consider including cross-references in proposed AS 1000 to other standards that address similar contexts (e.g., AS 2401.12).

AS 1001.02<sup>5</sup> and AS 1015.12-13 may be beneficial to investors who form expectations from the standards themselves. We believe that including some information of this type would contribute to the overall understanding of auditor responsibilities. We also agree that identifying limitations on auditor responsibilities should not be the main focus of the standard.

**Q25.** 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 believe that the effective date should be aligned to audits of fiscal years and be no earlier than 12 months after the final standard is approved by the Securities and Exchange Commission (SEC), while also considering the effective dates of other standards resulting from existing projects.

Auditors will need time to evaluate and implement the final standard, including amendments to performance standards, which involves relevant training of personnel. For example (as referenced in the text of the PCAOB release), auditors will need to assess that relevant guidance as proposed in paragraph 1000.15 is properly reflected in their methodologies and periodic trainings.

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<sup>5</sup> AS 1001.02: "The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected."



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1 February 2023

**PCAOB Proposal on a Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms (PCAOB Release No. 2022-006; Rulemaking Docket No. 046)**

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on Release 2022-006: *Proposal on a Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (the Proposal).

We believe a firm's system of quality control (QC) is foundational to audit quality. We agree that revising the PCAOB QC standards is necessary because the auditing environment has changed significantly since the PCAOB adopted the American Institute of Certified Public Accountants (AICPA) QC standard on an interim basis in 2003.

We appreciate the PCAOB's efforts to consider the views of stakeholders on its December 2019 QC Concept Release and to analyze and leverage the approaches other standard setters have taken to update their QC standards. We generally support the Proposal, but we have several recommendations that we believe would benefit audit committees and other stakeholders and would improve the final standard. The appendix to this letter contains our responses to most of the questions included in the Proposal.

**General support of the proposed risk-based QC standard**

We support establishing a risk-based approach to a firm's QC system that is based on the same eight components that the International Auditing and Assurance Standards Board (IAASB) identified in its International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*. We believe this approach is consistent with the top-down, risk-based approach that the Securities and Exchange Commission (SEC) describes in SEC Release No. 33-8810, *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, relating to a registrant's assessment of its internal control over financial reporting (ICFR) and is inherently scalable.

We agree that a principles-based standard built on a risk-based framework would enable firms to appropriately tailor their system of quality control to their size and complexity, the nature of the engagements they perform and the risks to quality.



We also support many of the provisions that would be incremental to ISQM 1. However, we believe that further alignment with ISQM 1 and the AIPCA's Statement on Quality Management Standards No. 1 (SQMS 1) in certain areas would serve the public interest by preventing confusion and complexity that could result if these provisions of the final PCAOB standard differ from those of ISQM 1 and SQMS 1. Global network firms have made substantial investments in people, processes and technology to support global consistency in their implementation of ISQM 1, and we believe that aligning further on the ISQM 1 reporting framework would enhance the understandability and usability of the QC annual evaluation for audit committees and other users.

### **Minimizing the annual evaluation and reporting date differences with ISQM 1**

We strongly believe that the Board should minimize any differences between the two standards regarding the definitions of deficiencies, the annual evaluation conclusions and the annual evaluation date. We believe that minimizing these differences would enhance the understandability and useability of firms' annual conclusions.

As the Board acknowledged in the Proposal, many audit firms are subject to the standards of both the PCAOB and the IAASB, and audit committees of listed companies that receive information from their auditors about the audit firm's system of quality management will be familiar with the ISQM 1 annual evaluation by the time a final PCAOB standard goes into effect.

### **Deficiency definitions and the annual evaluation conclusions**

We support the proposed requirement for firms to evaluate the effectiveness of their system of quality control annually. However, we are concerned that a firm that is subject to both the PCAOB standard and ISQM 1 could reach different conclusions under the two standards when evaluating the same set of facts, potentially undermining the credibility of the reports.

We recommend the definition of a QC deficiency in the final PCAOB standard be consistent with the definition of a deficiency in ISQM 1 to prevent audit firms from reaching different conclusions about when a deficiency exists under the two standards. We also recommend the PCAOB's defined term "major QC deficiency," which results in a not effective (or qualified) annual evaluation conclusion, align with an unremediated severe and pervasive deficiency as described in ISQM1. We believe the QC 1000 definition of a major QC deficiency should be a severe and pervasive unremediated QC deficiency or combination of unremediated QC deficiencies that, based on the evaluation under paragraph .78, prevent the firm from concluding that the firm has achieved the reasonable assurance objective or one or more quality objectives. This alignment with ISQM 1 regarding both severity and pervasiveness would result in more consistent qualified annual evaluation conclusions between QC 1000 and ISQM 1.

Further on the annual evaluation conclusion, under ISQM 1 (and its First Time Implementation Guide dated September 2021), a firm would conclude that there is reasonable assurance that the objectives of the system of quality management have been achieved, even if there are unremediated deficiencies that are "neither severe nor pervasive" or "pervasive but not severe." However, under proposed QC 1000, the existence of any unremediated QC deficiency would require a firm to conclude that its system of quality control "is effective except for one or more unremediated QC deficiencies that are



not major QC deficiencies.”<sup>1</sup> We strongly recommend that the Board revise the annual evaluation conclusion of QC 1000 so that deficiencies that are not severe result in an effective annual evaluation conclusion, consistent with ISQM 1. We believe that this annual evaluation conclusion is also consistent with the reporting requirements of Auditing Standard (AS) 2201 on integrated audits of issuers where the auditor would issue an unqualified report when unremediated deficiencies exist that are neither significant nor material.

Finally, if the Board doesn’t align its annual evaluation conclusions with ISQM 1, we believe that communication of the audit firm’s annual conclusion about the effectiveness of its system of QC to audit committees should be required only when one or more unremediated major QC deficiencies exist and the annual evaluation conclusion is “not effective.” We believe this approach would provide audit committees with the most relevant information to help them fulfill their responsibilities.

Revising the proposed requirements in this manner would also more closely align them with the existing requirements for auditor communications to audit committees about an issuer’s internal control deficiencies identified during an audit.<sup>2</sup> That is, auditors would report to audit committees only those matters that are more severe than a deficiency so that the audit committee communications focus on major QC deficiencies that would be most relevant to audit committees in fulfilling their responsibilities.

### **Annual evaluation date**

We observe that the annual evaluation date of November 30 in the Proposal is based on the Board’s “understanding that many firms perform their internal inspections process during the second and third quarters, which allows them time to design and implement remediation efforts ahead of ‘busy season.’” While we appreciate that is one factor to be considered in establishing an annual evaluation date, we have concerns that a November 30 annual evaluation date could have the unintended consequence of being detrimental to audit quality and create unnecessary costs and complexity for both audit committees and audit firms.

A November 30 evaluation date could create challenges for audit committees of issuers with December 31 year-ends. Firms would have to report on their annual evaluation conclusions on Form QC by January 15, which would often be in close proximity to the conclusion of the registrant’s annual audit. If there are matters to be reported to the audit committee during this critical phase of the audit, such communications could detract from, rather than enhance, the completion of a quality audit and leave the audit committee with little time to consider and respond to the information before the due date of the issuer’s Form 10-K. In addition, we believe a November 30 annual evaluation date could create challenges for lead auditors because they would have little time to consider and respond to any information about other auditors before the issuer’s annual audit filing date. Finally, for firms subject to both ISQM 1 and QC 1000, we believe having different reporting dates would also create unnecessary complexity for audit committees receiving reports under the different standards at different points in time.

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<sup>1</sup> Proposed QC 1000 .77(b)

<sup>2</sup> AS 2201: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements .78-.80; AS 1305: Communications About Control Deficiencies in an Audit of Financial Statements .04



We note that a firm's QC system operates continuously throughout the year. Therefore, we recommend that the PCAOB allow firms to select their annual evaluation date, consistent with ISQM 1. Such a provision would allow firms to select the most relevant date based on their business processes and to avoid their busy season. Importantly, this would allow firms subject to ISQM 1 and QC 1000 to avoid the cost and complexity of completing two separate annual evaluations at different times of the year. We have already selected our fiscal year-end date (i.e., end of June) as our annual evaluation date under ISQM 1 because it aligns the evaluation with our existing business processes, including performance management, and avoids our busiest time of year. That date also aligns with transparency reporting requirements in certain non-U.S. jurisdictions. Further, the member firms of the global EY network have selected a globally consistent ISQM 1 annual evaluation date to enhance global consistency in our application of ISQM 1 and, ultimately, enhance audit quality.

### **Reporting to the PCAOB and documentation timeline**

We recommend that the Board provide firms more than 46 days<sup>3</sup> to complete their annual evaluation conclusion and report to the PCAOB. Consistent with the time that would be allowed under the alternative reporting model on a non-public portion of Form 2 discussed on p. 214 of the Proposal, we recommend that the Board provide firms up to 90 days after the annual evaluation date to report to the PCAOB. We believe that more than 46 days is needed to appropriately monitor the QC controls that operate on or near the annual evaluation date, assess the nature, severity and pervasiveness of any unremediated QC deficiencies, assess the effectiveness of remedial actions, and comply with the documentation requirements proposed in .83.

Consistent with the requirement under PCAOB standards<sup>4</sup> to assemble and retain a complete and final set of audit documentation, we also recommend that firms be provided no more than 45 days after filing their Form QC to assemble their QC documentation for retention.

### **Quality risk definition**

We support the Board's efforts to address the risks of intentional acts to deceive or violate applicable professional and legal requirements. However, we recommend that the term "quality risk" in all circumstances apply only to risks that have a "reasonable possibility of occurring." Such a threshold would be consistent with auditing standards that require firms to consider the magnitude of a risk of material misstatement and the likelihood that the risk will result in a material misstatement to the financial statements in identifying fraud risks.

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<sup>3</sup> Proposed QC 1000 .79 says: "The firm must report annually to the PCAOB on Form QC, in accordance with the instructions to that form, the results of the evaluation of its QC system not later than January 15 of the year following the evaluation date." That would be 46 days after the November 30 evaluation date in QC 1000 .77.

<sup>4</sup> AS 1215: Audit Documentation; .15 "A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (documentation completion date)."



### **Oversight function**

We believe that it is appropriate to promote the adoption by the largest firms of formal structures that provide independent perspectives into firm leadership; however, to avoid confusion over the use of the terms “governance structure” and “oversight function,” we recommend that the standard expressly acknowledge that independent advisory boards are a permissible approach.

### **Additional scalability consideration**

We appreciate the Board’s focus of the scalability of the proposed standard and suggest that the Board consider more limited QC obligations for PCAOB registered firms that are not currently performing engagements under PCAOB standards.

We recommend that the PCAOB consider these firms to be compliant with its standard if they fully comply with the design, implementation and operation requirements of another recognized QC framework, such as ISQM 1 or SQMS 1. We agree with the Board’s preliminary view on p. 6 of the Proposal “that the risk to investor protection is minimal if the firm is not performing or playing a substantial role in such engagements.” Therefore, we believe this alternative would address the investor protection risk while also scaling implementation costs for firms that fully comply with the design, implementation and operation requirements of another recognized QC standard and are not currently performing engagements in accordance with PCAOB standards.

### **Effective date**

We believe that an extended implementation period is necessary. We learned from our implementation of ISQM 1 that having the opportunity to perform field testing is critical.

Therefore, we encourage the Board to consider an effective date of 15 December 2025 so firms have sufficient time to design, implement and operate the new or incremental requirements of QC 1000 and also align with the effective date of the AICPA’s suite of new and revised quality management standards.

### **Other considerations**

We encourage the Board to continue its engagement with stakeholders as proposed QC 1000 is finalized. We believe that as adoption challenges arise, the PCAOB or its staff should also provide guidance that promotes consistent interpretation and application of the requirements.

\* \* \* \* \*





Phoebe W. Brown, Secretary  
Public Company Accounting Oversight Board  
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We want to again thank the Board and its staff for its consideration of this letter and the comments we previously submitted on this topic. We would be please to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

*Ernst & Young LLP*

Copy to:

**PCAOB**

Erica Y. Williams, Chair  
Duane M. DesParte, Board Member  
Christina Ho, Board Member  
Kara M. Stein, Board Member  
Anthony C. Thompson, Board Member  
Barbara Vanich, Chief Auditor

**SEC**

Gary Gensler, Chair  
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Caroline A. Crenshaw, Commissioner  
Mark T. Uyeda, Commissioner  
Jaime Lizárraga, Commissioner  
Paul Munter, Chief Accountant  
Diana Stoltzfus, Deputy Chief Accountant

## Appendix

Our responses to the questions in the Proposal are set out below.

### PROPOSED QC 1000: BASIC STRUCTURE, TERMINOLOGY, AND SCALABILITY

1. Is the proposed definition of “applicable professional and legal requirements” appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?

Because the Board would be updating and superseding its quality control standards with QC 1000, we recommend that the reference to “quality control policies and procedures” in the definition of Professional Standards, as defined in PCAOB Rule 1001(p)(vi), be revised to say “quality control standards” to more closely align with the scope, approach and terminology of QC 1000.

We are not aware of any other requirements that should be included.

2. Is the proposed definition of “engagement” clear and appropriate? If not, why not? Should the definition be narrower (e.g., limited to engagements required to be performed under PCAOB standards) or broader? If so, how?

We support the proposal to define “engagement” to include both (1) engagements in which a firm serves as lead auditor or as the “practitioner” in an attestation engagement and (2) engagements in which a firm “play[s] a substantial role in the preparation or furnishing of an audit report,” as defined in PCAOB Rule 1001(p)(ii). We agree that the definition of “engagement” should include engagements performed under PCAOB standards, regardless of whether PCAOB standards are applied due to rules, regulations, contracts or voluntarily. We also agree that the definition of “engagement” should not include referred work that is less significant than when a firm “play[s] a substantial role in the preparation or furnishing of an audit report.”

3. Are the proposed definitions of “firm personnel,” “other participants,” and “third-party providers” sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.

Paragraph 5 of proposed QC 1000 states “an effective QC system provides a firm with reasonable assurance that the firm, *firm personnel*, and *other participants* 1) conduct engagements in accordance with applicable professional and legal requirements; and 2) fulfill their other responsibilities that are part of or subject to the firm’s QC system in accordance with applicable professional and legal requirements.” We are concerned that the proposed definition of other participants and applicability of that definition creates differences from ISQM 1 and raises a number of implementation and operational challenges that we believe are unnecessary. As defined, other participants would include, among others, specialists engaged by a firm, other auditors, and internal auditors of the client providing direct assistance to the auditor. We believe that other PCAOB standards (e.g., AS 1201, AS 1210, AS 2101 and AS 2605) sufficiently address the auditor’s responsibilities, including supervision and review, when using the work of these groups.

We are concerned that, because these individuals would be included in the definition of other participants:

- ▶ Paragraphs 5 and 55 of the proposed QC 1000 could be read to imply that aspects of a firm's QC system could be outsourced to other participants outside of that firm's network, who would be made responsible for these aspects of the firm's QC system. We believe that a firm and its personnel are responsible for the firm's QC system.
- ▶ Paragraph 5 could be read too broadly to imply that all components of a firm's QC system would have to cover other participants. We believe the Board's intent is properly addressed in the component-by-component references to other participants without incorporating other participants in paragraph 5.

4. Is the other terminology used in QC 1000 clear and appropriate? Are there other terms that should be defined?

As stated in our response to question 53, the Proposal states that a QC finding that results in a "reduced likelihood of achieving the reasonable assurance objective or one or more quality objectives" would rise to the level of a QC deficiency. To promote consistency in the application of QC 1000 and ISQM 1, we recommend the Board revise the definition of a QC deficiency to better align with the definition in ISQM 1.

5. Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.

We support the view of the Board to require all PCAOB registered firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a quality control system because we recognize the importance of quality controls. However, as stated in our cover letter, we recommend that the QC requirements for those firms that have not and do not plan to perform engagements pursuant to PCAOB standards could also be satisfied by full compliance, including design, implementation and operation, with another recognized QC framework, such as ISQM 1 or SQMS 1. We believe such an alternative would address the investor protection risk while also scaling implementation costs for firms that are otherwise subject to the design, implementation and operation requirements of another recognized QC standard and have a low likelihood of performing engagements under PCAOB standards in the near term.

In addition, we recommend that the Board give firms that are transitioning to performing engagements under PCAOB standards during the one-year period preceding their annual evaluation date, and therefore subject to the implementation and operation requirements of QC 1000, an additional six months to one year from their annual evaluation date to file their Form QC for the transition period. We note that it is not unusual for firms to transition from not playing a substantial role to playing a substantial role in a short period of time (e.g., due to an increase in the relative size of a subsidiary or component of an issuer or an increase in the relative work effort required with respect to a subsidiary or component of the issuer). Even if such a firm has complied with the design requirements of QC 1000, implementing and operating a QC system that complies with the standard would involve a significant effort.

6. Is the proposed distinction between the obligation to design a QC system and the obligation to implement and operate a QC system appropriate? Is the proposed threshold for full applicability of QC 1000 – having obligations under applicable professional and legal requirements with respect to a firm engagement – appropriate?

No. We believe the proposed obligation to design a QC system is not appropriate. To enhance scalability of the proposed standard, we recommend that the Board consider more limited QC obligations for PCAOB-registered firms that are not currently performing engagements under PCAOB standards. We believe the greater risk resides with firms that are currently performing engagements under PCAOB standards. Therefore, consistent with our response to question 5, if a firm is subject to the design, implementation and operation requirements of another recognized QC standard, we recommend that compliance with those standards should be a suitable alternative to complying with QC 1000 for firms that are not currently performing engagements pursuant to PCAOB standards.

7. Is it clear how a firm's responsibilities under QC 1000 may change depending on the extent of "applicable professional and legal requirements" to which the firm is subject at a particular time? Please explain what additional direction may be necessary.

We believe that the proposed standard is sufficiently clear about how a firm's responsibilities under QC 1000 may change depending on the extent of "applicable professional and legal requirements" to which the firm is subject at a particular time. However, as discussed in our response to question 6, if a firm is subject to the design, implementation and operation requirements of another recognized QC standard, we recommend that compliance with those standards should be a suitable alternative to QC 1000 for those firms that are not currently performing engagements pursuant to PCAOB standards. In addition, to enhance scalability of the proposed standard, we recommend that the Board only require the filing of a Form QC if a firm performed engagements in accordance with PCAOB standards during the one-year period ending on the annual evaluation date.

8. Are there other provisions of QC 1000 that should apply to all firms? If so, which other provisions should we consider?

No, there are no other provisions of QC 1000 that should apply to all firms.

9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?

We agree with the Board's intent that the standard be scalable for all firms based on their nature and circumstances. Refer to our response to questions 5, 6 and 7 for our recommendation to enhance scalability for firms that are not currently performing engagements pursuant to PCAOB standards and comply with another recognized QC standard.

Additionally, in instances where scalability provisions would apply, we recommend that the Board specify a cut-off date for firms to evaluate whether they are above the stated scalable thresholds. We also suggest that the Board provide a transition period for firms that have crossed the threshold to apply the incremental requirements, similar to our recommendation in our response to question 5. We note that this approach would be similar to the SEC rules for issuers to determine their filer status.

## PROPOSED QC 1000: A FIRM'S SYSTEM OF QUALITY CONTROL

### *The Firm's QC System*

10. Is the reasonable assurance objective described in the proposed standard appropriate? If not, why not? Are there additional objectives that a QC system should achieve? If so, what are they?

We agree that a reasonable assurance objective as described in the proposed standard is appropriate and would be consistent with existing PCAOB QC, auditing, and attestation standards, as well as ISQM 1 and SQMS 1. We do not believe that there are additional objectives that a quality control system should achieve.

11. Are the proposed requirements regarding design of the QC system appropriate? Are there other aspects of QC 1000 that should be required as part of the design of the QC system? If so, what are they?

We agree that the proposed requirements regarding the design of the QC system are appropriate.

We do not believe there are other aspects of QC 1000 that should be required as part of the design of the QC system.

### *Roles and responsibilities*

12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?

The proposed requirements related to roles and responsibilities described in the proposed standard are clear, but we recommend that they be modified as follows:

Paragraph .12 requires that firms assign the specified roles to *firm personnel*, as defined. For firms that are part of larger network, it is common for such responsibilities to be assigned to individuals outside of the specific member firm, such as personnel having responsibility for those same matters at multiple member firms within a specific country, geographic region or other management unit of the network organization. Personnel in such situations may not meet the definition of *firm personnel*. However, such assignments are often implemented to enhance the experience, competence and authority of the individual and/or to give the individual the time to carry out the assigned responsibility. Consistent with paragraph A34 of ISQM 1, we recommend that the final standard permit the assignment of the roles in paragraph 12 to personnel outside the member firm (i.e., part of the larger network)

when such personnel have the experience, competence, authority and time to enable the person to carry out the assigned responsibility and such assignment is supported by a formal arrangement made by the firm or the firm's network.

We recommend that the final standard state that more than one individual can have responsibility for each of the roles in paragraph .12 if the responsibility is clearly defined. While we agree that responsibility for a specified role may not be delegated, there may be situations where responsibility for a specified role may be shared among more than one person. For example, in current practice firms may assign responsibility for compliance with certain ethical requirements to a different person than the person responsible for compliance with independence requirements to better align with relevant expertise on the subject matter.

We recommend that firms be provided sufficient flexibility to supervise the annual evaluation of the QC system based on their organizational structure. Based on our experience in adopting ISQM 1, we believe that responsibility for the annual evaluation of a firm's system of quality management (SQM) is best shared between the individual with operational responsibility for the SQM and the individual with operational responsibility for monitoring and remediating the SQM. That is, we believe the individual with operational responsibility is best suited to recommend the annual evaluation conclusion to the individual assigned ultimate responsibility and accountability for the SQM, and the individual with operational responsibility for monitoring and remediation is best suited to concur with, or recommend changes to, that conclusion based on the results of the monitoring and remediation process. We believe this approach would be consistent with ISQM 1.

13. Would firms have difficulty filling the specified roles in light of the proposed requirements?

We are optimistic that we would be able to fill the specified roles in light of the proposed requirements.

#### ***The Firm's Risk Assessment Process***

14. Are the proposed definitions of "quality risks," "quality objectives," and "quality responses" sufficiently clear and comprehensive? If not, why not?

Yes, the proposed definitions of "quality risks," "quality objectives" and "quality responses" are sufficiently clear and comprehensive. Refer to our response to question 16 and 17.

15. Is the threshold of "adversely affecting" set out in the proposed definition of quality risk clear, or would more guidance and examples be helpful?

The threshold of "adversely affecting" set out in the proposed definition of "quality risk" is sufficiently clear.

16. Should the proposed definition of “quality risks” explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?
17. In the proposed definition of “quality risks” should the threshold of “reasonable possibility of occurring” also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?

We support the Board’s efforts to address the risks of intentional acts to deceive or violate applicable professional and legal requirements. However, we recommend that the definition of “quality risks” include a threshold of “reasonable possibility of occurring” that would apply to all risks, including risks of intentional misconduct. Such a threshold would be consistent with auditing standards that require firms to consider the magnitude of a risk of material misstatement and the likelihood that the risk will result in a material misstatement to the financial statements in identifying fraud risks. In addition, page 79 of the Proposal indicates that “the “reasonable possibility” term in the proposed definition of quality risks is aligned with the use of the term in PCAOB standards: there is a reasonable possibility of an event when the likelihood of the event is either “reasonably possible” or “probable,” as those terms are used in the FASB Accounting Standards Codification (“FASB ASC”) Topic 450, *Contingencies*.”

We are concerned that, if the “reasonable possibility of occurring” threshold is not applied to all quality risks, including risks of intentional misconduct, firms would have a duty to identify quality risks relating to intentional misconduct that have a “remote” likelihood of occurring. This requirement would cause firms to expend effort identifying quality risks with a “remote” likelihood of occurring, which appears inconsistent with the Board’s stated intent on Page 84 of the Proposal that a firm “concentrate[e] its effort on more pervasive and larger risks and not on every conceivable act of misconduct.”

Further, as we discuss in our response to question 3, we recommend that the Board exclude specialists engaged by the firm, other auditors and internal auditors of the client providing direct assistance to the auditor from the definition of “other participants” because, including them in the definition of quality risks would impose quality control requirements on firms to assess the actions of these participants that are more appropriately addressed by engagement teams applying existing auditing standards.

18. Are the proposed requirements for the firm’s risk assessment process appropriate? Are changes to the requirements necessary for this process? If so, what changes?

Yes, the proposed requirements for the firm’s risk assessment process are appropriate. We appreciate the flexibility that the guidance appears to provide rather than rigid assessment categories. However, if the Board expects firms to designate quality risks as lower, higher or significant (or some other categorization) based on the risk assessment process, we request that the final standard clarify such a requirement.

19. Are the proposed requirements sufficient to prompt firms to appropriately identify, assess, and respond to quality risks, or is supplemental direction needed? If supplemental direction is needed, what would assist firms in identifying, assessing, and responding to quality risks?

Yes, the proposed requirements are sufficient to prompt firms to appropriately identify, assess, and respond to quality risks.

20. Are the specific examples included in Appendix B helpful in assisting the firm in identifying and assessing quality risks? Should additional examples or guidance be provided? If so, what additional examples or guidance would be helpful?

Yes, the examples included in Appendix B are helpful.

### ***Governance and Leadership***

21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Yes, the proposed quality objectives for governance and leadership are appropriate. We do not believe any changes are necessary.

22. For the proposed specified quality response related to the firm's governance structure, is the threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, what is an appropriate threshold?

Yes, the threshold appears reasonable and appropriate.

23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?

We believe that it is appropriate to promote the adoption by the largest firms of formal structures that provide independent perspectives into firm leadership. However, to avoid confusion over the use of the terms "governance structure" and "oversight function," we recommend that the standard expressly acknowledge that independent advisory boards are a permissible approach.

24. Is the proposed specified quality response related to the firm's policies and procedures on receiving and investigating complaints and allegations appropriate? Are there any other specified quality responses in this area that we should consider, and if so, what are they?

Yes, the proposed specified quality response related to the firm's policies and procedures on receiving and investigating complaints and allegations is appropriate.



25. Are there any other specified quality responses for the governance and leadership component that we should consider? If so, what are they?

No, there are no other specified quality responses for the governance and leadership component that we believe should be considered.

### *Ethics and Independence*

26. Are the proposed quality objectives for ethics and independence requirements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

We believe the Board should clarify the ethical requirements that are subject to the responsibility of the individual assigned operational responsibility for the firm's compliance with ethics and independence requirements. For example, competence and due care are characteristics required both by ethical standards (i.e., AICPA Code of Professional Conduct) and QC standards. As a result, there could be confusion over whether such requirements are ethical requirements or quality control requirements when determining the responsibility of the individual assigned operational responsibility for the firm's compliance with ethical and independence requirements. Therefore, clarification of the responsibility of the individual in that role as it pertains to requirements also addressed in standards other than ethical standards would improve understandability of the final standard. Also, see our response to question 12 regarding more than one individual having responsibility for compliance with independence and ethical requirements.

27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?

Yes, the proposed specified quality responses for ethics and independence requirements are generally appropriate. However, requiring that, as part of its QC system, a firm obtain certifications from firm personnel upon any changes in personal circumstances may not be practicable (for example, in the case of marital status change). Therefore, we recommend that paragraph 34(e) be revised as follows:

- e. Obtaining certifications from firm personnel regarding familiarity and compliance with SEC and PCAOB independence requirements and the firm's independence policies and procedures (1) upon employment, (2) at least annually thereafter, and (3) upon any change in ~~personal circumstances, such as firm role and geographic location, or marital status, that is relevant to independence;~~ and

We believe a firm should have the flexibility to determine its own policies and procedures for certifications beyond requiring them at employment, annually thereafter, and upon any change in firm role and geographic location. For example, quarterly certification accompanied by training on the impact of life events may be more effective and practicable than event-driven review and certification.

28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?

Yes, the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests is appropriate.

29. Is the proposed specified quality response related to communication of changes to the list of restricted entities at least monthly (and more frequently, if appropriate) to firm personnel and others performing work on behalf of the firm who are subject to independence requirements appropriate? Could communication to a more limited group accomplish the goal of alerting all individuals whose actions and relationships are relevant to independence? If so, to whom should changes be communicated?

While we support the objective of the specified quality response, we believe the standard should be more flexible. Specifically, the proposed requirements regarding communicating changes to the list of Restricted Entities may not be appropriate for firms that use technology to continuously update and make available their Restricted Entity list to all firm personnel and others performing work on behalf of the firm who are subject to independence requirements. In addition, we have IT systems that continuously perform automated comparisons of all engagements, business relationships and financial relationships with our Restricted Entity list, allowing us to make targeted communications to affected personnel how changes to our Restricted Entity list apply to them. We believe this targeted approach to communications is more effective than communicating a list of all changes to the Restricted Entity list to all firm personnel. Accordingly, we recommend that the specified quality response be worded in a manner that explicitly allows these targeted communications.

30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?

Yes, we believe the proposed standard should require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures.

We support a requirement that firms should adopt firm-wide codes of ethics. We believe that this sets the appropriate tone for the organization and supports compliance with all applicable standards.

***Acceptance and Continuance of Client Relationships and Specific Engagements***

31. Are the proposed quality objectives for acceptance and continuance of client relationships and specific engagements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Yes, the proposed quality objectives for acceptance and continuance of client relationships and specific engagements are appropriate.

32. Are the proposed specified quality responses for acceptance and continuance of client relationships and specific engagements appropriate? If not, what changes to the specified quality responses are necessary for this component?

Yes, the proposed specified quality responses for acceptance and continuance of client relationships and specific engagements are appropriate.

***Engagement Performance***

33. Are the proposed quality objectives for engagement performance appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Yes, the proposed quality objectives for engagement performance are appropriate and no changes are necessary.

34. Should we include specified quality responses for the engagement performance component? If so, what should they be?

We do not believe that specified quality responses for the engagement performance component are necessary since they should be based on a firm's risk assessment.

35. We are proposing to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. Should the standard include specified quality responses explicitly directed to non-U.S. firms that audit issuers? If so, what are they?

We support the Board's proposal to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. We also believe that QC 1000 should not include specified quality responses for non-U.S. firms because each firm's quality control system should consider the objectives in Appendix K when developing their quality responses to their specific facts and circumstances.

Under the proposal's risk-based approach, the Board suggested that some firms might add another member to the engagement team who possesses the necessary experience to bridge a gap in experience with engagements under the legal and professional requirements that apply to audits of U.S. public companies. We agree that, as part of an effective quality control system, firms may need to

identify and allocate additional resources to support engagement teams that lack experience on professional or legal requirements. However, it may not be necessary in each instance to have such a resource be a member of the engagement team, and we recommend that the Board clarify this point. It may be appropriate for a firm to utilize the input and expertise of personnel who are not part of the engagement team, which would be consistent with the proposal's reference to the possible use of engagement quality reviewers to address risks in this area, as well as the fact that engagement quality reviewers are not considered members of an engagement team under the existing definition.

### **Resources**

36. Are the proposed quality objectives for resources appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

The quality objectives related to the firm's personnel are appropriate. However, because paragraph 44c also applies to other participants, as defined, please see our response to question 3. We believe that the responsibilities related to the use of specialists engaged by the firm, other auditors, and internal auditors of the client providing direct assistance to the auditor are appropriately addressed in existing auditing standards as engagement team responsibilities.

37. Does the proposed quality objective and specified quality response related to technological resources provide sufficient direction to enable the appropriate use of emerging technologies? If not, what additional direction is necessary?

Yes, the proposed quality objective and specified quality response is sufficient to address the use of emerging technologies. The proposed principles-based approach can be applied to emerging technologies because the principles are aligned with common IT general controls, including common system development lifecycle controls over the development of technology applications.

38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?

The proposed specified quality responses for resources are appropriate. No changes from that proposed are necessary.

39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients? If yes, what should the requirement be?

No. We support the proposed principles-based approach of including a risk factor to prompt consideration of technology as part of the firm's risk assessment process, including the assessment of the technology risk profile of the firm's clients. We do not believe the proposed standard should include a specific quality response in this area.

**Information and Communication**

40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Yes, the proposed quality objectives for information and communication are appropriate except as noted in our responses to questions 41 and 42.

Further, we encourage the Board to consider how its Firm and Engagement Performance Metrics research project may inform policy decisions being made in QC 1000.

41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?

Yes, but we recommend that the requirements in paragraphs 53(d) and (e) pertaining to the firm's external communications be limited to information or communications regarding a firm's audit practice and engagements performed in accordance with PCAOB standards. We believe information and communications on such topics are most appropriate for inclusion in a firm's system of quality controls, and requirements on such topics would most directly relate to, and promote, audit quality.

42. Are the proposed quality objective and specified quality response addressing information and communication related to other participants appropriate? If not, why not, and what changes are necessary?

As discussed in our response to question 3, we recommend that specialists engaged by the firm, other auditors, and internal auditors of the client providing direct assistance to the auditor be excluded from the definition of other participants, including this reference. Further, if an other participant is a firm that is not registered with the PCAOB and not subject to QC 1000, firms may be unable to cause the other auditor to communicate its most recent evaluation of its QC system and a brief overview of the remedial actions taken or to be taken because the other auditor would not be obligated to do so. Provided that the firm can otherwise comply with the applicable auditing standards, we do not believe that its inability to obtain the most recent evaluation of the other auditor's QC system and a brief overview of the remedial actions taken or to be taken should result in noncompliance with QC 1000. Accordingly, we do not believe such a requirement should be part of the specified quality response.

43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.

While we are not aware of legal or regulatory concerns, we believe the PCAOB should state that firms wouldn't violate this requirement if laws or regulations exist in the jurisdiction(s) of the other participant that prevent compliance with this requirement.

44. Are the proposed specified quality responses for information and communication appropriate? If not, what changes to the specified quality responses are necessary for this component?

Yes, the proposed specified quality responses for information and communication are appropriate.

***Monitoring and Remediation Process***

45. Are the proposed requirements for the monitoring and remediation process appropriate? Are changes to the requirements necessary for this process? If so, what changes should be made and why?

Yes, the proposed requirements for the monitoring and remediation process are appropriate and we do not believe changes are required.

46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?

Yes, the proposed requirement for inspecting each partner on a cyclical basis is appropriate.

47. Is it appropriate to require monitoring of in-process engagements by firms that issue audit reports with respect to more than 100 issuers during a calendar year? If not, is there a more appropriate threshold?

Yes, it is appropriate to require monitoring of in-process engagement by firms that issue audit reports with respect to more than 100 issuers during a calendar year. Given that there are various options for in-process monitoring, the requirement appears to be sufficiently scalable for smaller firms.

48. Are the purposes of in-process monitoring (as proposed within this standard) clear and appropriate, including how in-process monitoring differs from the requirements of engagement quality reviews under AS 1220? If not, what additional direction is needed?

Yes, the purposes of in-process monitoring are clear and appropriate.

49. Is it appropriate to require firms to consider performing monitoring activities on work they perform on other firms' engagements? If not, why not?

Yes, it is appropriate to require firms to consider performing monitoring activities on work they perform on other firms' engagements.

50. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which engagements to select, appropriate? If not, what other factors should be specified?

Paragraph 64 of the proposal states that a firm cannot rely solely on monitoring activities performed by others, including network activities, in lieu of performing its own inspections of completed engagements. We recommend that the Board permit networks to perform monitoring activities on behalf of a member firm, including in certain circumstances as the sole source, of a firm's QC engagement monitoring under the standard. We also believe network monitoring activities performed on a member firm's engagements should be considered in determining whether the member firm needs to perform additional monitoring activities.

We believe monitoring of completed and in-process engagements by the network may provide member firms in the network with more objective and experienced monitoring resources. Smaller member firms may not have the resources to perform objective monitoring on completed and/or in-process engagements without leveraging the global network.

51. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of QC system-level monitoring activities appropriate? If not, what other factors should be specified?

See our response to question 50. Otherwise the proposed factors for firms to take into account when determining the nature, timing, and extent of QC system-level monitoring activities appear appropriate.

52. Are the proposed requirements for firms that belong to a network that performs monitoring activities appropriate? If not, what changes should be made?

Yes, the proposed requirements for firms that belong to a network that performs monitoring activities are appropriate.

53. Are the proposed definitions for "engagement deficiency," "QC finding," and "QC deficiency" sufficiently clear and appropriate? If not, what changes should be made and why?

The proposal states that a QC finding that results in a "reduced likelihood of achieving the reasonable assurance objective or one or more quality objectives" would rise to the level of a QC deficiency. To promote consistency in the application of QC 1000 and ISQM 1, we recommend the Board revise the definition of a QC deficiency to better align the definition with ISQM 1.

54. What, if any, additional direction is needed regarding:

- a. Evaluating information to determine whether QC findings exist;
- b. Evaluating QC findings to determine whether QC deficiencies exist; or
- c. Responding to engagement and QC deficiencies?

No additional direction is needed.

55. Should firm personnel be allowed to inspect engagements or QC activities in which they are involved? If so, please explain why and provide examples of mechanisms that could reduce to an appropriate level the risk that noncompliance with PCAOB standards or the firm's policies and procedures would not be detected.

Consistent with ISQM 1, engagement team members and the engagement quality reviewer for an engagement should not be allowed to perform an inspection of an engagement in which they are involved. However, with respect to QC activities, we believe that self-assessments are an important element in driving accountability at the control operator and owner levels. While self-assessment should not be the sole QC monitoring activity, firms that use self-assessments should be allowed to consider them in determining the overall nature, timing, and extent of their QC monitoring activities.

56. Are the proposed requirements related to monitoring and remediation sufficiently scalable for smaller firms? Are there aspects of the proposed requirements that could be further scaled?

The proposed requirements related to monitoring and remediation are sufficiently scalable for smaller firms.

### ***Evaluating and Reporting on the QC System***

57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?

No, we do not believe November 30 is an appropriate evaluation date. We observe that the annual evaluation date of November 30 in the Proposal is based on the Board's "understanding that many firms perform their internal inspections process during the second and third quarters, which allows them time to design and implement remediation efforts ahead of 'busy season.'" While we appreciate that is one factor to be considered, we have concerns that a November 30 annual evaluation date could have unintended consequence of being detrimental to audit quality and create unnecessary costs and complexity for both audit committees and audit firms.



A November 30 evaluation date could create challenges for audit committees of issuers with December 31 year-ends. Firms would have to report on their annual evaluation conclusions on Form QC by January 15, which would often be in close proximity to the conclusion of the registrant's annual audit. If there are matters to be reported to the audit committee during this critical phase of the audit, such communications could detract from, rather than enhance, the completion of a quality audit and leave the audit committee with little time to consider and respond to the information before the due date of the issuer's Form 10-K. In addition, we believe a November 30 annual evaluation date could create challenges for lead auditors because they would have little time to consider and respond to any information about other auditors before the issuer's annual audit filing date. Finally, for firms subject to both ISQM 1 and QC 1000, we believe having different reporting dates would also create unnecessary complexity for audit committees receiving reports under the different standards at different points in time.

We note that a firm's QC system operates continuously throughout the year. Therefore, we recommend that the PCAOB allow firms to select their annual evaluation date, consistent with ISQM 1. Such a provision would allow firms to select the most relevant date based on their business processes and to avoid their busy season. Importantly, this would allow firms subject to ISQM 1 and QC 1000 to avoid the cost and complexity of completing two separate annual evaluations at different times of the year. We have already selected our fiscal year-end date (i.e., end of June) as our annual evaluation date under ISQM 1 because it aligns the evaluation with our existing business processes, including performance management, and avoids our busiest time of year. That date also aligns with transparency reporting requirements in certain non-U.S. jurisdictions. Further, the member firms of the global EY network have selected a globally consistent ISQM 1 annual evaluation date to enhance global consistency in our application of ISQM 1 and, ultimately, enhance audit quality.

58. Is the proposed definition of "major QC deficiency" clear and appropriate? If not, what changes should be made and why?

No, the definition is not clear. We recommend the definition of "major QC deficiency" incorporate the concept of pervasiveness to better align with the pervasiveness determination factor included in paragraph 78 of QC 1000 and ISQM 1 as follows:

Major QC deficiency: **A severe and pervasive** ~~An~~ unremediated QC deficiency or combination of unremediated QC deficiencies ~~that~~, based on the evaluation under-paragraph .78, ~~that prevents the firm from concluding that both severely reduces the likelihood of~~ **that prevents the firm from concluding that both severely reduces the likelihood of** the firm **has achieved** ~~achieving~~ the reasonable assurance objective or one or more quality objectives.

This revised definition would better align a major QC deficiency resulting in a no reasonable assurance conclusion with the ISQM 1 conclusion when a deficiency is both pervasive and severe.

59. Is it appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist? Are the circumstances described in the proposed definition appropriate? Should there be other circumstances that give rise to such a presumption? If so, what are they?

No, we do not believe it is appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist. We believe that the factors provided in .78 are sufficient to make the evaluation of whether a QC deficiency is a major QC deficiency.

60. Are the proposed factors for determining whether an unremediated QC deficiency is a major QC deficiency appropriate? If not, what other factors should be specified?

Yes, the proposed factors for determining whether an unremediated QC deficiency is a major QC deficiency are appropriate.

61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

We understand the Board's objective in proposing a requirement that firms report on their evaluation of their QC system to the PCAOB.

62. Should we require individual certifications of the evaluation of the QC system? Is the language in Appendix 2 regarding the certifications appropriate? If not, why not?

While we believe the language is appropriate for individual certifications, we recommend that the certification of the report on the annual evaluation in Appendix 2 say "to the best of my knowledge" rather than "based on my knowledge."

63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?

As stated in our cover letter, we recommend that the Board provide firms with more than 46 days to complete their annual evaluation conclusion and report to the PCAOB. Consistent with the time that would be allowed under the alternative reporting model on a non-public portion of Form 2 discussed on p. 214 of the Proposal, we recommend that the Board provide firms with up to 90 days after the annual evaluation date to report to the PCAOB. This timing would allow firms to appropriately monitor the QC controls that operate on or near the annual evaluation date, assess the nature, severity and pervasiveness of any potentially unremediated QC deficiencies, assess the effectiveness of remedial actions, and comply with the documentation requirements in .83<sup>5</sup> on a more thoughtful basis than if reporting were required in 45 days.

<sup>5</sup> We do not take exception to the documentation requirements in QC 1000.83, however, it would be a timing challenge when considering the timetable as currently proposed.

64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?

As stated above in response to question 57, we believe the evaluation date should not be prescribed by the PCAOB but should instead be determined by each individual firm, based on its business cycle (as is allowed under ISQM 1 and SQMS 1). As discussed in our response to question 63, we believe that a 90-day reporting period after the annual evaluation date is appropriate.

65. Is the information required on proposed Form QC in Appendix 2 appropriate? Why or why not?

No, consistent with our response in question 59, we do not believe that there should be circumstances when a major QC deficiency is presumed to exist because we believe the guidance in paragraph 78 is sufficient and, therefore obviates the need to make the disclosure under paragraph 80C on Form QC Items 2.5.

Additionally, within Item 4.1 of Form QC is a yes/no inquiry on whether the Board should inform a party of a subpoena for information on Form QC. We believe it is appropriate for the Board to make such notifications, and therefore we support the inclusion of this question in Form QC.

66. Are proposed Rule 2203A, Report on the Evaluation of the Firm's System of Quality Control, and the proposed Form QC instructions included in Appendix 2, clear and appropriate? If not, why not?

As we say in our cover letter, we support the proposed requirement for firms to evaluate the effectiveness of their system of quality control annually. However, we are concerned that a firm that is subject to both the PCAOB standard and ISQM 1 could reach different conclusions under the two standards when evaluating the same set of facts.

We recommend the PCAOB's defined term "major QC deficiency," which results in a not effective (or qualified) annual evaluation conclusion, align with the unremediated severe and pervasive deficiency as described in ISQM1. We believe the QC 1000 definition of a major QC deficiency should be a severe and pervasive unremediated QC deficiency or combination of unremediated QC deficiencies that, based on the evaluation under paragraph .78, prevents the firm from concluding that the firm has achieved the reasonable assurance objective of one or more quality objectives. This alignment with ISQM1 regarding both severity and pervasiveness would result in more consistent qualified annual evaluation conclusions between QC 1000 and ISQM1.

Further on the annual evaluation conclusion, under ISQM 1 (and its First Time Implementation Guide dated September 2021), a firm would conclude that there is reasonable assurance that the objectives of the system of quality management have been achieved, even if there are unremediated deficiencies that are "neither severe nor pervasive" or "pervasive but not severe." However, under proposed QC 1000, the existence of any unremediated QC deficiency would require a firm to conclude that its system of quality control "is effective except for one or more unremediated QC deficiencies that are not major QC deficiencies." We recommend that the Board revise the annual evaluation conclusion of

QC 1000 so that deficiencies that are not severe result in an effective annual evaluation conclusion, consistent with ISQM 1. We believe that this annual evaluation conclusion is also consistent with the reporting requirements of AS 2201 on integrated audits of issuers where the auditor would issue an unqualified report when unremediated deficiencies exist that are neither significant nor material.

Finally, we recommend that the Board state in the General Instructions to Form QC Section 4. "Amendments to this Report" that firms would not be required to amend Form QC to correct clearly inconsequential information or to provide clearly inconsequential information that was omitted.

67. Are there any non-U.S. laws that would prohibit reporting the information required about the firm's QC system to the PCAOB on Form QC?

While we are not aware of non-U.S. laws that would prohibit reporting the information required about the firm's QC system to the PCAOB on Form QC, we believe the PCAOB should state that firms wouldn't violate this requirement if laws or regulations exist in the jurisdiction(s) of the firm that prevent compliance with this requirement.

68. Some of the PCAOB's reporting forms are permitted to be filed in XML format. Should we permit proposed Form QC to be filed in XML or another machine-readable format? Why or why not?

We support the PCAOB permitting widely accepted formats that support usability.

69. In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?

As the Board recognizes, Sarbanes-Oxley contains restrictions relevant to public disclosure of QC deficiencies. Other than our responses to questions 43 and 67, we do not have any comments on whether there are other public reporting alternatives that should be considered.

70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?

If our recommendation to align QC 1000's annual conclusion with ISQM 1 is incorporated in the final standard, we would support requiring the auditor to communicate to the audit committee about the firm's most recent annual evaluation conclusion of its QC system. We believe this communication would enhance the dialogue about the firm and its QC system.

However, as we state in our cover letter, if our recommendation to align QC 1000's annual conclusion with ISQM 1 is not incorporated in the final standard, we recommend that communication of the firm's annual evaluation conclusion to the audit committee be required only when one or more unremediated major QC deficiencies exist and the annual evaluation conclusion is "not effective." We believe that this

would provide audit committees with the most relevant information for fulfilling their responsibilities. Under our recommendation, firms' communications to audit committee about QC deficiencies would more closely align with the existing requirements for auditor communications about the issuer's internal control deficiencies identified during an audit.

Further, we believe our recommendation would more closely align with the provisions of the Sarbanes-Oxley Act that require the PCAOB to include its criticisms and observations about potential deficiencies in a firm's QC system in Part II of its inspection reports, which isn't public unless a firm fails to address the issues to the Board's satisfaction within 12 months after the issuance of the report. The proposed timeline for QC communications to the audit committees would accelerate those communications, most likely by years, in a manner that may not comport with the review structure as established by Congress.

### **Documentation**

71. Are the proposed documentation requirements appropriate? If not, what changes should be made?

We recommend that the final standard provide no more than 45 days after filing their Form QC to assemble their QC documentation for retention, which would be consistent with the requirement under PCAOB standards to assemble and retain a complete and final set of audit documentation.

72. Is the "experienced auditor QC threshold" set out in the in the proposed documentation requirement appropriate? If not, what threshold is appropriate?

Yes, the proposed "experienced auditor QC threshold" is appropriate.

73. Are there additional specific matters that the firm should be required to document about its QC system? If so, what are they?

There are no other matters that the firm should be required to document about its QC system.

### **ADDITIONAL PROPOSED AMENDMENTS**

#### ***Proposed Amendments to AS 2901, Consideration of Omitted Procedures After the Report Date, and Related Proposed Amendments***

74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?

We support the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits; however, we believe that implementation guidance would be necessary to promote consistent application by firms. For example, guidance might address whether it would be appropriate to conclude that an unqualified auditor's report on ICFR was no longer being relied upon if a subsequent disclosure by management indicated that the conclusion in that report was no longer applicable or when issuance of the following year's auditor's report is imminent.

75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported? If not, why not?

We believe that it is appropriate for remedial action to be required for all identified engagement deficiencies to promote an effective QC system. However, we encourage the Board to consider clarifying the note included in proposed QC 1000.69 as follows:

Note: Remedial actions a firm may take **include preventive, corrective, or a combination of these actions, such as take include**: (1) corrective actions on in-process engagements to address engagement deficiencies before the issuance of the engagement report; (2) corrective actions to address engagement deficiencies on completed engagements; or (3) preventive actions to deter future engagement deficiencies.

We believe that a firm should be able to evaluate the nature and severity of an engagement deficiency and determine whether preventive actions alone are appropriate. This clarification would resolve a possible unintended consequence of firms diverting resources from activities that drive audit quality and using them to develop corrective actions for engagements deficiencies that are not necessary (e.g., those engagements with deficiencies that have a properly supported audit opinion).

***Proposed rescission of ET Section 102; proposed new standard EI 1000; proposed amendments to ET Section 191***

76. Is the proposal to rescind ET 102 and replace it with EI 1000 appropriate in light of the changes proposed in QC 1000 and developments since 2003? If not, why not?

The proposed replacement of ET 102 with EI 1000 is appropriate. If the Board's intent is for EI 1000 to focus on Objectivity and Integrity (see our response to question 26), labeling the section as "OI" rather than "EI" may be appropriate.

77. Are the terms used in EI 1000 clear? Should additional terms be defined or additional guidance provided?

The terms used in EI 1000 are generally clear. However, in two cases, references to other standards may provide greater clarity. Specifically, rather than remove the reference to confidentiality to make it clear that it cannot be used as a shield against noncompliance with laws and regulations, it may be clearer to explicitly state or refer to the noncompliance with laws or regulations standards in the International Ethics Standards Board for Accountants (IESBA) Code Section 260. Similarly, if the Board's intent is for EI 1000.03.c to refer to the AICPA and IESBA concepts of conflict of interest, it may be clearer to refer explicitly to the relevant Code sections.

78. Is the proposal to amend ET 191, including the proposed rescission of certain paragraphs, appropriate? Should any of the proposed interpretations be retained in our standards?

Yes, the proposal to amend ET 191, including the proposed rescission of certain paragraphs, is appropriate.

### ***Other Proposed Amendments***

79. Are the proposed amendments to other PCAOB standards and rules appropriate? If not, why not? Are there additional amendments to other PCAOB standards or rules that the Board should consider?

The proposed amendments to other PCAOB standards and rules are appropriate. We are not aware of additional amendments to other PCAOB standards or rules that the Board should consider.

80. Are the proposed amendments to **Form 1 and Form 2 in Appendix 5** appropriate? If not, why not?

Yes, the proposed amendments to Form 1 and Form 2 in Appendix 5 are appropriate.

## **ECONOMIC ANALYSIS**

### ***Baseline***

81. Are there additional academic studies or data related to the baseline for measuring the potential impacts of the proposed requirements? If so, what are they?

82. Are there additional academic studies or data available related to the resources employed by NAFs or foreign affiliates of GNPs in the design, implementation, and operation of their QC systems? If so, what are they?

83. Are there additional academic studies or data available that could help us approximate the number of firms that will be implementing ISQM 1 or SQMS 1? If so, what are they?

### ***Need***

84. Should we consider any additional academic studies or data related to the need for standard setting?

***Economic Impact***

85. Does our analysis appropriately capture the potential benefits of the proposal? If not, please explain.
86. Are there additional potential benefits that should be considered? If so, what are they?
87. Does our analysis appropriately capture the potential costs of the proposal? If not, please explain.
88. Are there additional potential costs that should be considered? If so, what are they?
89. Are there additional academic studies or data related to the potential benefits and costs of the proposed requirements? If so, what are they?
90. Are there other potential unintended consequences of the proposal that we have not identified? If so, what are they?

We are not aware of additional information or potential costs other than those previously provided to the Board by certain firms.

***Alternative Considerations***

91. Are any alternative approaches to addressing the need for standard setting preferable to the proposed approach? If so, why?

We agree that standard setting is the preferable approach and have included in our other responses our views for consideration related to key policy choices.

**SPECIAL CONSIDERATIONS FOR EMERGING GROWTH COMPANIES**

92. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

We believe the proposal should apply to the audits of both emerging growth companies (EGCs) and non-EGC issuers. As the Board said in the Proposal, virtually all EGCs are audited by firms that also audit other clients, either non-EGC issuers or registered broker-dealers, under the PCAOB standards. Additionally, separate quality control systems for EGC and non-EGC clients would create unnecessary complexities for engagement teams, especially when an issuer loses EGC status during the year.



**EFFECTIVE DATE**

93. Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

We believe an extended implementation period is necessary to give firms, and especially smaller firms, the time to design, implement and execute the requirements that go beyond those in other QC standards (e.g., ISQM 1). We learned from our implementation of ISQM 1 that having the opportunity to perform field testing is critical.

Therefore, we encourage the Board to consider an effective date of 15 December 2025. Such a date would align with the effective date of the AICPA's suite of new and revised quality management standards.



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May 30, 2023

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

Via Email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Rulemaking Docket Matter No. 049, *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB standards***

Dear Office of the Secretary:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's or Board's) Rulemaking Docket Matter No. 049, *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (Proposal). We respectfully submit our comments and recommendations for the Board's consideration.

We commend the Board for undertaking an initiative to update all the interim standards, and we support the Board's project to modernize and clarify the "foundational standards," as defined in the Proposal, to reflect changes in the auditing environment and to eliminate outdated or inconsistent language. Nevertheless, we have considerable concerns with regard to the potential unintended consequences that might occur as a result of the manner in which the Board has proposed updating and streamlining the requirements. Most notably, we are concerned that the proposed standard could exacerbate the gap between the assurance that an investor (or other market participant) may believe an audit provides versus the assurance that reasonably can be provided, even through a properly planned and performed audit (hereinafter referred to as the "expectations gap").

**Reorganization**

We support the Board's approach to consolidating and reorganizing the general principles and responsibilities sections of the PCAOB's auditing standards. We



believe a single standard will drive a more efficient approach to understanding the general principles and responsibilities, as auditors will look to a single standard as opposed to navigating through multiple standards. While we have certain reservations, we also support the Board's efforts to streamline the terminology used throughout the standards in order to minimize confusion.

### Objectives

We are supportive of the proposed objectives of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, and believe they are appropriate and sufficiently clear.

### General principles and responsibilities

While we support the Board's reorganization and consolidation, we have significant concerns about the proposed elimination of important explanatory material with respect to certain concepts that place the auditor's responsibilities within the appropriate context. Without proper context for the auditor's responsibilities in an audit of financial statements or internal control over financial reporting, the "expectations gap" could become wider, which would ultimately be detrimental to the public interest. Therefore, we encourage the Board to reinstate certain explanatory material (discussed in greater detail below). We believe the inclusion of such explanatory material will help investors better understand the auditor's role and responsibilities, without altering the Board's goal of streamlining and clarifying the auditor's general responsibilities. Suggested edits for the remainder of this letter are shown as **bolded italics** for additions and ~~strikethrough~~ for deletions.

#### *Reasonable assurance*

We recommend clarifying paragraph .14 to more closely align with the characterization of *reasonable assurance* as described in the respective auditing standards promulgated by the International Auditing and Assurance Standards Board (IAASB) and by the AICPA's Auditing Standards Board (ASB). We also believe it is important for the proposed standard to explain why *absolute assurance* is not attainable. Further, we believe the balance between what reasonable assurance is, and what it is not, is important to ensure users of financial statements adequately understand the limits on the assurance that auditors can provide, even through a properly planned and performed audit. Therefore, we suggest the following changes to paragraph .14:

***Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Although not absolute assurance, Reasonable assurance is a high level of assurance...***

We note that concepts from paragraphs .11 through .13 of AS 1015, *Due Professional Care in the Performance of Work*, have not been incorporated into proposed AS 1000. We strongly believe that these paragraphs contain explanatory language that puts the auditor's responsibilities into appropriate context. We believe it would be a disservice to investors not to sufficiently describe what does and does not constitute



reasonable assurance. Toward that end, we ask the Board to incorporate the following as new paragraphs after proposed paragraph .14:

**.14A An audit conducted in accordance with applicable professional and legal requirements may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements. Judgment is required in interpreting the results of audit testing and evaluating audit evidence. Even with good faith and integrity, mistakes and errors in judgment can be made.**

**. 14B Since the auditor's opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and the auditor's report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the applicable professional and legal requirements.**

#### *Competence*

With regard to the note to paragraph .07, we are concerned that the term “expertise” implies a high bar that may not be attainable for less experienced engagement team members. We believe that “expertise” is ultimately achieved by the engagement team collectively and by the engagement partner identifying the appropriate resources to perform the work. Therefore, we recommend that the term “expertise” be replaced with “proficiency” as follows:

Competence includes knowledge and ~~expertise~~ **proficiency** in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

#### *Professional skepticism*

We agree with incorporating the notion of “potential bias” in proposed paragraph .11e of AS 1000. We believe that a specific discussion of this concept will enhance the auditor's awareness while executing audit procedures. Nevertheless, we are concerned that the intentions of this requirement are unclear. Page 24 of the Proposal states “In exercising professional skepticism, the auditor could mitigate such bias by being aware of ‘confirmation bias,’ considering alternatives provided by others, and seeking contradictory information as evidence.” Currently, AS 1105, *Audit Evidence*, does not require the auditor to seek contradictory evidence, and we believe applying the proposed requirement in AS 1000 in the context described on page 24 of the Proposal would be inappropriate and could ultimately be detrimental to audit quality. We believe any requirement in AS 1000 that relates to audit evidence should be consistent with the principles of AS 1105.



It is also unclear what “*consideration* of potential bias” [emphasis added] implies in the context of audit documentation. Because professional skepticism is exercised in a variety of ways throughout the audit, we do not believe it would be appropriate for auditors to document “considerations” of bias, particularly in areas that are not susceptible to either management or auditor bias. As such, we believe proposed paragraph .11e requires greater clarity and/or guidance in order for auditors to appropriately consider potential biases while remaining within the framework of the requirements of AS 1215, *Audit Documentation*.

#### **Information related to the audit**

We recognize the Board’s premise for proposing to use “information related to the audit” in order to emphasize that professional skepticism extends beyond audit evidence. We are concerned, however, that the phrase is overly broad. In addition, using such phrase could inappropriately alter the nature and intent of various requirements and create confusion among auditors in applying and documenting the requirements where this phrase is being proposed. We do not believe this phrase is sufficiently clear to enable auditors to appropriately fulfill what is expected, and we are unable to identify information, other than Form AP data, that would be “information related to the audit” that is not already audit evidence, given the broad definition of “audit evidence” in AS 1105. We recommend that the Board revert to “audit evidence” and, where appropriate, incorporate Form AP data specifically into the requirement.

#### **Relevant guidance**

We have significant concerns regarding the note to proposed paragraph .15, particularly footnote 26, which states that “Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the Board.” This appears to substantially broaden the population of information previously referred to as “guidance” in paragraph .11 of AS 1001 and its related note:

The auditor should be aware of and consider auditing interpretations applicable to his or her audit. If the auditor does not apply the auditing guidance included in an applicable auditing interpretation, the auditor should be prepared to explain how he or she complied with the provisions of the auditing standard addressed by such auditing guidance.

Note: The term “auditing interpretations,” as used in this paragraph, refers to the publications entitled “Auditing Interpretation” issued by the American Institute of Certified Public Accountants’ Auditing Standards Board as in existence on April 16, 2003, and in effect.

PCAOB Release No. 2015-002 included a discussion of interpretive publications related to the Board’s reorganization and renumbering of its standards. At that time of that release, the only additional guidance that auditors were required to consider was in the form of audit interpretations.

It is also unclear whether the release text of proposed standards would require consideration along with the release of final standards. In considering the practical application of Board release text being guidance that needs to be considered by



auditors, we question how auditors would reconcile the discussion in Release No. 2015-002 with the release of the final version of this proposed standard? Both discuss the concept of guidance, but one does not specifically supersede the other. We believe it will be difficult for auditors to reconcile information among different releases that accompany the Board's new standards and rules. Further, releases include economic analysis and other ancillary information, including information from the Board's disposition of specific comments received during the proposal process and references to legal proceedings and academic research, which would then be scoped into proposed paragraph .15. Because prior releases may not have been written with the approach to guidance described in this Proposal, we believe the Board would need to reevaluate previous releases of currently effective standards in order to ensure that they are clear to auditors. Given the depth and breadth of the Board's current standard-setting and rulemaking agendas, we question whether such an undertaking is feasible in the timetable for adopting AS 1000.

We encourage the Board to revert to the approach taken in Release No. 2015-002 and to limit "relevant guidance" to the standards and auditing interpretations. While we believe that relevant or important guidance, to the extent known at the time of adoption of a standard, should be incorporated into the standard itself, we recognize that application of requirements may evolve over time and future events may dictate the need for additional clarification through authoritative guidance. The Board could consider exploring a separate project to more holistically determine and establish a hierarchy of authoritative and nonauthoritative guidance, similar to the hierarchy established by the AICPA.

### **Rescission of AS 2815**

Though we understand the Board's approach to incorporating the concepts of AS 2815 into AS 2810, we are concerned that the proposed changes to AS 2810 are unclear with regard to the meaning of "present fairly" and may unintentionally change the underlying meaning. We believe the context provided by extant paragraph .03 of AS 2815 is essential for users and investors to understand the basis for the auditor providing an opinion on the financial statements, which is grounded in the applicable financial reporting framework. We recommend incorporating the following language as a new paragraph prior to proposed paragraph .30A of AS 2810:

***The independent auditor's judgment concerning the "fairness" of the overall presentation of financial statements should be applied within the applicable financial reporting framework. Without that framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, cash flows, and disclosures in financial statements.***

Similarly, we recommend adding "based on the audit evidence obtained, knowledge obtained in the audit, and the auditor's professional judgment" to the end of the lead-in to the list in proposed paragraph .30A to more clearly address the context in which the auditor makes their evaluation regarding fair presentation.



### **Documentation completion date**

Generally, we support the proposal to shorten the documentation completion date from 45 days to 14 days. We believe that shortening the period could improve the quality of audit documentation given the closer proximity to the report release date. We also believe that advancements in audit firms' technology support a shortened time period. However, the size of the firm could affect the time necessary to assemble a complete and final set of audit documentation, such as smaller firms that may not utilize electronic tools. Such a requirement may negatively impact smaller firms to the extent that they are unable to comply with the revised requirement without considerable investments that may not be economically feasible.

We would be remiss not to acknowledge, however, that the proposed shortened documentation completion date would require operational changes that could require a longer time to implement appropriately. For example, firms may need to revise their quality control processes, project management frameworks, audit tools (discussed further in the "Economic Analysis" section below), and resource management approaches. We encourage the Board to consider a staged adoption approach that would enable firms to take steps towards decreasing the documentation period from 45 days to 14 days, so that this change can be implemented in a manner that does not diminish audit quality in the short term. In light of our comments on the proposed effective date provided below, we recommend a staged approach for adopting the proposed documentation completion date, similar to what was provided for the adoption of critical audit matters.

We also note that the Board proposed a 45-day documentation completion period within QC 1000, analogizing to the existing documentation completion date in the auditing standards. We would have considerable concerns reducing the documentation completion of the firm's evaluation of its system of quality control to 14 days given the difference in the nature of the subject matter at hand.

#### *Form AP filing implications*

We agree that information underlying the engagement's Form AP filing is often retained with the audit workpapers. Generally, our Form AP filings occur between 14 and 21 days after report issuance. If other accounting firms were used in the engagement, it can take longer to obtain the relevant information from such firms. We expect that it would be appropriate, in the Board's view, for Form AP documentation to be appended to the audit documentation when Form AP is filed, which is likely to occur subsequent to the documentation completion date. We don't foresee significant difficulties with complying with paragraph 16 of AS 1215. However, it will require time and effort to establish policies and adjust our tools to accommodate adding Form AP documentation after the documentation completion date, as we expect such changes to impact substantially all of our issuer audits (that is, almost all engagements will require additions to the audit documentation subsequent to the documentation completion date).



### **Effective date**

While we recognize the Board's position that the proposed standard and related amendments are not fundamentally changing the auditor's responsibilities, we believe that audit firms will require more than the proposed minimum of six months to implement the proposed standard and related amendments if SEC approval occurs in the fourth quarter of the calendar year. Audit firms will require sufficient time to analyze the final standard and to evaluate how to update their audit methodologies. Firms will also need sufficient time to develop and deploy appropriate training to audit personnel to ensure they adequately understand the changes made to the auditing standards. Depending on firms' tools, programming changes along with adequate testing will likely be needed as well (discussed further in the "Economic Analysis" section below). Global network firms may have additional responsibilities and actions to ensure that their network firms have adequate training and guidance in place. Therefore, we believe audit firms will require at least 18 months in order to sufficiently and thoughtfully implement the new requirements into their policies and methodologies. Additionally, as discussed above, we believe an extended adoption period would be appropriate for the requirement related to the documentation completion date.

In our view, the profession would benefit from establishing the effective date in a manner consistent with other standard-setting projects, which tie the effective date to the period-end of the financial statements that will be subject to audit. As such, we recommend an effective date in the format of "for audits of periods ending on or after December 15, 20XX" where XX is the year at least 18 months subsequent to SEC approval, as discussed above. Having an effective date in the form used traditionally by the PCAOB will enhance auditors' understanding of the timeframe in which they need to implement the requirements and address training needs before the new requirements apply. In addition, we ask the Board to clarify the effective date in the context of interim reviews and other services, such as comfort letters. Typically, the effective date for interim reviews is the year after the year when the standard is effective for audits of financial statements; the effective date for services such as comfort letters is typically based on the date of issuance and is also generally effective after the audit effective date.

### **Other amendments**

#### *Required elements of documentation*

We are supportive of the Board proposing paragraph .06A in order to make the various components of existing paragraph .06 clearer. However, we do not believe the proposed addition to paragraph .06 of "who performed the work, the person or persons who reviewed the work, and the date of such review" is necessary and are concerned this phrase could trigger unintended consequences. The proposed change appears duplicative of the contents of paragraph .06A, and it is unclear whether the Board intends for a different level of documentation than what currently exists in the "reasonable auditor" lens of paragraph .06A. We recommend the Board remove the proposed change to paragraph .06 to avoid unnecessary confusion since auditors





sufficiently understand the existing documentation requirements described in proposed paragraph .06A.

*Documentation prior to report release*

In addition to the shortened documentation completion date, the Board proposes additional changes to actions and documentation required to take place prior to the report release date in paragraph .15. The Board proposes that, in addition to the audit procedures being completed and sufficient appropriate audit evidence obtained, the engagement partner and other engagement team members performing supervisory activities must have completed their reviews of audit documentation by the report release date. While it is appropriate and necessary to complete supervisory activities prior to releasing the auditor's report, we believe the documentation of such supervision and review before the report is released could create practical challenges and result in unintended consequences.

For example, consider a scenario where a potential illegal act is identified shortly before the issuer's filing deadline. The audit committee undertakes a full investigation, and the auditor receives an acceptable, final report from the audit committee and independent legal counsel on the day when the Form 10-K is due. The auditor thereby obtains sufficient appropriate audit evidence to date and releases the auditor's report. However, it may be impossible for the auditor to finalize its own memo and obtain final reviews and sign-offs prior to the filing being made. The proposed requirement implies that both the memo must be completed, and the reviews and sign-offs must take place before the filing is made. If that is what the Board intends, unintended consequences could include either (a) less than thorough documentation because auditors are left with inadequate time to draft, review, and finalize a memo; or (b) increased instances of late filings that are "caused" by the auditor, who has reached a conclusion that the filing can be made, but simply cannot complete their documentation in time. We believe that neither of these outcomes serve the public interest and could ultimately be detrimental to audit quality. If the Board does not intend formal documentation of such reviews of all audit documentation to be completed prior to report release, we ask the Board to formally clarify such point in the final standard.

We believe the existing requirement related to what must be completed prior to report release is adequately clear and provides auditors with the flexibility to appropriately handle audit matters that occur at or near report issuance. We believe that the shortened documentation completion date alone will enhance the quality of documentation overall while avoiding the potential unintended consequences described above.

*Other information in documents containing audited financial statements*

We recommend revising the proposed change to paragraph .05 of AS 2710, which refers to "between the auditor and client." We believe "management" would be a term more consistent with other standards of the PCAOB than "client."



*Reviews of interim financial information*

We recommend incorporating the phrase “to the extent those standards are relevant” to the proposed language related to AS 1000. We believe this is necessary considering that AS 4105 provides requirements to obtain limited assurance while AS 1000 has been drafted in the context of reasonable assurance. Providing clarity on the extent to which AS 1000 is relevant to AS 4105 will make paragraph .01 of AS 4105 more operational and understandable.

**Economic analysis**

We believe the economic evaluation of the potential costs of this standard setting is incomplete. The Board states that “[f]or firms with electronic audit tools and audit software in place, the earlier documentation completion date should not change the functionality or cost of software, which should facilitate a low-cost transition to the proposed archiving period.”<sup>1</sup> This statement does not contemplate the potential costs for firms that utilize proprietary audit software. We anticipate that such firms would incur costs related to reprogramming and testing, and that such costs could be exacerbated for network firms that are subject to differing jurisdictional requirements. Reprogramming could be complex in order to accommodate multiple documentation completion dates. While it is difficult to quantify the expected costs, we do not expect them to be negligible, and we believe the need for programming and testing require consideration, particularly in light of the proposed effective date.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or [Jeff.Hughes@us.gt.com](mailto:Jeff.Hughes@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP

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<sup>1</sup> Page 49 of the Proposal.



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February 1, 2023

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

Via Email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Rulemaking Docket Matter No. 046, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms***

Dear Board members and staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's or Board's) Rulemaking Docket Matter No. 046, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (the Proposal). We commend the Board for utilizing feedback from various stakeholders to propose a comprehensive, modernized quality control standard (proposed standard or QC 1000). A firm's system of quality control is paramount to maintaining and enhancing quality on audit, attestation, review, and other engagements. Our firm, like many others, has made a variety of enhancements to our system of quality control (QC) in recent years. In doing so, we recognize the need for changes to, and support meaningful revisions of, the PCAOB's QC standards in order to best serve the public interest. However, in order to be most impactful, such changes require striking an appropriate balance in order to avoid an unintended financial or operational burden that could ultimately have a negative effect on quality.

We support the Board's approach to using International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* as a base for the proposed standard, and we appreciate the commentary provided throughout the Proposal that compares and contrasts the proposed PCAOB requirements to those established in both ISQM 1 and Statement on Quality Management Standard (SQMS) 1, *A Firm's System of Quality Management*.

As discussed in our March 2020 letter responding to the PCAOB's 2019 Concept Release, *Potential Approach to Revisions to PCAOB Quality Control Standards*, we believe that ISQM 1 generally provides a principles-based approach to quality control that can provide flexibility and scalability, depending on each firm's assessment of risks



to quality control. We believe there could be great advantages to enabling global network firms to institute a consistent QC system, and the cost/benefit of incremental or divergent requirements should be weighed carefully.

We respectfully submit our comments and recommendations herein and have included as an Appendix to this letter our responses to certain of the questions posed in the Proposal.

### **Components of PCAOB proposed standard and impact on QC systems**

We acknowledged in our 2020 letter that certain incremental differences from ISQM 1 would need to exist due to basic jurisdictional differences but indicated that we had reservations about being overly prescriptive in the proposed standard due to the wide spectrum of accounting firms that would be impacted. The number and significance of the differences from ISQM 1 could also have negative unintended consequences to engagement quality that could ultimately be detrimental to public interest.

In considering the Proposal, we remain concerned about the unintended consequences associated with certain requirements that deviate in meaningful ways from ISQM 1, as well as the broad nature of certain of the requirements that may lack sufficient interpretative guidance to enable firms to implement satisfactory responses (discussed further below). We identify throughout this letter incremental areas in the proposed standard that may require significant additional time and cost for firms to design and implement; however, those incremental investments and increased costs may not be commensurate with the intended benefits. Further consideration of certain of the requirements may be warranted to confirm the cost of implementation and operation does not outweigh the benefit of the incremental requirement.

The addition of new definitions, certain ambiguous language, and other incremental requirements could create significant divergence in QC systems among firms around the world as opposed to enabling a cohesive, global system that will enhance and promote engagement quality in furtherance of the public interest. We believe such divergence could be a detriment to long-term engagement quality.

### **Role of professional judgment in a system of quality control**

The PCAOB's rules and engagement standards make clear that professional judgment is required in identifying risks and in developing appropriate responses to such risks. We are concerned that this foundational concept is absent from the Proposal. A system of quality control is effected by individuals, informed by a robust risk assessment, and grounded in professional judgment. We believe it is important for the PCAOB to explicitly incorporate the notion of professional judgment into the proposed requirements to reiterate the importance that professional judgment plays in the design, implementation, and operation of an effective system of quality control.

We draw attention to the requirements ISQM 1, which state in part that:

The firm shall design, implement, and operate a system of quality management. In doing so, ***the firm shall exercise professional judgment***, taking into account the nature and circumstances of the firm and its engagements... (emphasis added) (paragraph .19)



The firm remains responsible for its system of quality management, including ***professional judgments made*** in the design, implementation and operation of the system of quality management... (emphasis added) (paragraph .48)

Additionally, we note that ISQM 1, paragraph 16, includes the following definition of "professional judgment":

The application of relevant training, knowledge and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation and operation of the firm's system of quality management.

Similar to due professional care, which includes professional skepticism, professional judgment is essential in effective QC systems. Therefore, we strongly encourage the Board to revise paragraph .06 or .07 to incorporate the concept of professional judgment in the overall design, implementation, and operation of the QC system to clearly express the importance of professional judgment to all stakeholders. We also encourage the Board to explicitly define the term within Appendix A of proposed QC 1000 similar to the definition contained in ISQM 1.

### **Implementation and interpretive guidance**

We note that ISQM 1 and SQMS 1 each contains over 200 paragraphs of application guidance to their respective standards. In addition, the IAASB published an implementation guide that provides nearly 100 pages of additional guidance and examples to further assist firms in appropriately and adequately building their systems of quality management.

Given the importance of quality control and its key role in firms providing services that support the public interest, we strongly encourage the PCAOB to provide comprehensive, timely implementation guidance, along with practical examples, that will enable firms to succeed in complying with the final requirements. Absent significant interpretative guidance that includes practical examples, certain broad-based language and requirements in the proposed standard may be subject to varying interpretation, and the PCAOB's intent may be either misinterpreted or not fully understood by various parties, especially with the benefit of hindsight. Such misinterpretation could result in inspection outcomes that vary across firms with similar fact patterns or standard setting via inspections.

We believe comprehensive and timely guidance from the PCAOB is of particular importance due to the extent of the requirements proposed in QC 1000 that are incremental to both ISQM 1 and SQMS 1. We do not believe it will be sufficient for firms to leverage existing guidance issued by other standard setters, which might not align with the PCAOB's intentions or expectations. The Board plays a crucial role in the marketplace to protect investors and the public interest, and in this regard, clear and comprehensive PCAOB-specific guidance is undeniably imperative. We identify in the Appendix to this letter some of the specific areas where we believe that implementation guidance is necessary.

We also encourage the PCAOB to consider conducting working or listening sessions with the profession to address early implementation questions or challenges that firms may experience. This could give firms the opportunity to address those challenges



proactively and thoroughly, further strengthening a firm's QC system prior to the PCAOB's effective date.

### **Form QC and certifications**

We offer our support for the PCAOB's decision to treat Form QC as nonpublic. We continue to believe that the type of information that would be included in Form QC under the Proposal would be difficult for the general public to synthesize in a useful manner without the right level of context or understanding, including the observation that the Board "do[es] not believe making incomplete, potentially confusing, and potentially misleading Form QCs public would be in the interests of investors or other stakeholders...."<sup>1</sup> Further, we agree with the Board's determination that the Sarbanes-Oxley Act (SOX) contemplates that the type of information to be included in the proposed Form QC be nonpublic.

We provide more detailed comments in the Appendix to this letter regarding potential operational challenges that the proposed QC reporting requirements may cause, along with our recommendations that could assist in optimizing the effectiveness of QC-related reporting, including adjusting the level at which reporting occurs and providing a longer time period between the evaluation date and submission date.

### **Effective date**

There are a variety of areas where we believe the requirements proposed by the PCAOB that are incremental to ISQM 1 will require a significant investment of time and financial resources well beyond the investments made in implementing ISQM 1.

While we acknowledge that the "proposed evaluation date of November 30 builds in almost a full year delay between the effective date of the standard and the first evaluation date,"<sup>2</sup> we do not believe it is practicable to design, implement, and operate the PCAOB-related incremental portions of the QC system to an extent that would allow meaningful evaluation at the November 30 date (detailed feedback on the proposed November 30 evaluation date is included in the Appendix to this letter). In addition, firms will need time to consider whether and how to transition from their evaluation date previously established under ISQM 1. What's more, firms would greatly benefit from having a period of time to allow for pilot testing and fine-tuning aspects of their QC systems that address the PCAOB's incremental requirements.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or [Jeff.Hughes@us.gt.com](mailto:Jeff.Hughes@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP

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<sup>1</sup> PCAOB Proposal, page 213

<sup>2</sup> PCAOB Proposal, page 291



# Appendix: Responses to certain questions within the Proposal

## **Terminology and definitions**

**Question 1. Is the proposed definition of “applicable professional and legal requirements” appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?**

We believe the proposed definition of “applicable professional and legal requirements” is reasonable and understandable.

**Question 2. Is the proposed definition of “engagement” clear and appropriate? If not, why not? Should the definition be narrower (e.g., limited to engagements required to be performed under PCAOB standards) or broader? If so, how?**

The proposed definition includes circumstances in which the firm serves as the lead auditor or practitioner, as well as when the firm plays a substantial role in the preparation or furnishing of an audit report. We believe the notions of “lead auditor” and “substantial role” are generally well understood given their role in existing professional standards.

We are concerned, however, by requirements that go beyond the scope of “engagements” as it is proposed to be defined. In paragraph .07b, for example, the Board proposes that the QC system must go beyond “engagements,” indicating that, when a firm’s QC system is required to operate effectively, such system must operate over all work, even in instances where the firm plays less than a substantial role. We acknowledge that the Proposal includes the following commentary on page 162:

In situations where the firm participates in another firm’s engagement but does not play a substantial role, sometimes called “referred work,” while such work would not be treated as the firm’s own “engagement” for purposes of the proposed standard, any firm that was required to implement and operate an effective QC system under the proposed standard would be required to extend its QC system to all audit, attestation, review, and other work it performs under PCAOB standards, including other firms’ engagements in which the firm plays less than a substantial role.



We believe that additional clarity is needed as to why the definition of “engagement” in the Proposal does not align with the scope of work that is expected to be subject to the proposed standard, for example, how required monitoring activities are intended to apply to work where the firm plays less than a substantial role. We ask the Board to consider providing additional guidance addressing how firms may approach the various levels of work (that is, lead auditor, substantial role, and less than a substantial role) in a risk-based manner within their QC systems.

**Question 3. Are the proposed definitions of “firm personnel,” “other participants,” and “third-party providers” sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.**

We found the diagrams included in the Proposal extremely helpful and encourage the PCAOB to carry them forward into the final standard or related authoritative guidance. While we believe the definitions themselves are sufficiently clear, there may be challenges in applying the terms in the context of certain requirements within the proposed standard.

We concur with separately defining “other participants” and “third-party providers.” We note, however, that the term “other participants” encompasses a vast array of individuals or roles, and that the Board incorporates “other participants,” into a variety of requirements in addition to firm personnel. We ask the Board to reconsider the specific, pervasive inclusion of “other participants” throughout QC 1000.

This use of the term “other participants” in the Proposal deviates from its use in ISQM 1 and SQMS 1, and we believe the practicability of certain requirements will be challenging if they apply to both “firm personnel” and the various parties contained within “other participants.” In particular, the policies and procedures related to “other participants” would differ, depending on the type of other participant (for example, an internal auditor providing direct assistance differs from an auditor, specialist, or engagement quality reviewer). The underlying PCAOB engagement standards dictate differing requirements that apply to various other participants. In contrast, QC 1000 seems to impose the same requirements for each type of other participant. As a result, it would not be feasible to apply the requirements in each set of standards (AS and QC) the same way.

**Question 4. Is the other terminology used in QC 1000 clear and appropriate? Are there other terms that should be defined?**

In this Appendix, we have identified certain terms or phrases used throughout the Proposal that may be confusing or vague, requiring additional guidance to enable firms to implement the related requirements appropriately and sufficiently within their QC systems. Without further guidance or clarification, we believe that the proposed requirements could be unintentionally misinterpreted or misapplied. We provide a variety of recommendations where additional clarity could enhance firms’ successful execution of the requirements in the remainder of this Appendix.





### Scalability

**Question 5. Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.**

We are concerned about the proposed standard's potential unintended consequences on global networks, and particularly whether QC 1000 will diminish the availability of global network resources. Smaller firms around the world may view the proposed standard as unsustainable or cost prohibitive and, therefore, decline to assist US firms in executing their global audits, which could be detrimental to overall engagement quality.

An alternative approach might be to require firms that only play a substantial role (that is, they do not issue auditor's reports related to audits of issuers) in more than a certain threshold of PCAOB engagements to comply with ISQM 1, with a specific requirement to focus on quality risks related to engagements and work performed in connection with a PCAOB engagement of another firm. ISQM 1 is a robust quality management standard and would be understood and translated, as appropriate, across the globe. In addition, underlying PCAOB engagement standards, particularly those related to audit engagements, have recently been enhanced with respect to appropriate supervision and review. We believe requiring compliance with ISQM 1 in such circumstances, combined with the lead firms' compliance with both QC 1000 and with the underlying PCAOB engagement standards applicable to the engagement, would protect the public interest, at a reasonable cost.

**Question 6. Is the proposed distinction between the obligation to design a QC system and the obligation to implement and operate a QC system appropriate? Is the proposed threshold for full applicability of QC 1000—having obligations under applicable professional and legal requirements with respect to a firm engagement—appropriate?**

As noted in our response to Question 5 above, we are concerned that the proposed threshold for full applicability will create difficulties for foreign firms that are members of global networks. We believe certain firms will be challenged with assessing the extent to which the requirements apply to their firm, particularly those firms that are at or near the 100-issuer mark.

We appreciate the effort taken by the Board to provide clear delineation regarding the level of obligation applicable to each firm. Nevertheless, we still had difficulty in navigating the requirements within paragraph .07. If the Board moves forward with the distinction between (a) design and implementation and (b) operation, we recommend the following clarifications:

- We believe the requirements would be clearer if sub-bullet (d) were presented as a separate requirement. The content of the sub-bullet does not appear to align with the lead-in of the requirement since the lead-in speaks to implementing and operating



the QC system. By separating sub-bullet (d), we believe that content will be easier to understand.

- We recommend putting paragraph .07 closer to the beginning of the standard. While we understand its proposed positioning, currently, the distinction between design obligations and operation obligations as one begins reading the standard is not readily apparent. By explicitly addressing the distinction at the beginning of the standard, the Board could achieve greater clarity about the extent of applicability.

**Question 9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?**

We appreciate the Board's intention of creating a quality control standard that is scalable for all firms. We believe the scalability of the standard would be even more effective if the Board could incorporate more explicitly certain concepts, such as professional judgment and relevance and reliability. Without these concepts, we are concerned that the requirements lose the notion of being risk-based because they are set forth in such definitive terms. For example, professional judgment is essential in operationalizing a standard that is intended to be scalable based on a firm's size and circumstances. As discussed in the body of our letter, we believe the standard could be even stronger by incorporating the notion of professional judgment throughout the proposed standard in the context of the design, implementation, and operation of a firm's QC system. Similarly, the information and communication component could refer to "relevant and reliable information" to convey that not all information is intended to be obtained and disseminated to the required individuals or roles.

#### **Firm's QC system**

**Question 10. Is the reasonable assurance objective described in the proposed standard appropriate? If not, why not? Are there additional objectives that a QC system should achieve? If so, what are they?**

We continue to believe that the concept of *reasonable assurance* is not well understood generally as it relates to systems of quality control and recommend that additional clarity is needed. Without clear guidance specific to quality control, users of engagement reports, inspectors of audits, and auditors themselves may interpret the proposed standard, as well as the results from its application, in different ways, which could change their notion of what reasonable assurance should be as well as undermine the overall trust in the audit process itself.

We are concerned that, without additional guidance, the proposed phrase "an appropriately low level of risk" is open to varied interpretation and may result in unnecessary differences in application, even in situations with similar fact patterns. We strongly recommend that the Board add the guidance from footnote five of existing QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which states the following:

Deficiencies in individual audit, attest, review, and compilation engagements do not, in and of themselves, indicate that the firm's system of quality control is



insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.

We believe including such guidance as another note to paragraph .05 reinforces the notion that a firm's QC system provides reasonable, not absolute assurance. It also provides more clarity regarding the impact that QC deficiencies may have on a firm's overall conclusion regarding the operating effectiveness of its QC system.

### **Roles and responsibilities**

#### **Question 12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?**

We support the roles identified in the Proposal. We encourage the Board to consider whether a firm's head of the audit practice should also be included in the standard. The accountability that comes with that position across firms could align with the governance component of the QC system.

While we believe the roles identified are those that are most accountable for a successful QC system, we foresee potential challenges in operationalizing certain aspects of the requirements.

#### *Assignment of roles*

We are concerned about the expectation that only one individual is to be assigned responsibility for each role discussed in paragraph .12. Practically speaking, it may not be operational for only one individual to fulfill the robust QC responsibilities set out in the Proposal while still executing their day-to-day job functions, especially when considering the disparity in the size of firms subject to the operation requirements of QC 1000. We believe this requirement could contradict the authority, requisite skillset, and time necessary to appropriately design, execute, and oversee all of the responsibilities included in the Proposal.

In order to dedicate sufficient time to the QC system, firms may designate multiple individuals for a particular role, which may be appropriate depending on how firms are structured. For example, the concept of "ethics" is a broad term that might encompass a variety of areas. The concept of "ethics and independence" is used throughout the PCAOB's standards and rules. However, a broader view of the term "ethics" could include concepts such as compliance with ethical standards and a firm's code of conduct. We request clarification as to whether the use of the phrase "ethics and independence" is intended to be read consistent with its use in existing professional standards or whether a broader definition is intended. The current ambiguity creates concerns that, again, one individual may not be able to operate in this role in a practicable manner.

#### *Communication loop*

We agree with creating an appropriate feedback loop among the individuals described in paragraphs .11 and .12. It is unclear, however, whether "establish[ing] a direct line of communication" implies a direct reporting relationship between the roles identified in paragraph .12 and the firm's principal executive officer. Currently, firms may not be structured in a manner whereby these roles report directly to the principal executive



officer. In addition, the expectations for practical application are unclear with regard to the nature and frequency of these communications. We believe examples or implementation guidance will help firms consider how these requirements are expected to be achieved.

**Question 13. Would firms have difficulty filling the specified roles in light of the proposed requirements?**

We believe firms may have difficulty filling the specified roles in the proposed standard. The workload expectations for a single person to fulfill in each role may not be operational (refer to our response to Question 12 above). Given the size of some firms and the proposed limitation to a single individual, these roles, by design, may be too broad to bear the expectations related to accountability.

Public accountants and firms know that accountability is important and necessary. However, the fact that the Proposal specifically discusses designing the roles requirements in QC 1000 so that “enforcement action could be brought against the individual if they fail to meet those responsibilities”<sup>3</sup> sets a troubling tone, which may deter the best and the brightest from seeking these important roles given the impact of an enforcement matter on a professional’s career.

SEC Commissioner Hester Peirce discussed similar concerns in a recent statement:

The PCAOB has set for itself an objective of “[i]mpos[ing] more significant penalties and other relief,” [citation deleted] which could deter well-qualified people from joining the profession and undercut audit quality. [citation deleted] The smallest firms could suffer disproportionately, diminishing competition in an industry already dominated by several large firms.<sup>4</sup>

A more practical approach that would result in the same behavioral change while also attracting the right professionals for the role would be to have a specified response that the effectiveness of the quality control system is prominently embedded in these individuals’ performance evaluations.

**Risk assessment**

**Question 14. Are the proposed definitions of “quality risks,” “quality objectives,” and “quality responses” sufficiently clear and comprehensive? If not, why not?**

We believe those definitions are sufficiently clear and understandable, and particularly support the PCAOB’s use of the “reasonable possibility” notion within the proposed definition of “quality risks.” We provide further feedback on the definition of “quality risks” in our response to question 16 below.

**Question 15. Is the threshold of “adversely affecting” set out in the proposed definition of quality risk clear, or would more guidance and examples be helpful?**

The threshold of “adversely affecting” is also included in ISQM 1 and SQMS 1 with little clarifying guidance to assist practitioners. We believe the concept is reasonably

<sup>3</sup> PCAOB Proposal, page 75

<sup>4</sup> SEC Commissioner Hester M. Peirce, “PCAOB’s Ballooning Budget,” December 23, 2022



understood. However, we would welcome additional guidance or examples in order to align how firms are viewing risks through the expected lenses.

**Question 16. Should the proposed definition of “quality risks” explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?**

We understand the PCAOB’s concerns discussed in the Proposal and believe the proposed definition of “quality risks” will help “raise the bar” for firms to appropriately address intentional misconduct in their QC systems. However, our response to question 17 below provides further discussion on what we foresee to be considerable operational challenges with the proposed definition as a whole.

In addition, we believe additional guidance may be beneficial with regard to intentional misconduct by other participants. It is currently unclear how a firm’s QC system can be expected to assess and respond to risks associated with other participants that are not part of the firm.

**Question 17. In the proposed definition of “quality risks” should the threshold of “reasonable possibility of occurring” also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?**

We strongly believe that the threshold of “reasonable possibility of occurring” should apply to all risks, including risks of intentional misconduct. In order to remain scalable and risk-based, it is necessary to strike a balance that requires firms to address legitimate risks relating to intentional misconduct without requiring firms to dedicate disproportionate time and resources to every possible type of misconduct that could adversely affect the QC system, irrespective of the likelihood of such conduct occurring. The Proposal clearly acknowledges that the Board’s focus is on the “more pervasive and larger risks”:

Limiting risks of intentional misconduct to only those that have a reasonable possibility of adversely affecting achievement of the firm’s quality objectives would result in the firm concentrating its efforts on more pervasive and larger risks and not on every conceivable act of misconduct.

A focus on conduct that could create pervasive or larger risks must take into account the probability of the conduct occurring. Therefore, we do not believe the proposed definition sufficiently limits the extent of the expected risk assessment related to intentional misconduct as the Board believes it would. As such, we believe the notion of “reasonable possibility of occurring” should also apply to risks of intentional misconduct in order to appropriately focus firm efforts on the more pervasive and larger risks, as intended by the Board.

**Question 19. Are the proposed requirements sufficient to prompt firms to appropriately identify, assess, and respond to quality risks, or is supplemental direction needed? If supplemental direction is needed, what would assist firms in identifying, assessing, and responding to quality risks?**

Risk assessment is the first step in building and maintaining an effective QC system. We believe the profession would benefit greatly from timely supplemental direction in



the form of guidance and examples from the PCAOB. Addressing potential practical application challenges early in the implementation process, such as in working or listening sessions, would only make firms' QC systems stronger, which will ultimately serve the public interest.

**Question 20. Are the specific examples included in Appendix B helpful in assisting the firm in identifying and assessing quality risks? Should additional examples or guidance be provided? If so, what additional examples or guidance would be helpful?**

Generally, we found Appendix B helpful and appreciate the specific examples that are intended to assist firms in identifying and assessing quality risks.

While we do not currently have any recommendations of examples to add, we ask the Board to reconsider the inclusion of paragraph B.10b, which discusses "the extent of alignment of the third-party providers' standards of conduct with those of the firm." Various observations have been made throughout the years indicating that many third-party providers that are used to obtain evidence are not centrally governed by codes of conduct like the public accounting profession. We are concerned that this example could imply that a third-party provider may not be appropriate or sufficient merely because it falls outside the public accounting profession. We believe paragraph B.10d adequately addresses a firm's quality control responsibilities related to third-party providers. Therefore, we recommend removing paragraph B.10b given its ambiguity.

**Governance and leadership**

**Question 21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

We support the quality objectives set forth in paragraph .25 of the Proposal. We strongly agree with the need for "frequent and consistent communication from leadership to firm personnel regarding the commitment to quality."<sup>5</sup>

We suggest that firms would benefit from clarification of the term "leadership" within paragraph .25 and Appendix B. It is unclear whether the Board intends for "leadership" to apply to all partners and partner equivalents or just to the principal roles within the QC system set out in paragraphs .11 and .12. Clarification would enable firms to design and communicate appropriate expectations to a complete population of those considered to be firm "leadership." Since firms of varying size and circumstances would be implementing QC 1000, we believe the Board could provide clarification in general terms that can be widely applied.

We are, however, concerned with the implications of paragraph .25d. Certain actions taken by firms may take an extended time period in order to yield the benefits of quality. For example, a divestiture of a particular industry sector of an audit practice may temporarily strain resources, but the long-term benefits of such divestiture may ultimately far outweigh the initial stress that the transaction puts on the remaining audit practice. It is unclear how firms would operationalize or demonstrate the connection to

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<sup>5</sup> Page 93 of Proposal.



their commitment to quality, particularly if such decisions or actions have longer term benefits.

**Question 23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?**

We are supportive of the notion that independent directors or advisory committees can provide helpful business insights to audit firms. However, we believe that implementing the requirement for independent oversight could be challenging. We are concerned that such a requirement is overly prescriptive in that it dictates the form of the independent function rather than being principles-based.

We also found the requirement to be unclear, given the use of the phrases “oversight function” and “independent judgment.” While the Board notes that the largest six firms had some form of governance structure that included a non-employee, we are unsure whether existing independent advisers would fulfill the proposed requirement. For example, various firms’ governance structure includes independent members that sit on an audit quality advisory council. However, we do not believe such council’s purview is that of an “oversight” role, but rather it is primarily an independent function that objectively and sufficiently advises firm boards and audit leadership on the firm’s quality control system. While we believe this structure meets the spirit of the Proposal, we believe clarification is necessary for firms to understand whether existing structures, as acknowledged in the Proposal, do in fact meet the intended purpose of the proposed requirement.

Further, we recognize the Board’s commentary on the concerns raised from the concept release regarding such role being within the “chain of command,” and we acknowledge that the proposed requirement does not dictate the role be in the “chain of command.” However, practically speaking, it is unclear how an independent role could truly function as an “oversight” role in the firm *without* being in the “chain of command.” Therefore, the concerns originally voiced regarding the operational challenges that firms would encounter if the oversight role fell within the chain of command remain a barrier to implementing this particular requirement.

We continue to believe that the Board’s intended objective with this requirement could be met either by designating an individual on a firm’s board as an “audit quality expert” (similar to audit committee requirements for a “financial expert”) or by hiring independent external advisers outside the board (or a similar construct) to focus on and advise firms regarding audit quality and their systems of quality control.

**Question 24. Is the proposed specified quality response related to the firm’s policies and procedures on receiving and investigating complaints and allegations appropriate? Are there any other specified quality responses in this area that we should consider, and if so, what are they?**

We support having well-defined policies and procedures for addressing and resolving potential noncompliance. We appreciate the inclusion of the note to paragraph .29, which clarifies that the nature, timing, and extent of the process to investigate and resolve complaints and allegations would be commensurate with, and responsive to,





the significance of such complaints or allegations. We believe scalability is essential to being responsive to the risk and the successful execution of such process.

### **Ethics and independence**

#### **Question 26. Are the proposed quality objectives for ethics and independence requirements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

We support the direction of the proposed quality objectives for the ethics and independence component; however, we have identified certain areas where greater clarity could enhance firms' implementation of the related requirements.

Certain requirements throughout the ethics and independence component describe "with respect to work performed on behalf of the firm, by others subject to such requirements" (for example, paragraphs .31a, .33e, and .33f) while other requirements refer to "affiliates of the firm" (for example, paragraphs .33a and .34). Some requirements also refer to "others subject to such requirements" (for example, paragraphs .33c and .33e), which we believe relates to "other participants," but is unclear. We found the terms used throughout paragraphs .31 through .35 to be confusing and not fully aligned with the independence rules themselves. We are concerned that the proposed requirements that contain this language could go beyond the intended applicability of the independence rules to the various parties contemplated in the proposed standard (for example, application of the requirements to other participants, which may include the entity's internal auditor or an auditor's external specialist who are not subject to independence). Given the importance of compliance with independence and ethics requirements, it is critical that the requirements be clarified and also aligned with the rules of the PCAOB related to independence and ethics.

We also believe the phrases referenced above could create operational challenges because they are open to interpretation, and certain interpretations may be too broad to enable appropriate implementation by firms. For example, it is not possible for a firm to dictate policies and procedures for its affiliates to follow. Therefore, we ask the Board to clarify the language used in the proposed standard either by cross-referencing to definitions that already exist in PCAOB rules or by providing definitions within QC 1000. We also believe this is an area where the profession would benefit from more detailed implementation guidance.

#### **Question 27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?**

We support the Board's desire to bring greater attention and accountability to the ethics and independence component. However, we believe that the level of prescription in certain of the quality responses for this component will create operational challenges that could ultimately be detrimental to quality.

For example, paragraph .33f(2) specifies that firms must take "preventive and correction actions to address ethics or independence violations, as appropriate, on a timely basis." Ethical or independence violations may take a variety of forms and therefore latitude is required in determining the best approach to handling them in the QC system. Dictating





that preventive **and** corrective actions must be taken does not promote a risk-based approach to responding to the quality risks identified by a particular firm related to ethics and independence.

In addition, we noted that the proposed standard does not define “affiliates.” We recommend either referencing the definition provided within PCAOB Rule 3501 or defining this term in the proposed standard in a manner similar to Rule 3501’s definition.

**Question 28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?**

As noted in the Proposal, the existing SEC Practice Section (SECPS) requirements to implement an automated system to track investment holdings of partners and managers use a threshold of more than 500 SEC registrants. However, the proposed requirement in paragraph .34a(1) institutes a threshold of 100 or more issuers, and the basis for reducing the threshold from existing requirements is unclear.

Firms that are currently subject to the SECPS requirements have likely invested considerable capital and resources to implement and maintain the tools that enable compliance with those requirements. We view that investment as worthwhile and believe these processes have contributed to audit quality over the years. Nevertheless, we are concerned that costs associated with implementing an automated system that would be incurred by firms with between 100 and 500 issuers may be cost prohibitive and not necessarily commensurate with the quality risk to which it responds. We are currently unaware of any truly “off the shelf” independence monitoring solutions that would be readily available to firms, which means that firms could incur substantial time and costs to design, test, and implement a system that is responsive to this requirement. Such investment may be cost prohibitive to certain firms with fewer than 500 issuer clients.

We further note that while some processes may have automated components, it is possible that they are not fully automated. It is unclear what the Board’s expectations are with regard to the nature or level of automation, and we are concerned that the cost/benefit may only be realized by firms subject to the current SECPS threshold (that is, more than 500 issuers).

**Question 30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm’s ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?**

We believe that the proposed requirements highlighted in this question are already addressed by the requirement for mandatory training, which addresses ethics and independence requirements and firm policies and procedures. Successful completion of



such training would imply familiarity with those requirements, policies, and procedures. We are concerned, though, that paragraph .34e is overly prescriptive with regard to “obtaining certifications... upon any change in personal circumstances, such as role, geographic location, or marital status, that is relevant to independence.” We believe that obtaining such certification is not risk-based and may create scalability issues as there are cost implications for designing and maintaining processes or systems that would operationalize this type of requirement.

Instead, we believe these items would be better suited as examples or considerations included in the implementation guidance, and we recommend that such examples include when or how the actions proposed in Question 30 may be scalable to the related quality risks.

### **Acceptance and continuance**

#### **Question 31. Are the proposed quality objectives for acceptance and continuance of client relationships and specific engagements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

Generally, we found the proposed quality objectives to be reasonable. We support the Board’s view that it is important to focus “the client acceptance and continuance process on the firm’s ability to perform an engagement in accordance with applicable professional and legal requirements.”<sup>6</sup> Nevertheless, we have concerns with certain requirements.

Paragraph .38a(1) states, “Judgments about whether to accept or continue a client relationship or specific engagement are... made as part of or before performing preliminary engagement activities.” We are concerned that this paragraph may be overly prescriptive and, therefore, may not sufficiently address the intended quality objective. Generally, acceptance or continuance of client relationships or specific engagements is an ongoing obligation for each firm throughout the year.

Prescribing that such judgments be made “as part of or before preliminary engagement activities” could have unintended consequences, such as (1) inappropriately narrowing or misconstruing the intention of the quality objective and (2) misaligning this portion of the quality objective with the quality response proposed in paragraph .40. At a minimum, we ask the Board to consider specifying that this paragraph relates only to *initial* judgments about whether to accept or continue a client relationship or specific engagement.

We fully support the need for firms to consider the nature and circumstances of the engagement as well as the integrity and ethical values of the client. However, we believe paragraph .38a(3) regarding “the integrity and ethical values of the client (including management and the audit committee)” is unclear. Does the Board intend for all members of management and the audit committee to be considered? Would it be appropriate for firms to consider solely the audit committee chairperson as opposed to the entire audit committee? We believe these are the types of questions that could be addressed by introducing the concept of “professional judgment” in QC 1000, as well as in the implementation guidance.

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<sup>6</sup> Page 120 of the Proposal



### **Engagement performance**

**Question 33. Are the proposed quality objectives for engagement performance appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

Generally, we support the proposed quality objectives for engagement performance. We believe that certain items would benefit from greater clarity either in the requirements themselves or in the implementation guidance. In particular, we note that in paragraph .42b, the requirement related to consultations says: "Consultations on complex, unusual, or unfamiliar accounting and auditing matters are undertaken with qualified individuals from within or outside the firm..."

We found the reference to "unfamiliar" accounting and auditing matters unclear. We note that "unfamiliar" is currently referenced in paragraph .19 of QC 20; however, that is in the context of providing examples of consultation matters: "for example, when dealing with complex, unusual, or unfamiliar issues." We are concerned that explicitly incorporating the word "unfamiliar" into the requirement creates an unnecessary level of prescription that will be difficult to operationalize. In addition, a potential unintended consequence is that auditors may infer from the proposed requirement that consultations may compensate for a lack of appropriate knowledge, skill, and experience on the engagement team, which we do not believe is the ultimate intention of the requirement. We recommend reverting to the current standard's language, which uses this term as part of an example. Alternatively, we propose the Board consider replacing the term "unfamiliar" with a term such as "unique" or "infrequent." We believe such revision would not diminish the objective of driving firms to continue focusing on the importance of consultation and resolution of matters prior to the issuance of the engagement report.

**Question 34. Should we include specified quality responses for the engagement performance component? If so, what should they be?**

In order for the proposed standard to be scalable and risk-based for all registered firms, we do not recommend including specified quality responses for the engagement performance component. We believe the quality objectives are sufficient and will allow firms to develop the quality responses that are most appropriate for their particular circumstances.

**Question 35. We are proposing to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. Should the standard include specified quality responses explicitly directed to non-U.S. firms that audit issuers? If so, what are they?**

We do not agree with eliminating the existing Appendix K requirements. We believe there is merit and benefit to Appendix K reviews in their current form, and we are concerned that the unintended consequences of firms incorporating Appendix K reviews into their QC systems, without explicit direction from QC 1000, could be significant.

Currently, Appendix K procedures are limited to reading the draft filing and holding discussions with the engagement partner. These "filing reviews" are appropriately



limited given the objective of such reviews. Additionally, paragraph .01a(3) of Appendix K states the following:

Because of the limited nature of the procedures described above, it is recognized that the filing reviewer cannot and does not assume any responsibility for detecting a departure from, or noncompliance with, accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, or SEC rules and regulations.

The existing requirements provide a clear separation of the reviewer from the engagement team, including the engagement quality reviewer. This distinction is an extremely important one, which could be lost by eliminating Appendix K. The result would be that the reviewers become members of the engagement team, thus subjecting them to all applicable standards and rules that use the term "engagement team." We believe this would be inappropriate given the limited nature of the filing review. Additionally, the reviewers' firms would become "other accounting firms" for purposes of Form AP reporting, and reviewers' hours would be included in Form AP. We believe this inappropriately positions the reviewer in the context of the audit itself. In addition, inadvertently incorporating these filing reviewers into the definition of "engagement team" could create a host of application challenges that may be a detriment to audit quality.

If the Board chooses to move forward with eliminating Appendix K, we strongly encourage the Board to provide this important distinction between the limited review function and the engagement team elsewhere in the standards or related guidance.

## **Resources**

### **Question 36. Are the proposed quality objectives for resources appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

We believe paragraph .44j could be further clarified to enhance its implementation and operability. As proposed, the paragraph applies to both networks and third-party providers, but a firm's approach to each of these groups may be significantly different, resulting in differing quality objectives. The Board separated networks and third-party providers in proposed Appendix B to QC 1000, and we recommend the Board reconsider instances where these two terms are combined in the proposed requirements. Keeping them together may imply that the Board expects firms to use a consistent approach to each group within the firm's QC system, which may not be operational.

### **Question 37. Does the proposed quality objective and specified quality response related to technological resources provide sufficient direction to enable the appropriate use of emerging technologies? If not, what additional direction is necessary?**

We believe the proposed quality objective and specified quality response provide sufficient direction to enable the appropriate use of emerging technologies. As noted in the body of our letter, we welcome any implementation guidance, including information about emerging technologies, that the PCAOB is able to provide in order to enhance firms' success in implementing the Proposal.



**Question 38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?**

While we have no specific recommendations, we observed that certain of these quality responses relate closely to PCAOB auditing standards, including AS 1201, *Supervision of the Audit Engagement*. We believe the profession would benefit from greater clarity with regard to how QC 1000 is intended to interact with engagement-related auditing standards so as to minimize potential duplication of efforts or documentation.

**Question 39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients? If yes, what should the requirement be?**

In considering the various types of firms that are registered with the PCAOB as well as the various technologies that may be used by clients, we do not believe it would be appropriate to require the use of technological resources in this manner. If the Board observes best practices that would enhance firms' systems of quality control, we believe that information would be best positioned in either the implementation guidance or in ongoing guidance that the Board makes available to all firms.

### **Information and communication**

**Question 40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?**

In our view, the requirements associated with information and communication appear ambiguous and overly broad. The Board acknowledges on page 156 of the Proposal that they "propose not to use a similar qualifier [of relevant and reliable]" related to this objective. While we recognize this may not be the only relevant qualifier as it relates to successful quality controls over the information and communication component, by not providing any qualifiers at all, the Proposal leaves the notion of "information" open to wide interpretation and does not enable firms to focus on information that is most important and meaningful in the operation of a QC system.

We disagree that relevance and reliability is implied within the context of the drafted requirements; we believe the term "information" needs some parameters and qualifying language to provide some boundaries to the vast amount of information that exists or could be created in the context of a firm's QC system.

Moreover, we are concerned that the breadth of information that the Proposal implies must be considered and/or communicated within a QC system will inhibit firm leaders from identifying and focusing on information most relevant to the successful operation of the QC system. Without some appropriate qualifiers, firms may be overwhelmed by the sheer amount of information that is arguably related to the firm's QC system, which could be detrimental to quality. The auditing standards' expectations regarding the communication of internal control findings provide a helpful framework in this regard. Under those standards, every possible control deficiency is not required to be communicated to the audit committee. Rather, the standards require communications focused on findings that merit the audit committee's attention – significant deficiencies



and material weaknesses. In so doing, the standards implicitly recognize that information overload can be detrimental to good oversight and decision-making. So too with information required to be considered and communicated within a firm's QC system.

**Question 41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?**

We agree that information disseminated externally should be accurate and communicated in a manner so as not to be misleading. Nevertheless, we believe this requirement is wide-ranging and leaves too much room for interpreting the population to which this requirement relates. External communications range from transparency reports and key performance indicators to marketing and proposal materials. We do not believe it is the Board's intention to encompass all possible firm materials that may be provided externally, and we encourage the Board to clarify this requirement so that it focuses on the external information that is most relevant to a firm's QC system.

**Question 42. Are the proposed quality objective and specified quality response addressing information and communication related to other participants appropriate? If not, why not, and what changes are necessary?**

Page 46 of the Proposal defines "other participants" to include networks, among other parties. However, paragraph .53 is written in such a manner that .53f specifically addresses networks, while .53g addresses other participants. It is unclear whether .53g also applies to networks given their inclusion in the definition of "other participants" or if the Board intends for .53g to apply to any other party defined within "other participants." We believe this could be confusing in a similar manner related to mixing networks with third-party providers, as discussed in our response to Question 36.

**Question 43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.**

We are concerned that requiring network or non-network firms to share the most recent evaluation of the QC system could potentially undermine the protections afforded to such information under SOX. This is particularly concerning with regard to requiring a brief overview of remedial actions, which would specifically relate back to QC deficiencies.

We believe firms should be able to take a risk-based approach in determining whether it is necessary to request specific information regarding an other participant firm's QC system or whether it can be sufficiently handled at the engagement level based on the applicable PCAOB auditing standards.

**Question 44. Are the proposed specified quality responses for information and communication appropriate? If not, what changes to the specified quality responses are necessary for this component?**

We are concerned that expanding the requirement to communicate quality control policies and procedures beyond firm personnel to include other participants may not be operational, particularly when considered in tandem with our other comments on the



various types of other participants. Firms' policies and procedures can be voluminous and are made available through manuals, templates, and practice aids, among other things. Further, firms may have a centralized repository for these various materials with access limited to firm personnel. Accordingly, we believe it would be inappropriate to provide, in writing, a firm's entire library of policies and procedures to any other participant given the proprietary nature of this information. We believe existing PCAOB engagement standards already sufficiently address the auditor's or practitioner's responsibilities related to the use of other participants. We also believe the proposed standard may inappropriately blur the lines between a firm's system of quality control and engagement-level requirements. The quality control system relates to the firm and its personnel and addresses implementing policies and procedures for the appropriate use of other participants consistent with professional standards. Other participants themselves are not necessarily subject to those policies and procedures.

Additionally, proposed paragraph .56 states, in part, that:

The firm should communicate information related to the monitoring and remediation process to firm personnel to enable them to take timely action in accordance with their responsibilities, including, to the extent necessary, a description of ...

b. Identified engagement deficiencies and QC deficiencies, including the nature, severity, and pervasiveness of such deficiencies; ...

This proposed requirement implies that each engagement deficiency should be communicated to firm personnel. The language, as drafted, could hold firms to a higher standard than may be prudent. While we are not opposed to communicating thematic engagement deficiencies based on professional judgment, a perceived requirement to communicate each engagement deficiency seems imbalanced to appropriately influence change.

### **Monitoring and remediation**

#### **Question 45. Are the proposed requirements for the monitoring and remediation process appropriate? Are changes to the requirements necessary for this process? If so, what changes should be made and why?**

We support requiring a mix of proactive and detective monitoring activities that allow firms to determine the appropriate firm- and engagement-level processes based on the firm's risk assessment. We believe many firms have adopted processes such as these already. As such, we agree that ongoing monitoring activities could be beneficial in the timely identification and correction of potential quality issues. On the other hand, such activities can be time consuming and costly to maintain, which is why we believe a principles-based approach that allows for a risk-based response by firms would be the most beneficial to firms' engagement quality, while also allowing for appropriate scalability. While the Board notes on page 167 of the Proposal that "ten of the twelve annually inspected firms performed some in-process engagement monitoring activities," it is unclear whether the Board believes such activities, as they existed in 2021, would be sufficient to meet the proposed requirements or whether the Board expects such activities to be expanded or enhanced to meet the intended purpose of the proposed requirements.





**Question 46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?**

We support the proposed requirement to inspect engagements for each engagement partner on a cyclical basis. We are concerned, however, that the note to paragraph .62 introduces an unnecessary level of prescription to that requirement, particularly given the additional discussion in the note to paragraph .64d. We believe it is not unreasonable to consider whether engagement partners have been subjected to external inspections/reviews when determining if and when to subject them to an internal inspection. Additionally, this level of prescription does not account for the potential unintended consequences of inspection for engagement partners that serve clients subject to both PCAOB audits and AICPA audits and could unnecessarily drive firms to two separate cyclical inspection programs (that is, doubling inspection program activities) based on the applicable set of professional standards.

Firms should have the flexibility to determine the appropriate cadence of internal inspection based on the quality risks identified and information available from other monitoring-related activities, including external inspections. We agree with the Board's inclusion of requiring an element of unpredictability into the selections for inspection and encourage the Board to focus the note to paragraph .62 both to reflect that notion and to remove the prescription related to cycle length.

**Question 48. Are the purposes of in-process monitoring (as proposed within this standard) clear and appropriate, including how in-process monitoring differs from the requirements of engagement quality reviews under AS 1220? If not, what additional direction is needed?**

We believe that the proposed standard clearly distinguishes between in-process engagement monitoring and engagement quality reviews under AS 1220. We recommend the Board consider further clarifying that in-process engagement monitoring is equally not supervision or review as per the underlying PCAOB engagement standards.

**Question 50. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which engagements to select, appropriate? If not, what other factors should be specified?**

We found the proposed factors in paragraph .64 to be helpful in determining the nature, timing, and extent of engagement monitoring activities. We would welcome implementation guidance to assist firms in understanding how the factors could impact the extent, in particular, of monitoring activities.

The characterization of in-process engagement monitoring in the proposed requirements and in the commentary provided in the Proposal are unclear, however. We recommend one clarifying edit to paragraph .64c, which refers to "inspections of in-process engagements." We do not believe the characterization of in-process engagement monitoring as an "inspection" is consistent with how in-process engagement monitoring is described in the Proposal, as the in-process monitoring activities observed by the PCAOB do not include inspections of in-process engagements in its observations. We recommend revising this phrase to "monitoring of





in-process engagements.” We believe the distinction between “inspection” and “monitoring” is meaningful, and that consistent characterization will avoid inappropriate interpretation of the Board’s expectations.

**Question 52. Are the proposed requirements for firms that belong to a network that performs monitoring activities appropriate? If not, what changes should be made?**

We believe the proposed requirements in paragraph .66 are reasonable. We agree with the Board’s position that, if networks perform monitoring activities, the existence and results of such activities would inform the firm’s own monitoring activities.

**Question 53. Are the proposed definitions for “engagement deficiency,” “QC finding,” and “QC deficiency” sufficiently clear and appropriate? If not, what changes should be made and why?**

We appreciate the discussion and examples provided in the Proposal regarding engagement deficiencies; we believe the additional information is helpful in better understanding the proposed definition. We encourage the Board to memorialize such discussion and examples in implementation guidance that may be issued with or shortly after the final standard is approved.

Nevertheless, the introduction of the proposed definitions of “engagement deficiency” and “major QC deficiency,” as well as the related requirements, represents a fundamental and incremental shift away from ISQM 1 and SQMS 1, which could minimize the desired benefits of having consistent, global QC-related standards and QC systems. We believe the incorporation of these definitions and related requirements will require additional time that firms will need to implement these incremental concepts thoughtfully and effectively into their existing QC systems.

**Question 54. What, if any, additional direction is needed regarding:**

- a. Evaluating information to determine whether QC findings exist;**
- b. Evaluating QC findings to determine whether QC deficiencies exist; or**
- c. Responding to engagement and QC deficiencies?**

There are a few areas where we believe additional direction is needed with regard to these topics. In relation to evaluating QC findings, we ask the Board to consider addressing the concept of *compensating responses* when considering QC findings. Paragraph A160 of ISQM 1 includes “whether there are other responses that address the same quality risk and whether there are findings for those responses” as an example of a qualitative factor that a firm may consider in determining whether findings give rise to a deficiency. We believe a similar factor would be beneficial to include in proposed paragraph .72 for compensating responses. Alternatively, the Board could address compensating responses more broadly in the implementation guidance.

Additionally, paragraph .68d of the Proposal instructs firms to evaluate whether similar engagement deficiencies exist on other in-process engagements or whether they would arise if remedial action is not taken. The concept is reasonable. The example, however, refers to an issue in a firm’s methodology which, by its nature, would be a deficiency at the QC level resulting in potential issues at the engagement level. Additional examples



of engagement deficiencies would be helpful to firms as the concept of applicability to other in-process engagements, as noted in paragraph .68d of the proposed standard, could be broadly interpreted and subject to varying interpretations.

**Question 55. Should firm personnel be allowed to inspect engagements or QC activities in which they are involved? If so, please explain why and provide examples of mechanisms that could reduce to an appropriate level the risk that noncompliance with PCAOB standards or the firm's policies and procedures would not be detected.**

In order to sufficiently address this question, we believe we need greater clarity on the inspection-related requirements proposed in QC 1000. As noted in our response to question 50 above, one proposed requirement characterizes in-process engagement monitoring as "inspection" while other requirements do not. We do not view in-process engagement monitoring as a form of inspection and encourage the Board to revise paragraph .64 as a result.

We believe this distinction is important because it is essential to allow individuals that perform in-process engagement monitoring to also be "involved" in the engagement. For example, the engagement team may consult with an engagement monitor on an accounting or auditing matter that requires consultation under firm policies. It will create a significant resource constraint that may be very difficult for firms to overcome if the Board intends for in-process engagement monitoring to be "independent" of other individuals within the firm who may be involved in the engagement through consulting with engagement teams, evaluating engagement team progress, or monitoring turnover on the engagement team.

### **Evaluating and reporting on the QC system**

**Question 57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?**

We appreciate the Board's desire to have consistent reporting among firms with regard to their annual evaluation of their QC system and related reporting to the PCAOB. However, we have significant concerns with the proposed November 30 evaluation date. Page 201 of the Proposal provides the following basis for the Board's proposal:

Our proposed evaluation date is based on our understanding that many firms perform their internal inspections process during the second and third quarters, which allows them time to design and implement remediation efforts ahead of "busy season."

Presuming that firms substantially complete internal inspections by September 30 each year, a November 30 evaluation date gives firms less than 60 days (considering the Thanksgiving holiday) to complete all of the following QC-related activities:

- Accumulation and aggregation, where appropriate, of inspection findings;
- Root cause analysis and determination of causal factors;
- Identification of remedial actions; and



- Design and implementation of remedial actions.

In addition, the proposed standard would expect that such remedial actions also be evaluated and tested to determine whether the related quality control findings are remediated. This timetable may neither allow for a sufficient period for firms to remediate the findings, considering the need for root cause analysis, nor afford them an opportunity to conclude on the effectiveness of its remediation.

The proposed standard would require firms to consider findings related to external inspections, such as that of the PCAOB. We note that the date of Grant Thornton LLP's (United States) most recent inspection report was November 4, 2022. Such timing, if consistent in future periods, would give our firm less than one month to evaluate, design, implement, and test remediation resulting from the findings within the inspection report.

The November 30 evaluation date (and January 15 submission date for Form QC) could have the unintended consequence of rushing firms through evaluation and remediation during a time of year that is already extremely busy for our personnel with both professional engagement-related preparations and personal celebrations of the holiday season. We believe the November 30 evaluation date and the January 15 submission date do not provide firms with an appropriate amount of time to complete their assessment thoughtfully and adequately, including remedial activities, given the proximity to when substantive internal inspection procedures (internal and external) are performed.

In addition, the Proposal notes that the January 15 submission date correlates to the 45-day document assembly period within PCAOB standards. However, the 45-day period is the document assembly period and not the period after the "as-of" date in an auditor's report of internal control over financial reporting (ICFR). Similar to issuer reporting deadlines for ICFR audits, we believe additional time is required for Form QC preparation, similar to that of issuer reporting deadlines, with a document assembly period following after the Form QC submission (refer to our response to Question 71 below for further feedback on the document assembly period).

**Question 58. Is the proposed definition of "major QC deficiency" clear and appropriate? If not, what changes should be made and why?**

Refer to our response to question 53 above with regard to the impact the proposed definition and related requirements could have in terms of firms' implementation efforts.

**Question 60. Are the proposed factors for determining whether an unremediated QC deficiency is a major QC deficiency appropriate? If not, what other factors should be specified?**

While we do not disagree with the factors set forth in paragraph .78, we believe it is important that either the proposed standard or the related implementation guidance acknowledge that the evaluation of unremediated QC deficiencies can be undertaken only based on what is known or reasonably knowable at the time of that evaluation.

In addition, we ask the Board to consider addressing the concept of *compensating responses* when considering whether a QC deficiency rises to a major QC deficiency, similar to our response to Question 54 above. Paragraph A163 of ISQM 1 includes



guidance on whether there are compensating responses to address the quality risk to which the response relates as a factor that firms may consider in evaluating the severity and pervasiveness of an identified deficiency. We believe compensating responses are an important factor in appropriately evaluating QC deficiencies and that they should therefore be explicitly included in the proposed factors.

Finally, the proposed evaluation date of November 30 may not leave sufficient time for firms to appropriately analyze and remediate identified QC deficiencies, which could increase unnecessarily the number of unremediated QC deficiencies.

**Question 61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?**

There may be challenges with regard to the reporting as proposed in QC 1000. We believe the requirement to report unremediated deficiencies is at too granular a level in order for the reporting to be meaningful. We draw attention to a portion of our response to Question 40 above, which discusses the volume of information that would be required and analogizes to the level of information that is required to be communicated to audit committees in financial statements audits – significant deficiencies and material weaknesses. Requiring that all unremediated deficiencies be reported could ultimately be detrimental to oversight and decision-making.

For firms with more than 100 issuers, those firms are subject to annual inspection activities, including evaluation of a firm's quality control system. For these firms, all quality control-related documentation and conclusions would be available and subject to PCAOB inspection. Therefore, preparing a formal report to be submitted to the PCAOB in addition to the inspections process may be unnecessarily duplicative.

**Question 63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?**

Refer to our response to question 57 above.

**Question 64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?**

While the timing of expanded Form 2 reporting could alleviate the time constraints and challenges discussed in our response to question 57 above, we agree with the Board's observation in the Proposal that expanding Form 2 would make the form longer and more complex, requiring multiple people from different areas of the firm to collect, report, and sign the various parts of the form.

**Question 70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?**

We support a certain level of disclosure regarding firms' systems of quality control to audit committees. In the PCAOB's "Conversations with Audit Committees" publication, the PCAOB observed that "most audit committee chairs evaluated audit quality with an emphasis on their engagement team, with a lesser degree of focus on the



characteristics of the audit firm.”<sup>7</sup> We are concerned that proposed paragraph .04b to AS 1301, *Communications with Audit Committees* is overly prescriptive, and the level of specificity of the required communication (that is, providing an overview of remedial actions taken or to be taken) could be a source of confusion, not clarity, for audit committees, particularly since audit committees appear focused more on the specific engagement team as opposed to the audit firm overall, as observed by the PCAOB’s past outreach described above.

We are also concerned that firm conclusions with regard to identified deficiencies and quality control effectiveness would be vastly misunderstood when considered in the context of other publicly available information. Particularly since there may be a considerable time lag between when the firm is required to conclude on effectiveness and when an inspection report, or portions thereof, could be made public.

Those quality issues could be misconstrued and viewed as contradicting the firm’s previous conclusion that the system of quality control is effective. It could be extremely challenging for audit committees to understand and reconcile the information that would be communicated to them under the proposed changes to AS 1301, especially given the considerable time period between the issuance of public portions of firm inspection reports and the potential release of nonpublic inspection findings.

Finally, we believe it is possible this proposed communication could also be construed as contradictory to the PCAOB’s conclusion that Form QC would be treated as nonpublic under SOX.

## **Documentation**

### **Question 71. Are the proposed documentation requirements appropriate? If not, what changes should be made?**

We are concerned that the proposed requirements related to documentation are unnecessarily broad. For example, paragraph .83a states that documentation needs to be “in sufficient detail to support a consistent understanding of the QC system by firm personnel...” We do not believe this type of threshold currently exists, so it may not be easily understood.

Further, the proposed requirements may not be clear as to how they relate back to the requirements for each quality control component. For example, the phrase “successive senior levels” is used only in paragraph .82a, and no additional commentary on this phrase is provided in the Proposal. It is unclear what this phrase is intended to mean and how it relates back to other references within QC 1000, such as those to “leadership” and the roles defined in the roles and responsibilities section. We ask the Board to clarify the various paragraphs to make the terminology more consistent with other requirements.

#### *Document assembly period*

We do not disagree with the proposed 45-day document assembly period; however, we believe the assembly period should **begin** on the date when Form QC is submitted to the PCAOB (assume the proposed due date of January 15). Currently, it is proposed

<sup>7</sup> “Conversations with Audit Committee Chairs: What We Heard & FAQs,” Public Company Accounting Oversight Board, December 18, 2019.



that the assembly period **end** on such date. We propose that the assembly period should **begin** on January 15 by way of analogy to the document assembly period in the auditing standards. AS 1215, *Audit Documentation* requires “a complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date.” With regard to the firm’s QC system, the “report release date” would be the date of submission of Form QC. Therefore, following the spirit of the audit standards, the QC documentation would be assembled and archived within 45 days after submitting Form QC to the PCAOB.

#### *Document retention*

We believe additional guidance would be necessary in order for firms to appropriately adopt documentation retention policies that meet the PCAOB’s expectations. It is currently unclear whether “all books and records” related to the QC system and the firm’s evaluation thereof (that is, the operation of controls as well as tests of operating effectiveness) would require assembly and retention. For example, invites on individuals’ calendars may provide evidence of the occurrence and timing of certain meetings that are identified as a quality response. Is it sufficient to retain the workpaper indicating the evaluation of such evidence, or does the proposed documentation standard contemplate the calendar invites themselves to be retained? We believe clear implementation guidance could help narrow the interpretation of the proposed documentation requirements to an appropriate level that is consistently applied among all firms.

We encourage the Board to consider adding language that appears in SQMS 1 that we believe will greatly assist audit firms in implementing the documentation requirements. SQMS paragraphs A224 and A227 state, respectively, that:

It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this SQMS may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk. However, in documenting the quality risks and how the firm’s responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.

While it may seem intuitive, we have observed that the execution of the documentation requirements in the related auditing standards have evolved over time. Providing this type of guidance allows for a principles-based approach to level-setting expectations across the profession with regard to the extent of a firm’s QC documentation.

#### *Retention period*

On page 226 of the Proposal, the Board “question[s] how the proposed retention period would be burdensome for firms since there is no obligation on the firm to take additional



actions once the documentation is assembled for retention.” We believe a seven-year retention period could be burdensome and costly because most, if not all, documentation related to a firm’s QC system would be retained electronically. The amount of documentation to be retained based on the proposed requirement is expected to equal terabytes of data needing storage for each evaluation period. This considers retaining all firm manuals, IT system info, and other significant design components in totality. The retention of this significant amount of data translates to a need for new servers to house this data, incurring an additional associated cost that could be challenging for certain firms to manage.

The Proposal indicates that a “firm’s remediation activities may span multiple years and the actions taken by the firm in certain areas may be informed by prior actions.” We believe this could reasonably be handled by firms on a case-by-case basis, and any necessary documentation that may impact or inform future periods could be specifically retained. We do not believe retaining all documentation for a particular evaluation period is necessary to realize the perceived informational benefits. Given the dynamic nature of QC systems, we foresee information becoming “stale” in a few years’ time and do not anticipate the information retained early on being used for such purposes as training or the retention of organizational knowledge in later years.

#### **Amendments**

##### **Question 74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?**

We do not object to expanding the scope of AS 2901 to include engagement deficiencies on ICFR audits. As we were reviewing the proposed changes to AS 2901, however, we observed that the language within Note 1 to paragraph .01 may be counter to what we believe firms observe in practice. We believe that there are situations where it would be unreasonable for a firm to automatically conclude that financial statements (and the auditor’s report thereon) are still being relied upon. Such situations may include, for example, when a client has filed for bankruptcy; although the entity’s most recent SEC filing remains available to the general public, it may be reasonable to conclude that the filing no longer is being relied upon. Since there are circumstances where an auditor’s report in the most recent SEC filing is no longer being relied upon, we believe it is problematic for AS 2901 to mandate (i.e., the use of “must”) that the auditor treat the report as being relied upon. We recommend the Board consider modifying the language to acknowledge that facts and circumstances exist where it may be reasonable for the auditor to conclude the financial statement (and the auditor’s report thereon) no longer are being relied upon.

##### **Question 75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor’s opinion may be unsupported? If not, why not?**

We believe the objective of this standard should be to address instances where, due to an omitted procedure, the auditor’s opinion may be unsupported. We believe this is where the risk exists for stakeholders and the investing public and that firms should, therefore, treat these instances with expeditious care. Requiring remedial action of all identified engagement deficiencies is overly prescriptive and could be unnecessarily





burdensome in instances where the auditor's opinion is adequately supported despite an identified engagement deficiency.

Because engagement deficiencies can arise from a variety of circumstances, we encourage the Board to reinstate the following language that exists currently in AS 2901.04:

When the auditor concludes that an auditing procedure considered necessary at the time of the audit in the circumstances then existing was omitted from his audit of financial statements, he should assess the importance of the omitted procedure to his present ability to support his previously expressed opinion regarding those financial statements taken as a whole. A review of his working papers, discussion of the circumstances with engagement personnel and others, and a re-evaluation of the overall scope of his audit may be helpful in making this assessment. For example, the results of other procedures that were applied may tend to compensate for the one omitted or make its omission less important. Also, subsequent audits may provide audit evidence in support of the previously expressed opinion.

We believe it is essential to include this language in the proposed new AS 2901 because it allows for professional judgment and a scalable response to an engagement deficiency while maintaining focus on the auditor's opinion being appropriately supported by sufficient appropriate audit evidence. In particular, we believe subsequent audits are an important component of engagement deficiency remediation considerations, including whether all identified engagement deficiencies require remediation.

**Question 79. Are the proposed amendments to other PCAOB standards and rules appropriate? If not, why not? Are there additional amendments to other PCAOB standards or rules that the Board should consider?**

For the amendments to AT 1 and AT 2, we propose similar recommendations and edits as those related to AS 2901 included in our response to Question 75 above.

Additionally, given the Board's current project to modernize the interim attest standards, this could be an opportunity to create a separate attest standard like AS 2901 of the auditing standards. We encourage the Board to consider creating a separate attest standard to minimize repetition within each attest standard, especially if the Board plans to adopt new standards beyond AT 1 and AT 2 in the future.

### **Economic analysis**

**Question 87. Does our analysis appropriately capture the potential costs of the proposal? If not, please explain.**

We believe the cost analysis described on pages 276-280 of the Proposal is reasonable. In considering the details of the Proposal, we anticipate considerable added cost to implement and operate the areas of QC 1000 that are incremental to the system that Grant Thornton established to comply with ISQM 1.





## Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards

Issued 30 May 2023

ICAEW welcomes the opportunity to comment on the PCAOB's *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* published by the PCAOB on 28 March 2023, a copy of which is available from [this link](#).

For questions on this response, please contact the ICAEW Audit and Assurance Faculty at [tdaf@icaew.com](mailto:tdaf@icaew.com) quoting REP 46/23.

This response of 30 May 2023 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 19,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.

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## GENERAL POINTS AND ANSWERS TO SELECTED QUESTIONS

1. We welcome the opportunity to comment on the PCAOB's proposed auditing standard on the general responsibilities of auditors and related amendments. Framing auditor activities in a holistic manner has value and we congratulate the PCAOB on these proposals. They bring together a number of important, overarching issues relevant to the audit and the length of the standard at just 8 pages is commendable.
2. We support the proposed reduction from 45 days to 14 days for file assembly. For many, probably most, firms it will make little difference as their internal policies have required a much shorter closedown period for some time now. The 45-day limit was set when paper files were the norm, and while all firms will need to amend audit methodologies and software to comply with the proposals, only a few should need to change current practices. Other auditing standard-setters seem likely to consider whether to follow the PCAOB's lead with a view to enhancing discipline to improve audit quality.
3. However, we do not support the removal without replacement of the material on the limitations of an audit. It is critical that reasonable assurance is properly understood by investors. None of the material on the limitations of an audit that has been removed is out of date or irrelevant. Regardless of how unpalatable some of this material may appear to some, the limitations are real. Eliminating references to the limitations will not eliminate the limitations. The removal of the references can also be construed, rightly or wrongly, as representing a potentially major change of substance or regulatory direction. We do not believe that this is the intention, but the issue has caused significant concern.
4. Investors and audit regulators need to understand the limitations of an audit. While auditing standards may not be the right home for them, their removal without replacement to somewhere accessible to investors risks creating unrealistic and inappropriate expectations. The descriptions of the limitations of an audit are widely accepted globally and are reflected in ISA 200 on the auditor's general responsibilities. If they are not reinstated, they should be moved somewhere equally authoritative.
5. Absent a statement in the audit report similar to the statement in ISA 700 which requires auditors to note that reasonable assurance is not a guarantee that an audit will always detect a material misstatement, investors are in the dark.
6. We support the inclusion of requirements relating to professional ethics, auditor reporting and audit documentation within AS 1000. These are not covered in ISA 200 but are included elsewhere within IAASB and IESBA standards.
7. Other than the general observations on the proposals above, we comment only on the specific questions that follow.

### ***Question 1 – additional principles or responsibilities that are fundamental to the conduct of an audit under PCAOB standards that merit inclusion***

8. There appear to be no equivalents to paragraphs 20 to 23 of ISA 200 in proposed AS 1000. These cover a prohibition on reporting compliance with the ISAs where that is not the case in full, the need to comply with all of an ISA where relevant, and the need to perform additional procedures beyond those required specified by ISAs if necessary. These requirements protect investors by helping maintain the integrity of auditing standards. We suggest that the PCAOB consider whether these protections, limited though they are, might usefully be incorporated in AS 1000 to the extent that they are not already covered here or elsewhere.
9. Maintaining the integrity of all standards seems likely to become increasingly important globally as sustainability reporting develops, and unregulated providers of audit services enter the market for reporting on sustainability issues.

**ICAEW REPRESENTATION 46/23: PROPOSED AUDITING STANDARD – GENERAL RESPONSIBILITIES OF THE AUDITOR IN CONDUCTING AN AUDIT AND PROPOSED AMENDMENTS TO PCAOB STANDARDS**

**Question 7 – reasonable assurance**

10. Page 37 of the consultation notes the following: *AS 1015 describes reasonable assurance with additional discussion of limitations of an audit. We did not retain the descriptions of the limitations; rather we discussed how reasonable assurance can be obtained.*
11. We do not believe that the removal of the description of the limitations of an audit in the proposed standard will help protect investors, who must understand what reasonable assurance is not, as well as what it is. We support the discussion of how reasonable assurance is obtained, but absent a discussion of limitations, investors risk being inadvertently misled by the PCAOB's auditing standards.
12. The limitations of an audit no longer described appear to include paragraphs .11 - .13 of AS 1015. These state, among other things, that:
- a properly planned and performed audit may not detect a material misstatement;
  - mistakes and errors in judgment can be made;
  - the measurement of accounting estimates is inherently uncertain and depends on the outcome of future events;
  - in the great majority of cases, auditors have to rely on evidence that is persuasive rather than convincing;
  - collusion may cause auditors who have performed audits properly to conclude that evidence is persuasive when it is false. Auditors are not trained as experts in the authentication of documentation, nor are they expected to be;
  - auditors may not discover the existence of side agreements that management or third parties have not disclosed;
  - auditors are not insurers and the audit report is not a guarantee. The subsequent discovery that a material misstatement exists in the financial statements does not of itself constitute evidence that the audit was defective.
13. All of these statements remain true. If they were not, audits would be fundamentally different and would require so much time and work that they would be impracticable and unaffordable. It is important that these statements are retained, if not in auditing standards, then somewhere accessible to investors, to prevent unrealistic expectations of audit arising. Investors will not be well served by the replacement of these important, if unpalatable, facts with the very limited description in paragraph .14 which states only that reasonable assurance is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence – particularly given that reasonable assurance is described as a high level of assurance in the same paragraph.
14. Similar material has been retained in paragraphs A47 to A54 of ISA 200, and in the auditor's report under ISA 700 (Revised). AS 3101 does not contain a similar statement.
15. Furthermore, we find it curious that analogous statements do appear to have been retained in the related proposed amendments to AS 2401: Consideration of Fraud in a Financial Statement Audit (para .12), AT Section 601: Compliance Attestation (para .31) and AT Section 701: Management's Discussion and Analysis (para .29).
16. We urge the PCAOB to re-instate paragraphs .11 - .13 of AS 1015 in their entirety either in this standard, or somewhere equally authoritative and accessible to investors.

**ICAEW REPRESENTATION 46/23: PROPOSED AUDITING STANDARD – GENERAL RESPONSIBILITIES OF THE AUDITOR IN CONDUCTING AN AUDIT AND PROPOSED AMENDMENTS TO PCAOB STANDARDS**

**Question 10 – proposed amendments to clarify the meaning of ‘present fairly’**

17. We congratulate the PCAOB on the proposed amendments to AS 2810 clarifying the meaning of fair presentation. In many jurisdictions, including the UK and the USA, auditors have long been required to use their judgement in determining whether fair presentation has been achieved, above and beyond compliance with the specific requirements of the relevant accounting framework. Accounting frameworks themselves have also long required this. However, auditors need regulatory support in this area.
18. Resistance to going beyond compliance with specifics is entrenched and it is important that auditors have support for judgements based on the substance over form argument. It is also important that the PCAOB acknowledges that the amount of detail provided is critical to fair presentation.
19. It has long been acknowledged that true and fair is equivalent to fairly presents. The UK’s FRC issued *True and Fair* in 2014 but many aspects of true and fair/fair presentation remain highly relevant. This publication gives examples of UK companies that have provided additional disclosures beyond those required by law or regulation to give a true and fair view. The best-known example of this is the additional disclosure of alternative earnings per share, to provide a complete picture of performance.
20. Examples more relevant to the USA, provided by the PCAOB, would encourage auditors to be firmer on the need for different policies or additional disclosures where necessary. We believe that the issue will be increasingly important as sustainability reporting rapidly becomes more widespread in the coming years.

**Question 11 – clarifying amendments related to engagement partner responsibilities**

21. It is invariably the case that the engagement partner is assisted in the performance of his or her duties and we support the proposed amendments to ASs 1201, 1215 and 2101 clarifying obligations attached to the engagement partner’s general duty of due professional care. However, the PCAOB should acknowledge that the responsibility for the audit opinion in practice is, and should continue to be, the responsibility of the firm as a whole, in addition to the personal responsibility of the engagement partner, as embedded in law and regulation.

**Question 13 – proposed amendment to accelerate the documentation completion date by reducing the maximum period to assemble audit documentation from 45 to 14 days from the report release date**

22. We have no objections to the acceleration of the file assembly date from 45 days to 14 days. We understand that in practice, many firms routinely aim to assemble documentation within a few days of audit completion, so this will have little effect in most cases. Audit regulators should nevertheless be cognisant of the efforts made by any firms that do have to make changes of substance to comply with this enhanced requirement.
23. These changes will affect the global operations of SEC registrants and the PCAOB is a global leader in auditing standard-setting. The proposed reduction seems likely to affect audits globally.

**Question 14 – compliance with AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in the light of the proposed requirement to assemble audit documentation for retention within 14 days**

24. Delays in filing form AP are less likely to be associated with the reduction in the time period for the assembly of audit documentation than they are with difficulties communicating with other auditors, which is a separate issue. Firms should focus on file assembly before they consider form AP. It would be helpful for the PCAOB to provide guidance on audit-related activities that are permissible after the assembly of the audit file.

**ICAEW REPRESENTATION 46/23: PROPOSED AUDITING STANDARD – GENERAL RESPONSIBILITIES OF THE AUDITOR IN CONDUCTING AN AUDIT AND PROPOSED AMENDMENTS TO PCAOB STANDARDS*****Question 15 – size of a firm or type of engagement affecting the time necessary to assemble audit documentation***

25. Regulatory caution is important when raising the bar, to ensure that the gap in terms of performance standards between firms currently supervised by the PCAOB, and those that are not but may aspire to be, does not become too great and effectively closes the door to new entrants to the market. Concerns that this may be happening in jurisdictions outside the USA are growing.

May 30, 2023

Ms. Phoebe Brown  
Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K St, NW  
Washington, DC 20006-2803

**PCAOB Release No. 2023-0001, March 28, 2023: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards**

Dear Secretary Brown and PCAOB Board Members:

Johnson Global Accountancy is pleased to submit its comments on the new proposed standard AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

Johnson Global Accountancy's mission is to be the most innovative and technically excellent advisory firm at the intersection of companies, auditors, and regulators, which improves investor decision-making confidence. We serve a diverse group of audit firms ranging from single office firms to more complex regional firms and the top 20 firms. We help firms interpret, respond, and comply with global auditing and financial reporting standards and regulatory requirements, including those standards set by the PCAOB. Our team of financial reporting quality advisors helps prepare firms to perform high-quality audits using innovative tools with a shared commitment to implement effective policies, procedures, and controls. We also provide firms with integrated software and service solutions to help them comply with audit quality standards.

Overall, we support the PCAOB's objective to streamline, clarify and modernize the general requirements and responsibilities of auditors. Making the standards easier to read, understand, and apply, would enhance the performance of quality engagements and overall firm audit quality.

The proposal's scope and guidance are generally clear, and consolidating foundational standards related to reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment into one new single standard serves to clarify and simplify the requirements for auditors.

We have considered the Board's questions and are providing comments based on our experience and work with PCAOB-registered firms worldwide.

**Professional Judgement, Proposed AS 1000, paragraph 12**

Paragraph 12 explicitly requires auditors to exercise professional judgment. It explains that professional judgment "involves applying relevant training, knowledge, and experience to make informed decisions, and reach well-reasoned conclusions about the course of actions that are appropriate in the circumstances, such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements." Professional judgment is a foundational audit principle referenced in other existing standards, and we agree that describing professional judgment



here is important. We support this description and requirement and its consistency with the IAASB and AICPA definitions.

We, however, encourage the Board to add more explanatory material to this section. In our work, we have heard auditors express the need for more clarity about the degree of documentation necessary to demonstrate their reasoned judgment. While many frameworks exist, and firms have issued their own frameworks, we believe that adding a framework to the standard will assist in developing skills and clarity in this area for all auditors. In addition, consolidating guidance in one place for auditors will further the Board's objective to streamline, clarify and modernize the standards.

#### **Audit Documentation, Proposed AS 1215, paragraph 15**

The proposal proposes to accelerate the date for completing audit documentation from 45 days to 14 days. It further notes that in practice, there is a wide range of archiving periods amongst firms – everything from as short as two days to as long as 45 days. We agree that best practice would require engagement teams to archive their documentation as close to the opinion date as possible. An efficient and effective project management process would support this acceleration and be a key audit quality driver.

However, we understand that the accelerated archiving date would require certain firms to change their workflows and that certain smaller firms would incur additional costs, at least in the short term. Coupled with existing talent shortages, we are concerned about the impact of this change on the smaller firm sector and encourage the Board to reach out to these firms for additional research. We also agree that setting one archiving date for all firms is preferable; we encourage the Board, however, to provide the smaller firm sector with a more extended period to comply with the proposed standard.

We also note that the proposal does not articulate why the Board selected 14 days for archiving over another number of days. It would be helpful to expand the discussion and basis for this period.

The Board further notes that this date would differ from the 35 days provided to file the Form AP. The Form AP Rules state that "the Firm should document in its files the method used to estimate hours when actual audit hours are unavailable and the computation of total audit hours on a basis consistent with AS 1215, *Audit Documentation*. Under AS 1215, the documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the computation of total audit hours and the method used to estimate hours when actual hours were unavailable." This would seem to suggest that the Form AP 35-day deadline should also be reduced to be commensurate with the 14-day documentation completion date deadline. We encourage further study here on selecting the number of days and simplifying the requirements.

#### **Consistency with IAASB and AICPA Standards**

The proposed standard aligns in many respects with the comparable IAASB and AICPA standards. There remain, however, some differences with respect to language as illustrated in the PCAOB's March 28, 2023 "Comparison of Proposed AS 1000 with ISA 200 and AU-C 200".

Similar to our comments on the proposed QC 1000, *A Firm's System of Quality Control*, we recommend that the Board carefully consider whether these differences are necessary and will align with the Board's objective to streamline and clarify the standards.

We are concerned that these differences continue to amplify ambiguity, complexity for firms operating in multi-jurisdictions and will further strain resources and the ability to focus on audit quality. We encourage the Board to keep differences, other than those due to legal frameworks, to a minimum.

### **Professional Qualifications of the Auditor, Proposed AS 1000, paragraphs 4-8**

#### *Independence and ethics*

We support the Board’s proposal to bring forward to AS 1000 the existing requirements in AS 1005, *Independence*, and the proposal to express more directly the auditor’s obligation to comply with the PCAOB’s independence rules and standards and the SEC’s independence criteria.

As noted in the proposal, the independence requirements are vast – they are included within the standards, incremental changes made by the PCAOB since 2003, and the rules and regulations of the SEC. Accordingly, while we support the additions here, we encourage the Board to consider clarifying and consolidating all the independence requirements, including providing FAQs to assist firms in complying with this basic tenet of the audit profession.

#### *Competence*

Replacing “adequate technical training and proficiency” in AS 1010, *Training and Proficiency of the Independent Auditor*, with “competence” is clearer and aligns with the proposed QC 1000, *A Firm’s System of Quality Control*. Nevertheless, the section could use additional supporting guidance as to what components of competence mean. The proposal refers to academic education, professional experience in accounting and auditing with proper supervision and training, including accounting, auditing, independence, ethics, and other relevant continuing education. These terms are also somewhat vague; additional examples and clarification would be helpful.

### **Due Professional Care, including Professional Skepticism, Proposed AS 1000, paragraphs 9-11**

Professional skepticism includes a critical assessment of information in the audit. Proposed paragraph 11 states that the auditor’s exercise of professional skepticism includes:

- a. *Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management’s assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;*
- b. *Remaining alert to conditions that may indicate possible misstatement due to error or fraud;*
- c. *Not relying on evidence that is less than persuasive;*
- d. *Not assuming that management is honest or dishonest; and*
- e. *Consideration of potential bias on the part of management and the auditor.*

We find the above unclear and would encourage the Board to revise the language to be more direct and highlight that auditors should be neutral in their evaluation – that means evaluating evidence that both supports assertions and evidence that does not. Consider separating paragraph 11.a into two parts as follows:

*Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management’s assertions regarding the financial statements or internal control over*



*financial reporting and information that contradicts such assertions) and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence.*

*Objective evaluation of evidence includes information that (1) supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting, and (2) information that comes to the attention of the auditor that contradicts management's assertions regarding the financial statements or internal control over financial reporting.*

In addition, proposed paragraph 11 would be more straightforward if it were to require the auditor to be neutral in their assessment more directly.

We appreciate the opportunity to provide our comments and support the PCAOB's efforts to simplify and modernize auditing standards. We would be pleased to discuss our comments with you at your convenience. Please direct any questions to Jackson Johnson, President ([jjohnson@jgacpa.com](mailto:jjohnson@jgacpa.com)) or Geoffrey Dingle, Managing Director ([gdingle@jgacpa.com](mailto:gdingle@jgacpa.com)). They may be reached at (702) 848-7084.

Sincerely,

A handwritten signature in cursive script that reads "Jackson Johnson".

Johnson Global Accountancy



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May 30, 2023

By email: [comments@pcaobus.org](mailto: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

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accurate and decision-useful to investors and maintain the public trust in our capital markets,<sup>1</sup> 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 1000<sup>2</sup>, 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 intention<sup>3</sup> is not to change or expand the expectations of 'competence' of an

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

<sup>2</sup> "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).

<sup>3</sup> 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).

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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..."<sup>4</sup> The audit expectation gap is also discussed in the Release<sup>5</sup> 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

<sup>4</sup> 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](https://www.researchgate.net/publication/339797224_The_audit_expectation_gap_A_review_of_the_academic_literature)

<sup>5</sup> 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).

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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.

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As described in the PCAOB's Standard-Setting Process<sup>6</sup>, 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

<sup>6</sup> 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).

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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

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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 text<sup>7</sup>. 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.

\* \* \* \* \*

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

<sup>7</sup> 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).



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Office of the Secretary  
PCAOB  
1666 K Street, NW  
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BY ELECTRONIC SUBMISSION  
Re: PCAOB Rulemaking Docket Matter No. 046

To the Board and Staff of the PCAOB:

It is my honor to provide these comments on the exposure draft of QC 1000, a firm's system of quality control.

By way of introduction, I am a long-time institutional investor who has been the investment manager or fiduciary for more and \$100 billion in assets. I am vitally interested in protecting the quality of accounting and auditing. I believe that is a prerequisite to fulfilling the audit profession's public purpose of providing high-quality information so as to allow the proper functioning of the capital markets. I have been a member of both the WorldCom and Adelphia official creditors' committee, two of the biggest frauds and bankruptcies in history, so I understand what happens when audit quality doesn't exist.

I am member of Deloitte's Audit Quality Advisory Committee (AQAC), the PCAOB's Standards and Emerging Issues Advisory Group (SEIAG), and the Corporate Oversight and Governance Advisory Board (COGB) of CPA Canada. I was formerly a member of the PCAOB's Standing Advisory Group (SAG)<sup>1</sup> and CPA Canada's Foresight Group.

What follows are my personal opinions; nothing in this submission should be taken to mean that any member of Deloitte's management or the AQAC or the members of the AQAC, the SEIAG or the PCAOB or their members, the COGB or its members or CPA Canada necessarily agree with any of my comments. They are solely my own opinions.

First, let me congratulate the PCAOB. While efforts to maintain and improve audit quality at the engagement level are important, a firm's system of quality control is the necessary complement. Combining a robust firmwide system of quality control with engagement-level efforts will result in an audit-quality sum greater than the two parts.

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<sup>1</sup> As the QC 1000 exposure draft notes the PCAOB has explored the need for a new QC standard for more than a decade. As a member of the SAG during some of those discussions, I supported (and obviously continue to support) that effort, and can attest that the exposure draft is correct when it states, on page 18, that SAG members were generally supportive of efforts to include firm leadership, governance and culture in a QC standard.

However, I do believe there is missing context to the proposed QC 1000; there should be an explicit acknowledgement that auditing serves a public purpose and that the system of quality control therefore should serve investors and the capital markets as much as – and probably more than – it serves the firms and the issuers.

That is why I have emphasized ethics and public purpose in my comments. As an investor, it is clear to me that auditors who understand and respect the public purpose of the profession strive to have the necessary skills and mindset to perform quality audits. On the other hand, auditors inclined to take shortcuts, no matter how experienced, and no matter what the firms' systems of quality control, are quality risks. To be clear, my experience is that the majority of auditors and audit firms take audit quality seriously and have appropriate ethical standards (including independence) and act accordingly. However, scandals such as cheating on the ethics portions of state licensing exams, or seeking inside knowledge of the PCAOB's intended audit selections for its inspection program or manipulated work papers after they are selected for inspection suggest that some auditors regard ethical considerations and audit quality requirements as a game and they try to win by finding the cheat code.<sup>2</sup> Such ethical lapses not only affect audit quality but also public confidence in the profession. I don't know how an investor could trust an audit opinion signed by someone who would cheat on an ethics exam or use insider knowledge to try to rig a PCAOB inspection. They raise doubts as to whether auditors are committed to the public purpose of auditing and understand that following the rules is how that public purpose is fulfilled. Again, I have no doubts that the vast majority of auditors find such behaviors as abhorrent as I do. My hope is that a robust QC 1000, with an emphasis on ethics and purpose, can help move that proportion from the majority to virtually all.

Here are my specific comments to some of the exposure draft's questions. Please note that I have only chosen to respond to a subset of the questions asked in the exposure draft.

Q1: "Is the proposed definition of "applicable professional and legal requirements" appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?"

A: I believe that the proposed definition of "applicable professional and legal requirements" is too narrow, in that it does not explicitly include the profession's ethical standards. It should be broadened to add the applicable ethical standards of the PCAOB, SEC, state and foreign accounting licensing authorities, and IESBA.

Q5: "Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in

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<sup>2</sup> See, generally, footnotes 57-64 in the exposure draft.

accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.”

A: It is not only appropriate, but important that the standards do so. As Senators Warren and Wyden note in their recent letter to the PCAOB, when private companies such as FTX collapse, the knock-on effects create doubt about the quality of audits generally. While the PCAOB does not have authority over the audits at private firms, the fact that two PCAOB-licensed firms were involved as auditors of some portions of the FTX complex raises questions about the dedication to audit quality at those firms. Mandating that all PCAOB-licensed firms have a QC system in accordance with QC 1000 would mean that the firms would know the system of quality control for public companies. They would be aware of the processes and controls for audits performed under a system of quality control aligned with QC 1000 and how those processes and controls compare to those which are not. And, of course, private clients or the audit firms themselves could, at their own discretion, insist upon their audits being done under the QC 1000 standards, which would provide an additional layer of voluntary quality control to those audits. Additionally, the firms would undoubtedly learn of audit quality risks that cut across both public company and private company audits. One could infer a great deal about the professionalism of those firms which if they chose to not address them for private issuers, compared to those that do.

Q 18: “Are the proposed requirements for the firm’s risk assessment process appropriate? Are changes to the requirements necessary for this process? If so, what changes?”

A: I suggest three additions

- As the proposal explicitly notes, change is constant, and that these can affect the specific manifestations of quality risks. I therefore suggest that the firms be required to create, as part of the firm’s system of quality control, an individual or other entity charged with maintaining situational awareness. While the requirements state the firms should be aware of changes that create quality risks, I suggest that there be a specific requirement to identify a mechanism to do so. My personal expertise is in the financial sector, so I will use the following example: Beginning in late 2021, I had discussions that rising interest rates and the end of a very loose liquidity regime could create going concern questions for some issuers (as has now happened with crypto “exchanges” and others in the crypto ecosystem and some cash-flow-negative speculative companies). Mandating some mechanism or accountability for situational awareness would be additive to the entire system of quality control.
- There should be a requirement for a whistleblower mechanism within the system of quality control. It should include protections for whistleblowers (ability to report anonymously if desired, no retribution, etc.) and a requirement that the individual responsible for the system of quality control also be responsible for appropriately investigating whistleblower complaints related to quality issues, and remediation of issues brought to the firm’s attention via a whistleblower reporting mechanism.
- Compensation’s impacts on firm culture should be considered. As the exposure draft notes, previous SAG discussions supported considering a firm’s governance structures

and culture as a key to audit quality. A governance tenet is that compensation incents behavior, and it is as true for audit firms as it is for issuers. While the requirements talk about resources, they do not specify the compensation structure at the firm as part of the system of quality control or as a potential source of quality risk. The individual responsible for the system of quality control should also be responsible for ensuring that the compensation policies of the firm do not create quality risks and, in fact, are aligned with promoting audit quality.

Q 30. "In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?"

A: Yes. This is a vital need, and some firms already do this. As I wrote in the introduction to this submission, all these obligations need to be anchored to the firm's public purpose and ethical requirements. Auditors should be reminded, at least annually, that there is a public purpose to auditing, and that the rules exist for a reason. This "nudge" behavioral-modification tool is low-cost, both provides a rallying point for those within a firm who seek and applaud ethical behavior and a behavioral nudge to those who might otherwise succumb to the day-to-day pressures that might otherwise compromise the conditions necessary for independence and other ethical behavior. The main arguments against such annual affirmations are that it imposes a cost and that it becomes a tick-the-box exercise. I maintain that the cost is de minimus given that other annual declarations need to be made by firm personnel, so a mechanism for tracking such declarations already exists (for instance the firm-wide tracking of CPE credits). In addition, some firms already do this, which suggests that the cost is not a deterrent and that they recognize it as a benefit and cost-effective. Insofar as the devolution of such an annual declaration to a perfunctory exercise, that can (and should) be combatted by firm leadership embracing the ethics code, which would also send an appropriate signal.

Q 61: "Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?"

A: Yes. Such reports will assist the PCAOB in its prudential regulatory function and in future standard setting.

Q 69: "In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?"

A: Within the current public disclosure constraints, I suggest two additional measures.

- Firms should affirm to the PCAOB on form QC that any information that the firms voluntarily released (e.g. in transparency reports, audit quality reports, speeches by CEOs, etc.) over the time period covered by form QC was consistent with the state of their quality control system, as of the time the voluntary disclosure. This would help prevent “quality-washing” in those public documents.
  - As that affirmation does not reveal any of the firm’s QC deficiencies and only relates to the information that the firm has previously released voluntarily, that affirmation should be publicly available.
- The PCAOB should have the ability to use the information in form QC on an aggregate and anonymized basis, to report on the state of the profession’s systems of quality control.

I thank you for the opportunity to comment.

Sincerely,  
Jon Lukomnik



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May 30, 2023

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

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

Dear Office of the Secretary:

Mazars USA LLP (“Mazars USA”) welcomes the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or the Board) proposed audit standard regarding the auditor’s general responsibilities and related proposed amendments (collectively “proposed standard”) and related amendments. Mazars USA appreciates the PCAOB’s work to enhance the quality of audit engagements through the revision of existing PCAOB audit standards.

Mazars USA has over 100 partners and 900 professionals across the United States and is an independent member firm of the Mazars Group, an organization with over 1,200 partners and 30,000 professionals in over 95 countries around the world, and a member of Praxity, a global alliance of independent firms. As a member of an international network, we strive for continuous improvement by collaborating with our other member firms to set high standards for audit quality throughout the Mazars Group. Mazars USA has a unique perspective that may differ from our international counterparts due to the U.S. regulatory and litigation environment and variations in our client population.

Our view on the proposed standard is driven by our position in the U.S. marketplace as a medium sized public accounting firm servicing mostly small to mid-size public and private businesses in a variety of industries and as a member firm in a global network. We are fully committed to the highest levels of audit quality in the execution of our audits and appreciate the efforts the PCAOB invested in the detailed proposal.

We support the Board’s modernization of the foundational standards through the proposed AS 1000 and related amendments with the intent not to impose new requirements on auditors or significantly change the existing requirements of the PCAOB auditing standards. We understand and agree with the objectives of the proposed standard and related amendments to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation to enhance useability by making them easier to read, understand, and apply. However, we believe that certain aspects of the proposed standard expand the auditor’s responsibilities, reduce clarity, and may create confusion for investors and other stakeholders. The recurring themes that we express in many of our responses to the questions in the following section center around our belief that it is in the best interests of investors and other stakeholders for the auditing standards to be clear regarding the responsibilities of the auditor, the level of assurance provided, and the limitations of the auditor’s report.



We have not responded to each question asked in the proposal. Rather, we have concentrated our comments on the areas for which we have significant concerns related to implied expansion of the auditor's responsibilities, including extension of management responsibilities to that of the auditor, and the related lack of clarity that may create unintended confusion amongst stakeholders regarding the responsibilities of the auditor and the assurance provided by the auditor's report.

## Questions

**Q1** 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?

### **Response:**

We believe that the general principles and responsibilities of auditors related to reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgement are all appropriate and are the foundation for performing quality audits under PCAOB standards. We agree that the auditor has a fundamental role in serving the public interest within the financial reporting landscape; however, the language used in the proposed AS 1000.01 may cause confusion about the role and responsibilities of auditors by inappropriately implying that auditors have a fiduciary duty to investors and removing the concept of materiality in the context of the auditor's obligation to provide an objective and independent opinion on whether a company's financial statements are presented fairly.

We therefore ask the Board to consider revising paragraph .01 to remove language related to the auditor having a fundamental obligation to protect investors and adding "in all material aspects" after "presented fairly" in the second sentence of paragraph .01 to be consistent with language in other extant standards.

No additional principles or responsibilities fundamental to the conduct of an audit under PCAOB standards merit inclusion in the proposed standard and amendments.

**Q6** Are the proposed requirements related to the auditor's competence clear and comprehensive? If not, why not?

### **Response:**

We agree with the proposed requirements related to auditor competence and believe it is appropriate for such requirements to apply to the collective engagement team, including any specialists used on an audit. We recognize the importance and would expect an auditor to be proficient in the industry in which the issuer operates. This is usually the result of the partner having the relevant industry experience, but we believe it could also be the result of the other senior members of the engagement team or others within the firm with such industry experience providing support to the engagement partner.

We have concerns that the requirements as described in proposed AS 1000.07 and the example used in the release are not entirely clear. The text may imply that an engagement team is expected to be an expert in the industry in which the issuer operates and that an audit led by a partner without relevant industry expertise or knowledge, even with the assistance of other engagement team members or others in the firm with relevant industry expertise or knowledge, may not have the competence to perform the audit of the issuer.

As such, we ask the Board to consider making revisions to the language in proposed AS 1000 paragraph .07 to be clear that the competence requirements apply to the auditor and any specialists used in the audit, collectively, and that competence to conduct the audit in accordance with applicable professional and legal requirements includes "sufficient knowledge" of SEC rules and regulations relevant to the company and the related industry or industries in which the company operates.



**Q7** 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?

**Response:**

We believe that the proposed removal of certain language from the extant standards related to reasonable assurance, due professional care, and the distinction of responsibilities of the auditor and management may reduce the level of transparency regarding the auditor's responsibilities and the level of assurance provided by and limitations of an auditor's report. The auditing standards contain technical and complex concepts, and the elimination of certain language in the proposed standard eliminates valuable context regarding the meaning of the general principles and may cause some confusion.

Reasonable Assurance:

We support the Board's proposal to retain the concept of reasonable assurance from AS 1015 as a high level of assurance. However, we are concerned that removal of certain language from extant AS 1015 related to the inherent limitations of an audit reduces transparency and may result in inappropriate and unrealistic expectations of the auditor by investors and other stakeholders. The language in extant AS 1015.10 to .13 provides investors with important relevant context regarding the expectations of the auditor and the limitations of an auditor's report, including that the auditor is not an insurer and the auditor's report does not constitute a guarantee. This language is consistent with the concepts outlined in ISA 200. As such, we ask that the Board consider retaining the paragraphs from extant AS 1015.10 to .13 in the final standard.

Due Professional Care:

We believe the Board's proposal to delete paragraph .03 from extant AS 1015 as part of the consolidation into the proposed AS 1000 will result in reduced transparency related to the potential limitations of the auditor's report and may unintentionally change the meaning of due professional care. This could in turn result in unreasonable expectations of the auditor or potentially increase the level of responsibility beyond performing the audit with integrity. As such, we ask the Board to retain the reference to "Cooley on Torts" contained in AS 1015.03 in the final standard or include revisions to the proposed AS 1000.09 to incorporate the relevant concepts and limitations related to due professional care as noted in "Cooley on Torts".

Distinction Between the Responsibilities of the Auditor and Management:

We believe it is of utmost importance for investors and other stakeholders to understand the distinction between the responsibilities of the auditor and management. The language included in extant AS 1001.02 and .03 provide important context to users of the financial statements regarding that distinction between the financial reporting roles of management and those of the auditor, which we believe are important to retain in the final standard. As such, we recommend the Board retain paragraphs .02 and .03 of AS 1001 related to the distinction between the responsibilities of the auditor and management in the final standard.

Professional Skepticism:

We believe the extension of professional skepticism in proposed AS 1000.10 from the critical assessment of "audit evidence" as required in extant AS 1015 to a critical assessment of "information related to the audit" is overly broad. During the course of an audit, the auditor comes across a significant amount of information related to the audit, not all of which would be relevant to the audit itself. Without any specificity related to the Board's intended meaning of "information related to the audit", it is unclear what the actual requirement for the auditor is in the proposed standard. Further, AS 1105 provides a framework for the auditor to use to critically assess audit evidence, but the proposed AS 1000.10 and .11 do not provide a framework for the auditor to use to critically assess information related to the audit beyond that of audit evidence. As such, we ask that the Board consider revising proposed AS 1000.10 to revert back to the requirement of extant AS 1015 for the auditor to critically assess "audit evidence."

We agree with the Board's example in the release text that it is important for the auditor to exercise professional skepticism when preparing the Form AP, including evaluating the information used to prepare the Form AP. As such, we ask that the Board consider adding to proposed AS 1000.11 a requirement that the auditor critically assess information obtained and used in the preparation of the Form AP.

We agree that an auditor may be susceptible to bias; however, we have concerns regarding the introduction of a





requirement to consider auditor bias in proposed AS 1000.11, as this may create a burden on the auditor to document their consideration of every possible way the auditor's judgment may have been impacted by bias and how each consideration was resolved. Further, we believe the requirements in AS 1105 already inherently encompass consideration of auditor bias in the auditor's requirements related to obtaining sufficient and appropriate audit evidence. As such, we ask that the Board consider revising proposed AS 1000.11e to remove the requirement to consider the potential bias of the auditor.

**Q9** 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?

**Response:**

We believe that relevant PCAOB guidance including PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB contain useful information for auditors to refer to when applying the requirements of PCAOB auditing standards. However, relevant PCAOB guidance is not currently in a practical format for auditors to easily locate and distinguish between current and superseded guidance and interpretations, which we believe will lead to inconsistent application of relevant PCAOB guidance amongst auditors. Further, the language in the proposed standard does not state that the auditor should take into account only the relevant PCAOB guidance in interpretations, guidance and releases accompanying the final standards and rules of the PCAOB, which may also lead to inconsistent application of PCAOB guidance.

We recommend that the Board consider accumulating and codifying relevant PCAOB auditing interpretations, Board-issued guidance, and releases that accompany the final standards to ensure consistent application of relevant guidance by auditors. In addition, we ask that the Board consider clarifying what is encompassed within "Board-issued guidance" as the PCAOB website currently does not include any category of guidance with that description. We ask the Board to consider revising the proposed requirement in AS 1000.15 requiring the auditor to take into account only the relevant guidance accompanying the final standards and rules of the Board to avoid the auditor potentially confusing or misapplying guidance that has been progressively released.

**Q10** Are the proposed amendments to clarify the meaning of "present fairly" appropriate? If not, why not?

**Response:**

We note in the release text that the Board believes the auditor's existing obligation regarding the fairness of the financial statements extends beyond compliance with the applicable accounting framework. We do not agree that the auditor has an existing responsibility under the auditing standards to evaluate the fairness of financial statements beyond the relevant financial reporting framework. As noted in AS 3101, the auditor's responsibility is to evaluate whether the financial statements "present fairly, in all material respects, the financial position of the company...and the results of its operations and its cash flows...in conformity with the applicable accounting framework."

In addition, we do not believe it is appropriate for the auditor to make an evaluation of fairness beyond the evaluation of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework. This conclusion is supported by language in AS 2815.03, which states that the auditor's judgment regarding the fairness of the financial statements should be applied within the framework of generally accepted accounting principles and that absent such a framework, the auditor would not have a uniform standard for judging fairness.

We are concerned that the language used in proposed AS 2810.30, 17A and .30A to clarify the meaning of "present fairly" will unintentionally expand the auditor's existing responsibilities by imposing a requirement for the auditor to make a judgment concerning the fairness of the financial statements beyond the applicable accounting framework and potentially judgements around disclosures not required under the applicable financial reporting framework. Proposed AS 2810.30 FN17A may imply that the auditor is subject to the same legal responsibility as management under SEC Rule 12b-20 17, C.F.R. § 240.12b-20. While we recognize the importance of this rule as it applies to the requirement that management disclose necessary information for the financial statements not to be misleading, we do not believe it is appropriate for management's legal requirements under this rule to be applied to the auditor.

As such, we ask that the Board consider retaining the language from extant AS 2815.03 and .04 in the final standard.



**Q13** 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?

**Response:**

We acknowledge that 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 report release date may enhance audit quality. However, as acknowledged in the PCAOB's economic analysis, this could be challenging for smaller firms, which will require more time to adjust methodology, roll out new policies, adopt new staff resourcing practices, and change behaviors. Due to capacity restraints for SEC staff at many smaller firms, the proposed acceleration could also have an initial negative impact on audit quality as a result of accelerating the archiving process into the period when many SEC practice audit professionals are needed to roll on to other issuer audit engagements. The flexibility of a longer archive period would allow audit professionals to focus on audit procedures that contribute to audit quality. For example, a longer archive period would allow audit professionals rolling onto a new engagement to concentrate on robust risk assessment procedures without having to simultaneously work on finalizing the previous audit engagement files for archiving.

As such, we recommend that the Board consider a phased-in approach over a 2-year period after effective date to accelerate the documentation completion from the current 45 days to 14 days to allow firms sufficient time to implement necessary changes in methodology, policies and practices, behaviors and technology without causing unintended negative impacts on audit quality.

**Q15** Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required?

**Response:**

Yes, we believe the size of a firm may affect the time necessary to assemble a complete and final set of audit documentation. Smaller firms will have greater challenges to adjust its methodology, roll out new policies, adopt new staffing resourcing practices and change behaviors to move to a significantly reduced maximum period of time to assemble a final set of audit documentation for retention. This is due to many smaller firms not having an automated system in place to archive audit documentation and often having resource constraints within the SEC practice. As noted in our response to question 13, moving directly from a 45-day archiving requirement to 14 days may have unintended negative consequences on audit quality for smaller firms. As such, we recommend that the Board consider a phased in approach over a 2-year period after effective date to accelerate the documentation completion from the current 45 days to 14 days to allow firms sufficient time to implement necessary changes without causing unintended negative impacts on audit quality.

**Q25** 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?

**Response:**

It is important for firms to have sufficient time to adopt Proposed AS 1000 and related amendments as the proposed standard. We ask that the effective date for the standard after approval by the SEC to be tied to audits of fiscal years. Requiring compliance June 30<sup>th</sup> of the year following approval by the SEC would present challenges for firms to implement new or revised quality control policies and practices to comply with the requirements of the final standard in as little as six months, which would present additional challenges since some audits would already be in process.

As such, we recommend that the final standard be effective for audits of financial statements for periods beginning on or after December 15 of the year following final approval by the SEC. This would allow sufficient time for firms adjust existing quality control policies and practices to comply with the requirements of the new standard.



Overall, we support the proposed auditing standard and amendments and believe it will contribute to higher quality audits. We applaud the PCAOB's thoughtful consideration of the foundational standards and appreciate the opportunity to comment. We would be pleased to discuss our comments with you at your convenience.

Please direct any questions to:

- Joseph Lanza, Director, Quality & Risk Management  
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Very truly yours,

A handwritten signature in black ink that reads "Mazars USALLP". The signature is written in a cursive, slightly stylized font.

Mazars USA LLP



## Members of the Investor Advisory Group

May 16, 2023

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

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

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB or Board):

The Members of the Investor Advisory Group (MIAG) appreciate the opportunity to comment upon the PCAOB’s “Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards” (Proposal).<sup>1</sup> We agree with PCAOB Chair Erica Y. Williams that “Our capital markets never stop evolving, and PCAOB standards must keep up to keep investors protected. The Proposal would modernize standards that are foundational to audit quality, ensuring they are fit to meet today’s challenges.”

We understand the proposed standard AS 1000, “General Responsibilities of the Auditor in Conducting an Audit,” would entirely replace AS 1001, “Responsibilities and Functions of the Independent Auditor,” AS 1005, “Independence,” AS 1010, “Training and Proficiency of the Independent Auditor,” and AS 1015, “Due Professional Care in the Performance of Work.” We commend the Board for undertaking this project to bring the interim auditing standards into the twenty-first century, and approve the combination of the four single standards into one comprehensive standard. Our letter first addresses several major areas in the Proposal that we believe need attention if this is to be a high-quality standard. It then offers our views on the questions provided in the Proposal.

### **Responsibilities and Obligations to Investors**

The Sarbanes-Oxley Act of 2002 (SOX) established the PCAOB to oversee audits of public companies “...in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports” for companies the securities of which are sold to, and held by and for, public investors.”<sup>2</sup> The U.S. Supreme Court has defined and recognized the critically important “watchdog” role independent auditors serve with respect to the capital markets:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor **assumes a public responsibility transcending any employment relationship with the client.** The independent public accountant performing this special function **owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public.** This “**public watchdog**” function **demand**s that the accountant maintain **total independence** from the client **at all times** and **requires complete fidelity to the public trust.**<sup>3</sup> [Emphasis added.]

<sup>1</sup> This letter represents the views of Investor Advisory Group (IAG) and does not necessarily represent the views of all of its individual members, or the organizations by which they are employed. IAG views are developed by the members of the group independent of the views of the Public Company Accounting Oversight Board (PCAOB or Board) and its staff. For more information about the IAG, including a listing of the current members, their bios, and the IAG charter, see <https://pcaobus.org/about/advisory-groups/investor-advisory-group>.

<sup>2</sup> Sarbanes-Oxley Act of 2002, Section 101(a).

<sup>3</sup> United States v. Arthur Young & Co., 465 U.S. 805, 817-818 (1984).

In its ruling, the U.S. Supreme Court defined the responsibility and obligation of auditors to the investing public, including “the corporation’s creditors and stockholders.” It notes the ultimate allegiance of the auditor is not to the corporation being audited or to its management, but rather to those providing various forms of capital, for whom the audit is ultimately performed. While managers have the ability to obtain financial information they need in the format they desire and whenever they want it, investors do not have the same luxury. Instead, they can only rely on the auditor to work in their best interests when attesting to the audited financial statements.

We observe that the Proposal uses the word “investors” forty times, but only four of those instances are contained in the actual proposed standard. Unfortunately, the proposing release and proposed standard use the term “client” throughout, referring to the company and its management as the “client”, failing to recognize the “public responsibility transcending any reemployment relationship with the client.” In those instances where the term “client” is referring to the company and its management, we would prefer that “client” be replaced with the term “company under audit.” In fact, we would prefer to see it handled this way in any future proposed standards.

While paragraph .01 of the Proposal reminds auditors of their “fundamental obligation” owed to investors, it is a vague, nebulous concept that goes undescribed in the rest of the proposed standard. As drafted, the wording is left open to an array of interpretations as to whether that obligation is legal or regulatory in nature, and whether the obligation is binding or enforceable. Without a clear articulation of their obligation to investors, how can auditors and investors assess whether that obligation has been met? For that matter - how can the PCAOB assess the fulfillment of that obligation in their reviews of auditors’ work?

We believe the PCAOB should insert into the final standard language consistent with the previously cited U.S. Supreme Court opinion and any subsequent related court rulings. Using consistent wording would more clearly articulate and set forth the role and responsibility of the independent auditor to the corporation’s creditors and stockholders. The PCAOB also cited the Court’s opinion in its proposing release on quality controls issued in 2022. Given the significance of this opinion to the responsibilities and obligations of independent auditors, inserting it into a final standard would certainly enhance the standard.

Exacerbating the vagueness of the phrase “fundamental obligation,” paragraph .15 is equally opaque when it says, “the auditor should keep in mind their role in protecting investors.” Where is “their role” clearly articulated? How can they “keep it in mind” if they are not made aware of their role? The opening paragraph of Section B. of the Proposal, which is not part of the proposed standard per se, is somewhat more descriptive of auditors’ obligations to investors, and should be incorporated into the final standard – albeit with more authoritative references to court decisions that legally define auditors’ responsibilities.

Furthermore, the proposed standard does not even define “investors.” We find that in practice, the audit opinion is often addressed to the board of directors and shareholders. Such wording suggests that the audit report is not intended for or relevant to debtholders, general creditors or other users of financial statements, which we know is simply not true.

Therefore, we recommend the Board incorporate a definition of “financial statement users,” which brings a broader spectrum of capital providers into this proposed standard. This broader term should be consistent with the opinion of the U.S. Supreme Court cited above and with the language in SOX. To minimize the risk of inconsistencies between authoritative accounting and auditing standards, any wording should be aligned with Financial Accounting Standards Board’s Concepts Statement 8, “Conceptual Framework for Financial Reporting.” There is an appropriate symmetry to this: the Concepts Statement underlying the presentation of financial statements makes clear who are the users of financial statements. The Proposal is laying the groundwork for the professional execution of an audit of financial statements and should be equally clear about who the users of such financial statements may be – and the auditors’ responsibility to them. We include the Concept Statement 8 description of financial statement users here:

*OB5. Many existing and potential investors, lenders, and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.*

The Concept Statement's basis for conclusions holds satisfying reasons for its description of financial statement users:

*BC1.16 The reasons why the Board concluded that the primary user group should be the existing and potential investors, lenders, and other creditors of a reporting entity are:*

*a. Existing and potential investors, lenders, and other creditors have the most critical and immediate need for the information in financial reports and many cannot require the entity to provide the information to them directly.*

*b. The Board's and the IASB's responsibilities require them to focus on the needs of participants in capital markets, which*

*include not only existing investors, but also potential investors and existing and potential lenders and other creditors.*

*c. Information that meets the needs of the specified primary users is likely to meet the needs of users both in jurisdictions with a corporate governance model defined in the context of shareholders and those with a corporate governance model defined in the context of all types of stakeholders.*

**As mentioned above, the Proposal lays the groundwork for the execution of professional audits. In such a standard, we believe it is critical to remind auditors exactly whom they are serving when conducting a professional audit. Given the recent discussions about the lack of critical audit matters appearing in audit reports, auditors need to be reminded of exactly whom they should be communicating the results of their examinations.**

### **Fairly Presents**

We support the Board updating the auditing standard (AS 2815) stating what is meant when an auditor's opinion states the financial statements "present fairly." This standard was initially issued in July 1975, as a result of the well-known case referred to in auditing textbooks, *United States v. Simon*.<sup>4</sup> The central issue was the "fair presentation" of financial statements and disclosures of related party transactions. At the time of the case, neither generally accepted accounting principles (GAAP) nor generally accepted auditing standards (GAAS) included a standard on related party transactions. As a result, the auditors argued "...the jury was also required to accept the accountants' evaluation whether a given fact was material to overall fair presentation ...." In light of the lack of a GAAP or GAAS standard, the auditors argued the jury/court had to accept a judgment made by the auditor and "...only on the need for the auditor to make an honest judgment and their conclusion that nothing in the financial statements themselves negated the conclusion that an honest judgment had been made." However, the lower court disagreed as did the appellate court which ruled, "[s]uch evidence may be highly persuasive, but is not conclusive, and so the trial judge correctly charged." The U.S. Supreme Court denied a request for a review of the decision of the appellate court.<sup>5</sup>

As a result of the Court's decision in this case, the auditing standard stating what is meant by "fairly presents" was subsequently adopted and periodically updated. It recognizes that a standard setter or regulator cannot be expected to write standards that are all-encompassing with respect to all business transactions. As a result, the auditor needs to consider transactions and disclosures in the financial statements. AS 2815 currently states:

The auditor's opinion that the financial statements present fairly...in conformity with generally accepted accounting principles should be based on his or her judgment as to whether (a) the accounting principles selected and applied have general acceptance; (b) the accounting principles are appropriate in the circumstances; (c) the financial statements including the related notes, are informative of matters that may affect their use, understanding, and interpretation...; (d) the information presented in the financial

<sup>4</sup> *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969). "

<sup>5</sup> "AICPA Brief in *Continental Vending*," Amicus Curiae brief filed by AICPA in *Continental Vending* case, published in the *Journal of Accountancy*, May 1970, states the U.S. Supreme Court denied the petitioners' request for review on March 30, 1970.

statements is classified and summarized in a reasonable manner, that is, neither too detailed or too condensed...; and (e) the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in the financial statements. [footnote omitted]

Unfortunately, the proposed revisions on page A2-2, paragraph .31 of the Proposal refer to a financial reporting framework, but those revisions do not discuss when such a framework does not provide guidance. Those revisions have eliminated the actions currently mandated for auditors in cases where financial statements and accompanying notes do not disclose the necessary information required by the existing financial reporting framework. It also revises the language used in the current standard, such as in (c) above, which is not as clear and articulate as the current standard. Finally, the proposed standard would have a footnote 17A which states: "For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose 'in a statement or report...such further information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading.')." This language is drawn from the federal securities laws as well as the U.S. Securities and Exchange Commission's (SEC) rules, and companies are required to comply with them. Given the significance of this requirement, it would improve the standard if this language were in the body of the text and not relegated to a footnote.

On pages A2-3 and A2-4 of the Proposal, indicates the following language from AS 2815 is being moved to AS 2810:

Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of the transactions or events differs materially from their form.

However, we note that on page A2-3, only language similar to the second sentence is moved to the proposed AS 2810. We believe it is important to include the first sentence in AS 2810 as well.

**Perhaps the notion of an auditor evaluating "fairly presents" is best summed up by Warren Buffett. He noted that as a member of an audit committee, he would ask the audit partner and Chief Financial Officer one simple question, along the lines of this:**

**With all your knowledge and given what you know about the company today, is there any material information regarding that company that has not been disclosed, that if you were investing in the company, you would want to know?**

**As such, the Board should consider going substantially further. Audit firms should ensure that auditors focus on whether the financials are a fair presentation of the company's position rather than narrowly focusing on whether the company is following U.S. GAAP.**

### **Responsibility for Detecting Material Financial Statement Fraud**

We agree with how the PCAOB has restated the objective and responsibility of the auditor to detect material financial statement fraud, which is consistent with the current auditing standards and report of the independent auditor. We also understand the PCAOB is considering how to enhance the auditor's detection of material fraud. We note the former Chief Executive of PricewaterhouseCoopers has also indicated it is the auditor's responsibility to detect fraud when he stated in a Wall Street Journal interview:

WSJ: Is it an auditor's job to try and find fraud?

Mr. Nally: Absolutely. We have a responsibility to perform procedures that are detecting fraud just like we have responsibilities to perform procedures to detect errors in financial statements.

WSJ: You seem pretty certain, but the firms as a whole often eschew some responsibility for finding fraud, especially in court.

Mr. Nally: The audit profession has always had a responsibility for the detection of fraud. The debate has always gone toward how far do you carry that, what type of procedures do you have to develop and in what environment. The classic issue becomes the cost benefit of all of that and this is why I think there is this expectation gap.<sup>6</sup>

We note on page A1-5 of the Proposal, that the PCAOB has stated under Due Professional Care, an auditor should not assume that management is honest or dishonest. But in the report of The Panel on Audit Effectiveness, it was recommended:

“...auditors should modify the otherwise neutral concept of professional skepticism and presume the possibility of dishonesty at various levels of management, including collusion, override of internal control and falsification of documents. The key question that auditors should ask is “[w]here is the entity vulnerable to financial statement fraud if management were inclined to perpetrate it?”<sup>7</sup>

**Accordingly, the PCAOB should consider the implications of its project on fraud with respect to the language it uses regarding professional due care and avoid predetermining the outcome of its project.**

### **Sound Professional Judgment**

In the proposed AS 1000, the PCAOB discusses due professional care and determining “... that significant judgments and conclusions on which the auditor’s report is based are appropriate and supported by sufficient appropriate evidence.”<sup>8</sup> Indeed, professional judgments may be appropriate and at times, they have also been found to be erroneous. In recognition of this, The International Ethics Standards Board for Accountants (IESBA) International Code of Ethics for Professional Accountants, states in “Subsection 113 – Professional Competence and Due Care” that:

“Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.”

**When referring to judgment in a final standard for due professional care, we recommend the PCAOB, as IESBA has done, refer to “sound” judgment. We also noted the PCAOB has referred to “sound” accounting in the Proposal.**

### **Authoritative Guidance Not Included in Final Standard**

As discussed further below in response to Question 9 and set forth in footnote 26 to the proposed standard, the Proposal contains authoritative guidance that is not included in the actual standard. This approach runs counter to efforts in the profession to “codify” all relevant and applicable standards an auditor or accountant is required to follow, into the codification of such standards.

**By using the approach set forth in footnote 26, and not including this guidance in the actual standard itself, it will serve to have a negative impact on training of students in auditing, increase the time required of auditors to search various sources for relevant guidance, thereby increasing the cost of audit, increasing the likelihood and auditor may miss an audit requirement, and lower the quality of the audit. Accordingly, we urge the Board to include relevant guidance that is in the proposing release, into the final standards.**

### **Comparisons to the Work of Other Auditing Standard Setters**

We encourage the PCAOB to develop and adopt guidance and standards that will result in the highest quality standards. In attaining the highest quality standards, we believe it would be useful in writing standards, that the PCAOB should consider the contents of the similar standards issued by the AICPA Auditing Standards Board, the International Audit and Assurance Standards Board and the IESBA, and assess whether they have any guidance in their standards that may result in higher quality audits.

<sup>6</sup> David Reilly, Accounting’s Crisis Killer, Wall St. J., Mar. 23, 2007, <https://www.wsj.com/articles/SB117461651648146411>.

<sup>7</sup> Panel on Audit Effectiveness, Report and Recommendations: August 31, 2000, U. Miss. eGrove 88-89 (footnote omitted), [https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1351&context=aicpa\\_assoc](https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1351&context=aicpa_assoc).

<sup>8</sup> Proposed Auditing Standard – General Responsibilities of the Auditor in conducting an Audit and Proposed Amendments to PCAOB Standards, Release No. 2023-001, at A1-4.



**Possibly, this kind of comparison has already been made in preparing the Proposal, but there is no evidence of it. Inclusion of this kind of comparison, in tabular form, would likely stimulate additional comments from the PCAOB's interested parties.**

## **Responses to Questions**

Our address of the listed questions follows:

*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?*

While we are in general agreement with the principles and responsibilities described in the Proposal, we have been genuinely concerned about the general lack of critical audit matters appearing in audit reports. We hold this to be an especially important communication between the auditor and users, and in practice, we believe it has been reduced to nearly a “check-the-box” exercise. We believe that the Proposal, which deals with professional standards, should emphasize the importance of these communications to financial statement users. We request that critical audit matters be explicitly addressed as a “must contain” item in the auditor’s report, in paragraph .17a. We understand that it is referenced in footnote 30, but we recommend that the entire footnote 30 be elevated to inclusion directly in paragraph .17a. Treating it as a footnote underplays its importance.

On page A4-23 of the Proposal, it discusses in paragraph .11 Determination of Critical Audit Matters. In item (2) of that paragraph, it uses the term “especially” which has given rise to a concern this term is being used to avoid reporting of a critical audit matter. We believe this word should be deleted.

We would also suggest that the training of auditors should be required to include a focus on users of financial information, including investors, as the primary beneficiary of the audit process. Another area of auditor training that would benefit investors is increased training on the concept of materiality. We would suggest that paragraph .08(c) be revised along these lines:

“Training, including a focus on investors as the primary beneficiary of the audit process, and how audits can be made more transparent and responsive to investor needs, as well as accounting, auditing, independence, ethics, materiality and other relevant continuing professional education.”

In addition, it has been found that a common characteristic of frauds that were not detected by independent auditors, is that they did not understand the business they were auditing, as required by the PCAOB auditing standards. In the case of *Colonial BancGroup v. PricewaterhouseCoopers LLP* the judge stated: “It is axiomatic that an auditor cannot audit what the auditor does not understand.”<sup>9</sup> The opinion goes on to further state: “Therefore, the auditing standards require an auditor to obtain a sufficient level of knowledge of its client’s business sufficient such that the auditor can properly plan and perform an audit in accordance with GAAS. AU § 311.06...”<sup>10</sup>

As a result, we agree with paragraph .07 of AS 1000 and believe it could be strengthened to highlight that competence must include experience with and an understanding of the operations of the business that affect the financial statements being audited.

*2. Is the approach to reorganize and consolidate the general principles and responsibilities appropriate? If not, why not?*

We believe the approach taken in the Proposal is appropriate. See our previous comments.

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<sup>9</sup> *Colonial BancGroup v PricewaterhouseCoopers LLP*, No. 2:11-cv-975-BJR, Order on the Liability Phase of the PWC Bench Trial, at 35, (M.D. Ala. Dec. 28, 2017), <https://www.dandodiarary.com/wp-content/uploads/sites/893/2019/03/pwc-liability-order.pdf>.

<sup>10</sup> *Id.*

*3. Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?*

See our discussion appearing before our responses to the listed questions. Also, see our response to Question 1. Furthermore, we suggest the addition of the word “and” immediately before the phrase “in conformity.” As currently read, “are presented fairly, in all material respects, in conformity with the applicable financial reporting framework” limits analysis to the financial reporting framework. Adding the term makes clear that there is an expectation that the financials are presented fairly, in all material respects in addition to conforming to the applicable financial reporting framework. This addresses the issue presented in the *United States v. Simon* case.

*4. Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not?*

As set forth in the three paragraphs on page A1-2, there is little said with respect to Independence and Ethics. But in response to the question, the standard could be improved by:

1. Also stating an auditor cannot subordinate their judgment to others, with respect to the audit. This would include not only within the audit firm associated employees of that firm, but also with respect to others such as management and employees of the company being audited or external specialists whose work the auditor relies upon, such as actuaries or valuation specialists. The new proposed EI 1000 only discusses subordination in the context of others within the same auditing firm.
2. The standard would be greatly enhanced if, as with the SEC Rule referenced, the final standard stated: When determining whether an auditor is independent, the SEC and PCAOB “will consider all relevant facts and circumstances”<sup>11</sup> Disclosure by the company and/or auditor or approval of a violation of an SEC or PCAOB rule by an audit committee does not “cure” the violation.
3. An auditor may only include in the heading to the auditors’ report that they are an independent accountant, if they have complied with the SEC and PCAOB rules.

*5. Are the proposed requirements related to ethics clear and comprehensive? If not, why not?*

No. The proposed standard fails to address the items set forth in the response to Question 4. above. The proposed standard fails to address ethics in a meaningful way. The statement in paragraph .06: “The auditor must comply with applicable ethics requirements, including the rules and standards of the PCAOB” does not make for a robust ethical requirement where one is greatly needed. During our March panel discussion on fraud, Andy Fastow made the point that before Enron reached its end, the company’s auditors put their heads together with management and helped Enron in producing ways to work around the rules. The weak language in the proposed standard indicates that such activity is in fact ethical given that the focus remains on merely complying with the “rules and standards of the PCAOB.” As such, ethics need not apply.

*6. Are the proposed requirements related to the auditor’s competence clear and comprehensive? If not, why not?*

As discussed earlier, we believe the proposed requirements related to auditor competence should discuss the need for knowledge of the business being audited, including knowledge of its operations that affect the financial statements and risks of material errors in those statements.

*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?*

See the comments above, including with respect to the use of “sound judgment.” We recommend that the final standard be strengthened regarding the exercise of professional skepticism. We believe the final standard should explicitly state: “In evaluating any potential bias of its own, the auditor should affirmatively consider the risk of bias, particularly confirmation bias, arising out of the financial relationship between management and the auditor.”

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<sup>11</sup> See Qualifications of Accountants, 17 C.F.R. § 210.2-01 (as amended 2020), available at: <https://www.law.cornell.edu/cfr/text/17/210.2-01>.

The PCAOB's standards require an auditor to act with due professional care. An auditor's engagement letter with the audit committee of a public company states the auditor will perform its audit in accordance with PCAOB standards, as does the auditor's report to investors. Due professional care was appropriately described in the Colonial BancGroup v. PricewaterhouseCoopers LLP litigation by Judge Watkins when noted that:

In Alabama, one who contracts with another and expressly promises to use due care is undoubtedly liable in both tort and contract when his negligence results in injury to the other party. He is liable in contract for breaching an express promise to use care. He is liable in tort for violating the duty imposed by law on all people not to injure others by negligent conduct.<sup>12</sup>

We agree with and support the standard that an auditor provides a high level of assurance. This standard should not be lowered.

The U.S. Courts have held an auditor is responsible for detecting material errors from fraud.<sup>13</sup> Paragraph 3. of AS No. 8 (Audit Risk) states "To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud." The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud". Paragraph .09(d) of AS 3101 (The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion) requires each and every independent auditor's report contain: "A statement that the PCAOB standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements, whether due to error or fraud." And paragraph .C1(b)(1) of AS 1301 (Communications with Audit Committees) requires the auditor to annually include in each engagement letter, that the auditor is responsible for conducting the audit in accordance with standards of the PCAOB. This includes that the auditor must: "Plan perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether from caused by fraud or error, and whether effective internal control over financial reporting was maintained in all material respects." Accordingly, the auditor's responsibility for the detection of fraud has been clearly established and that responsibility is no longer a matter of "an expectation gap."

As paragraph .14 of the Proposal indicates, "reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence." We note that reducing audit risk is a dynamic, fluid process that differs from one audit to another. We recommend that the final standard includes guidance towards determining whether audit risk is reduced to an appropriately low level, requiring consideration of changes in technology, the nature and quality of an issuer's financial reporting system, relevant academic and other research, and any other factor that can reduce the risk of material misstatements or fraud.

We also concur that the final standard should require an auditor to exercise due professional care "in all matters related to the audit." Also, see the comments above with respect to the detection of fraud and the mindset of an auditor.

*8. Are the general principles and responsibilities appropriate in light of the availability of electronic audit tools and the use of audit software by both larger and smaller firms? If not, what changes should be made?*

See the previous comments above. We do note that machine learning and AI technologies are progressing rapidly, so there is a need to consider future possibilities and uses as well.

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<sup>12</sup> Colonial BancGroup v PricewaterhouseCoopers LLP, No. 2:11-cv-975-BJR, Order on the Liability Phase of the PWC Bench Trial, at 25-26.

<sup>13</sup> See *e.g., id.* at 29 ("The Court concludes that PWC did not design its audits to detect fraud and PWC's failure to do so constitutes a violation of the auditing standards.").

*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?*

As stated above, we believe authoritative guidance should be included in the final standard, not in the accompanying release. We believe the approach adopted in the Proposal could increase the costs incurred and lower the quality of audits. It would also be much more difficult, especially for younger auditors who provide the vast majority of audit hours incurred, for training and remaining competent with audit requirements.

*10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not?*

We believe the proposed amendments to clarify the meaning of “present fairly” are generally appropriate, but we note that when the auditor evaluates the financial statements for fair presentation, it is an exercise in professional judgment. Paragraph .30A should mention that professional judgment bears heavily on the evaluation, as a reminder to auditors that their professional judgment might be called into question if financial statements do not “present fairly.”

See the previous comments made with respect to “fairly presents” as well as with respect to “sound” judgment. See also, for consideration the concept that referencing to the “applicable financial reporting framework” should not represent a limiting factor to fair presentation.

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

On page 22 of the proposing release, it discusses that the audit partner is responsible for assigned tasks and supervision. We agree with this. However, as recommended by the Panel on Audit Effectiveness, “An important objective of these discussions...would be to identify the appropriate engagement team members to address the potential for fraud (e.g., the engagement team members who should interview company personnel) and how their work is to be supervised and reviewed.”<sup>14</sup>

*12. Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?*

See comments above.

*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?*

Given the trend toward electronic audit workpapers, which we hold to be profession-wide and not restricted to just the largest of firms, we find the reduction of the time period to be quite achievable and would recommend that it be shortened further – to the 2 days that the PCAOB has observed in its inspections. The Proposal makes a good argument for why the completion period should be shorter in an age of instant documentation and communication, but it fails to make a convincing argument for why 14 days is better than any other shortened period. We believe that the shorter the period, the less chance there is for the occurrence of any revisionist history by the auditor. We also believe that the shorter period would allow the PCAOB to schedule its inspections more efficiently, providing additional benefits to investors.

*14. Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?*

Given that we see no real difficulties in shortening the documentation assembly time by at least 31 days, we see no reason that the time for filing the Form AP should take as long as 35 days. Accordingly, we believe that the filing of Form AP should also be shortened correspondingly to the maximum time period selected for the audit workpaper assembly.

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<sup>14</sup> Panel on Audit Effectiveness, Report and Recommendations: August 31, 2000, U. Miss. eGrove at 88. The Panel on Audit Effectiveness, Report and Recommendations, August 31, 2000. Page 88.

*15. Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required.*

We believe that companies that approach the public markets for capital should be reporting financial statements of the highest quality, and we are not favorably inclined to automatically reduce reporting requirements for them simply because of their size. We hold the same belief regarding their auditors. Furthermore, if auditors are willing to assume the risks of auditing publicly traded firms and to reap the consequent rewards, they should be fully prepared to abide by the rules and standards set by the PCAOB without exceptions. Therefore, we do not prefer to see any “scaling” of the time necessary to assemble a complete and final set of audit documentation once the time frame has been set by the PCAOB.

*16. Are the amendments to the general principles and responsibilities described in the PCAOB’s attestation standards appropriate? Should other relevant amendments be made to the PCAOB’s attestation standards? If so, what are they?*

We note that American Institute of Certified Public Accountants (AICPA) AU-C Section 230 on Auditor Documentation includes useful guidance that is not included in the Proposal. For example: Paragraph .13 states that if an auditor judges it necessary to depart from a requirement, the auditor must document the justification for the departure, how alternative audit procedures performed were sufficient to meet the intent and objective of the standard. We believe this language should be incorporated into the final standard as it would provide accountability and discipline to the auditing process. It would also greatly enhance the supervision and review process.

*17. Are the amendments to the general principles and responsibilities described in AS 4105, Reviews of Interim Financial Information, appropriate? Should other relevant amendments be made to AS 4105? If so, what are they?*

To the extent they are consistent with the Proposal for audits, we have no comment.

*18. We request comment generally on the baseline for evaluating the economic impacts of the proposed standard. Are there additional factors we should consider? If so, what are they? Is there any evidence that auditors are failing to understand their obligations under today’s standards, or that the standards set insufficiently robust expectations and obligations associated with the performance of an audit? If so, please explain.*

We believe the “foundational” standards as proposed, are consistent with the existing standards that auditors are currently required to comply with when performing an audit in accordance with the standards of the PCAOB. As such, the proposed changes should not result in any significant additional costs to auditors or the companies they audit. Likewise, it is unlikely they would provide any significant benefits to market participants. However, there are benefits such as the ability to inspect audits quicker, enhancing audit quality, and some changes which would bring greater accountability and discipline to audits that should be useful to investors, without significantly increasing costs.

*19. We request comment generally on the analysis provided above regarding the need for the proposal. Should we consider any additional arguments, academic studies, or sources related to the need for standard setting? If so, please specify.*

See our comments in this letter, located before these listed question responses.

*20. Are there additional potential benefits and costs that should be considered? If so, what are they? Please provide relevant data or other reference information.*

See previous comments.

*21. We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?*

If the final standards do not include authoritative guidance set forth in the accompanying release, we believe the possibility exists for the negative results described above.

22. *Are there any other economic impacts we did not describe above that are relevant for consideration? If so, please specify.*

We do not foresee any other economic impacts not already described.

23. *What academic studies or data should the Board consider in evaluating the potential benefits and costs of the proposed requirements? Please provide citations and other reference information for such studies and data.*

At this time, we cannot offer any suggestions; we will supply any relevant studies or data, however, if we discover them soon after the submission of this letter.

24. *The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.*

The MIAG includes former audit partners among its members. Based on the experience of all our members, we believe the analysis of the impact of the Proposal on EGC's is reasonably accurate. We support the Proposal's conclusion that the standard should apply equally to audits of EGCs. See our response to Question 15: our reasoning in that answer applies to the financial reporting requirements of EGCs and to their auditors as well.

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?*

In the worst-case scenario, the SEC would approve the Proposal on December 31, making compliance required in six months. That might be sufficient for firms that have been following the approval process and readying themselves for changes. If firms are not preparing for changes, one might question why they should be allowed to be registered with the PCAOB and to audit publicly traded firms.

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We remind the Board that the views expressed in this letter are solely those of the Investor Advisory Group members who prepared them and do not necessarily reflect the views of the PCAOB, the PCAOB staff, the members of the Board, or the Board's staff. Those views do not necessarily represent the views of its individual members, or the organizations by which they are employed.

If you, any members of the Board, or your staff have questions or seek further elaboration of our views, please contact Amy McGarrity at [amcgarrity@copera.org](mailto:amcgarrity@copera.org).

Sincerely,

*Members of the IAG*



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May 25, 2023

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

Via email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Rulemaking Docket Matter No. 049 – Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit, and Other Proposed Amendments to PCAOB Standards**

Dear Members of the Public Company Accounting Oversight Board (PCAOB):

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to comment on the PCAOB's Proposed Auditing Standard, *General Responsibilities of the Auditor in Conducting an Audit, and Other Proposed Amendments to PCAOB Standards* (Proposal).

Founded in 1908, NASBA serves as a forum for the nation's Boards of Accountancy (State Boards), representing fifty-five jurisdictions. NASBA's mission is to enhance the effectiveness and advance the common interests of the State Boards that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories, which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

In furtherance of that objective, NASBA offers the following comments.

### **General Comments**

NASBA commends the PCAOB for their continued efforts in modernizing the standards. As noted in the Proposal, since the PCAOB's adoption of the foundational standards, both the International Auditing and Assurance Standards Board and the Auditing Standards Board of the AICPA have updated their analogous standards. NASBA commends the PCAOB for conforming, when possible, to those standards.

Leveraging the work performed by other standard setters and making standards uniform wherever possible helps avoid confusion and potential misapplication by the CPA and aids in enforcement from a regulatory perspective. Consistency among standard setters is in the public interest.

### **Conducting an Audit**

Paragraph 15 of proposed AS 1000 states that “the auditor must comply with applicable professional and legal requirements in conducting an audit.” The paragraph references Note 26 that the auditor should take into account relevant guidance applicable to the audit and that relevant guidance includes PCAOB auditing interpretations, Board-issued guidance and releases accompanying the standards and rules of the PCAOB.

NASBA believes that it is not clear whether all of the referenced classes of guidance are considered authoritative. This could potentially create confusion as to the hierarchy of PCAOB standards and guidance. From a regulatory perspective, enforcement could be problematic when considering whether a standard has been violated.

### **Audit Documentation**

Paragraph 15 of AS 1215 proposes to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days. The Proposal states that a 14-day period between the report release date and the documentation completion date would enable the PCAOB to potentially begin the inspection process sooner after completion of an audit, which could enhance investor protection and ultimately enhance investor confidence. We agree with the stated goal of enhancing public protection. While addressing this goal, it should be remembered that auditors are already required to document the date that information is added after the report release date. As a guiding principle, NASBA believes that it may be more important that the file be complete and of high quality, void of documentation errors and omissions.

We believe that other factors should be considered in this area. While improvements in technology have generally enhanced the task of assembling audit documentation, audit completion and other reporting requirements have increased in complexity and extent since the 45-day period was established. For example, firms are required to report on critical audit matters. In addition, the use of automated audit tools has not necessarily been fully embraced by all firms and will require additional investments in resources to facilitate that goal. Finally, technological risks have increased during that period with the increasing occurrences of hacking and other cyber security events. Resulting technology interruptions or any type of cyber security matter could impact the ability of the auditor/audit firms to meet these deadlines. NASBA is concerned that the 14-day period may be too short to handle any unforeseen consequences and may result in inadvertent non-compliance, which, from a regulator’s perspective, is not in the public interest.

Additionally, paragraph 15 of AS 1215 includes a proposed change that states “...If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 14 days from the date that fieldwork was substantially completed.” It is possible that 14 days may elapse from the date of substantial completion of fieldwork until a decision is made to not



issue a report. NASBA recommends that in those cases the start of the documentation date be the date when the decision is made to not issue the report regardless of the status of fieldwork.

### **Integration with QC 1000**

The Proposal makes reference to integration with QC 1000, which we understand has not yet been finalized. As QC 1000 is currently still under consideration, reference to QC 1000 may need to be revisited upon finalization.

### **Definitions**

NASBA recommends, as a guiding principle, that any changes or clarifications to existing terminology or phrases be substantive with clear rationale for the change. Many definitions and terminology have long-standing legal precedent and several decades worth of court adjudication around them. The PCAOB should reconsider if the new definitions or clarifications included in the Proposal are absolutely necessary.

### **Effective Date**

NASBA is concerned with the proposal to require compliance with the proposed standard and related proposed amendments by June 30 in the year after approval by the SEC. Depending on the approval date by the SEC, requiring implementation by June 30 in the year after approval could result in a wide variety of effective implementation dates and in some cases that timeframe could be very brief.

We would recommend the effective date be linked to the fiscal year beginning after the date of SEC approval in a manner which would allow at least one full year before the fiscal year end of adoption. Effective implementation of standards is in the public interest.

### **Special Consideration for Emerging Growth Companies (EGC)**

While the risk profile of an EGC is different from more mature entities, we agree that the Proposal should apply to EGCs. To exclude EGCs from the Proposal would be inconsistent with protecting the public interest.

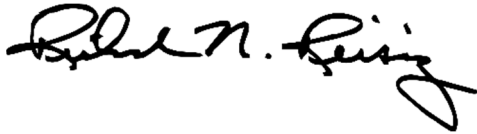
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Public Company Accounting Oversight Board  
May 25, 2023

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Again, we appreciate the opportunity to comment on the Proposal.

Very truly yours,

Handwritten signature of Richard N. Reisig in black ink.

Richard N. Reisig, CPA  
NASBA Chair

Handwritten signature of Ken L. Bishop in black ink.

Ken L. Bishop  
NASBA President and CEO



**Plante & Moran, PLLC**  
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May 30, 2023

Sent via e-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

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

**Re: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards; PCAOB Rulemaking Docket Matter No. 049**

Dear Office of the Secretary:

Plante & Moran, PLLC (“PM,” “the Firm,” or “we”) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (“PCAOB” or the “Board”) proposed new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (proposed standard or proposed AS 1000) and other proposed amendments to PCAOB Standards. We support the objectives of the proposal as set forth by the Board to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand and apply.

We fully agree with and join in the comments submitted by the Center for Audit Quality. Specifically, we agree with the auditor’s fundamental role to serve the public interest. However, we believe that certain aspects of the proposed AS 1000 may expand the auditor’s responsibilities, whether or not the PCAOB intends for that to occur. The proposal, as currently written, raises concerns that the expectations of the auditor’s responsibilities go beyond the applicable financial reporting framework and, similarly, that the auditor’s expertise goes beyond accounting and auditing. Further, certain proposed requirements for the auditor to consider various guidance are overly broad and do not provide the auditor with sufficient detail, nor a sufficient framework to allow them to effectively and consistently comply with proposed requirements.

Our comments below address only those aspects of the proposed standard about which we have additional comments beyond those already noted in the comment letter submitted by the Center for Audit Quality.

*Q7. 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?*

We do not believe the proposed requirements and related descriptions of the general principles are sufficiently clear and comprehensive, and we encourage the Board to revisit those aspects of

the proposal. Investors are best served when they have a clear, consistent, and transparent understanding of the role that an auditor plays in the financial reporting ecosystem. That understanding—which is founded on PCAOB standards—is fundamental to ensuring that investors accurately perceive what an audit is and what an audit is not. We are concerned that, if adopted as proposed, the amendments to AS 1000 will introduce unwarranted investor confusion regarding the auditor’s role with respect to financial statements and, where applicable, internal control over financial reporting. That confusion will arise directly from the Board’s removal of key contextual language used in the extant standards to describe reasonable assurance and due professional care.

Furthermore, we believe that the proposal does not adequately account for the significant economic costs associated with the proposed changes to the general principles. Many of the proposed changes would remove language that today provides critical context and transparency regarding the role of the auditor. Removing such language will exacerbate the already problematic audit expectations gap and sow confusion in the established legal landscape regarding the auditor’s duties. If the Board does not intend to alter the role of the auditor—as it asserts throughout the proposing release—then we encourage the Board to retain language from the extant standards in the descriptions of the general principles as outlined herein.

#### Reasonable Assurance

Under current PCAOB standards, reasonable assurance is not only defined directly (see AS 1015.10), but also indirectly through language that explains the import of what reasonable assurance does not include. For example, AS 1015.13 explains: “Since the auditor’s opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the Public Company Accounting Oversight Board (United States).”

Removing language from the current standards that clarifies the bounds of reasonable assurance will likely lead to investor misunderstanding regarding the concept. It will also further the already problematic audit expectations gap. As the Board’s own proposing release acknowledges, “research on the audit expectations gap concludes that the majority of investors prefer absolute assurance that financial statements are free of material misstatements” and that investors “appear to expect much more than reasonable assurance from auditors in order to prevent fraud and company failure.” See PCAOB Release No. 2023-001 at 39-40 (Mar. 28, 2023). The PCAOB’s standard-setting efforts should not widen the chasm of misunderstanding between investors, auditors, and others by removing language that seeks to close the audit expectations gap. Unfortunately, the proposed standard would do just that with respect to one of the most fundamental concepts underpinning an audit under PCAOB standards. Additionally, removing the cited language may well upset the settled legal landscape regarding the limitations of reasonable assurance. The noted language is often critical to providing judges and fact finders with a

complete and accurate understanding of the bounds of the auditor’s duty with respect to financial statements and/or internal controls over financial reporting.<sup>1</sup>

For these reasons, we propose that the Board retain the current language of AS 1015.13 in any revised standard to provide appropriate context to the meaning of reasonable assurance.

### Due Professional Care

Under current PCAOB standards, “due professional care” is defined directly by reference to and quotation from a legal treatise—namely, *Cooley on Torts*. See AS 1015.03. The PCAOB proposes to remove entirely the reference and quotations from the treatise, without adding any additional context to the long-standing understanding of what constitutes due professional care. Specifically, the proposed standard would remove all references from the treatise regarding the “degree of skill” that an auditor should possess and any consideration of the “good faith” of the auditor in making inherently complex and difficult professional judgments.

By deleting such context, the proposed amendments would remove concepts that have become a settled part of the understanding of the auditor’s duty of care. It would also contradict the PCAOB’s stated goal to not change the meaning of the phrase “due professional care.” See PCAOB Release No. 2023-001 at 22 (Mar. 28, 2023). Further, we believe that removal of these concepts will contribute to investor misunderstanding of the auditor’s role and thereby unnecessarily increase the economic costs of the proposed standard, including by subjecting auditors to otherwise unwarranted litigation risks. If nothing else, the changes will upset the established legal understanding of what is required of an auditor to exercise due professional care in accordance with PCAOB Standards. Accordingly, we propose that the standard retain the current reference and citation to *Cooley on Torts* from AS 1015.03.

\* \_ \* \_ \*

We appreciate the opportunity to comment on the Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, and we look forward to future engagement. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Steve Neiheisel (steve.neiheisel@plantemorán.com) or Bora Brock (bora.brock@plantemorán.com).

Sincerely,



Plante & Moran, PLLC

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<sup>1</sup> See, e.g., *DeLollis v. Friedberg, Smith & Co.*, 933 F. Supp. 2d 354, 362-63 (D. Conn. 2013).

Office of the Secretary  
Public Company Accounting Oversight Board

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May 30, 2023

*Plante Moran, P.C.*

Plante Moran, P.C.

cc: **PCAOB**

Erica Y. Williams, Chair  
Duane M. DesParte, Board member  
Christina Ho, Board member  
Kara M. Stein, Board member  
Anthony C. Thompson, Board member  
Barbara Vanich, Chief Auditor

**SEC**

Paul Munter, Chief Accountant  
Diana Stoltzfus, Deputy Chief Accountant



May 30, 2023

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

**RE: PCAOB Rulemaking Docket Matter No. 049**

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's) proposed auditing standard, *General Responsibilities of the Auditor in Conducting an Audit*, and other proposed amendments to PCAOB standards included in PCAOB Release No. 2023-001.

We support the objectives of the proposal to streamline and clarify general principles and the responsibilities of auditors and to provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand, and apply. We believe it is important for investors and other stakeholders to understand the role of auditors and have confidence in the quality of the auditors' services; clear and well-organized standards can help promote this understanding.

We agree that "a modernized standard may enhance investors' and audit committees' awareness and understanding of the auditor's responsibilities."<sup>1</sup> We are concerned, however, that some of the proposed changes — such as the proposed deletion of long-standing explanations of existing, pervasive concepts in today's PCAOB standards — could have the unintended consequence of causing confusion about the objectives and limitations of an audit engagement delivered under today's PCAOB standards. We offer recommendations to help in addressing this concern.

We fully support the Board's objectives of providing clarity to investors and audit committees about the foundational standards, particularly because our work is performed under the oversight of independent audit committees and our reporting is to the board and shareholders.

***Reaffirming the auditor's public interest role within the existing legal framework***

We appreciate the Board's desire to emphasize the auditor's public interest role in the proposing release for the foundational standards. Given the statement in the proposing release that "[t]he proposed standard and related amendments are designed to streamline and clarify general principles and responsibilities of auditors and provide a more logical presentation,"<sup>2</sup> we do not believe that the Board intends to alter the existing regulatory or legal landscapes, in particular the legal relationship between auditors and investors. There is a robust body of case law around the auditor's relationship to investors, and Congress has carefully considered the responsibilities of the various market participants in passing securities laws, including specifying burdens of proof where reliance is an element of the claim or lack of reliance is a potential affirmative defense.

As the proposing release notes, the PCAOB does "not have evidence that auditors are systematically confused about the meaning of the general principles and responsibilities or that the foundational

<sup>1</sup> PCAOB Release No. 2023-001, page 46

<sup>2</sup> PCAOB Release No. 2023-001, page 5



standards as they are in effect today are insufficiently robust to support high-quality audits, when applied appropriately.”<sup>3</sup> Yet, certain language within the proposed standard introduces new ambiguities regarding the auditor’s obligations to investors (such as the proposed requirement in paragraph .15 for the auditor to “keep in mind their role in protecting investors”), without any accompanying guidance in the proposal or the release. This leaves unclear how to reconcile an advocacy concept such as “protection” with auditor independence concepts of being “without bias” and “impartial” for the “general public” – which includes present and potential investors.<sup>4</sup> If the language is retained, we believe it would be necessary to develop and propose appropriate new performance, reporting, and documentation requirements.

Accordingly, after thoughtful consideration, we recommend the Board remove the requirement in proposed paragraph .15 and replace it with a statement such as the following: “**Audits conducted in accordance with PCAOB standards are intended to meet the needs of investors and add to investor confidence in financial reporting by contributing to the reliability, completeness, and timeliness of such reporting.**” Such a statement could be included in paragraph .01 of AS 1000 or in the text of the final release, since this concept flows throughout the general principles and responsibilities of the auditor when conducting an audit.

### ***Fair presentation***

Under existing PCAOB standards, auditors have a responsibility to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. We agree auditors should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

However, it is not clear to us that the reference to SEC Rule 12b-20 of the Securities Exchange Act of 1934 in proposed footnote 17A in proposed AS 2810 is appropriate in this context. Under the Rule, the requirement for registrants is “[i]n addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”

This is an overarching disclosure requirement addressing the total mix of information disclosed **by the registrant** to the market. Rule 12b-20 is not specific to the subset of disclosures contained within the financial statements. Suggesting that this concept is an element of the auditor’s evaluation of fair presentation is not appropriate.

The auditor’s responsibilities for disclosures are more tailored. In accordance with AS 2815,<sup>5</sup> the auditor’s opinion that financial statements “present fairly” an entity’s financial position, results of operations, and cash flows in conformity with an applicable financial reporting framework is based on the auditor’s judgment as to whether:

- the accounting principles selected and applied have general acceptance;
- the accounting principles are appropriate in the circumstances;

<sup>3</sup> PCAOB Release No. 2023-001, page 36

<sup>4</sup> AS 1005, *Independence*, paragraphs .02-.03

<sup>5</sup> AS 2815, *The Meaning of “Presents Fairly in Conformity with Generally Accepted Accounting Principles,”* paragraph .04





- the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation;
- the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed; and
- the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.

In forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor considers not only the specific disclosure requirements of the applicable financial reporting framework but also the underlying objectives and principles of those standards.

The proposed rule seems to suggest that there could be some principle other than Generally Accepted Accounting Principles (GAAP) that the auditor should apply to make these judgments. Under SEC rules and guidance, however, any override of GAAP presentation is presumed to be misleading.<sup>6</sup>

As a result, in setting out the additional auditor responsibilities in paragraph .30A of proposed AS 2810<sup>7</sup> coupled with the view on page 30 of the proposing release,<sup>8</sup> the PCAOB appears to have created an untenable potential conflict between existing SEC rules and guidance and PCAOB standards that needs to be addressed. Expanding the outer boundary of the auditor's responsibilities by essentially removing the anchor<sup>9</sup> of the applicable financial reporting framework and suggesting auditors could override management's well-reasoned judgments would be a significant change in practice. In our view, the proposal would essentially result in an individual auditor being required to "stand in the shoes" of management and their disclosure counsel and assess whether, notwithstanding the extensive information and disclosures required by GAAP and SEC requirements, a registrant's financial statements should contain different or additional information in order not to be misleading. Establishing additional auditor responsibilities would create an ambiguous obligation at risk of inconsistent application and susceptible to criticism with hindsight bias. If there are potential deficiencies in a particular registrant's disclosures that are not addressed by the applicable financial reporting framework, it is the SEC and FASB that should take appropriate action, such as through the comment letter process or by revising the requirements, rather than requiring the auditor to determine what those incremental presentation requirements or disclosures should be through the auditor's fair presentation evaluation.

We recognize that other major capital markets, such as the UK, have taken other approaches on this point and permit or even require the company to **override the applicable financial reporting framework** to present in the company's or the auditor's view a "true and fair" view,<sup>10</sup> but that is not the approach that the SEC has established.

<sup>6</sup> See Regulation S-X Rule 4-01(a)(1); see also SEC Division of Corporation Finance, Financial Reporting Manual, Section 1410.

<sup>7</sup> AS 2810, *Evaluating Audit Results*

<sup>8</sup> See paragraph .30A of proposed AS 2810, and page 30 of PCAOB Release No. 2023-001, which states that "the amendments would clarify that the auditor's obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework."

<sup>9</sup> Paragraph .03 of AS 2815 states "The independent auditor's judgment concerning the "fairness" of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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." This concept was omitted in the proposed amendments to AS 2810.

<sup>10</sup> See the UK Financial Reporting Council publication, *True and Fair*, available at <https://www.frc.org.uk/getattachment/fo8eecd2-6e3a-46d9-a3f8-73f82c09f624/True-and-fair-June-2014.pdf>. This publication notes that "[F]air presentation under IFRS is equivalent to a true and fair view" but explains that, among other



To the extent the PCAOB views the auditor’s responsibilities more broadly than those of reporting on whether the financial statements comply with the applicable financial reporting framework, we would embrace a fulsome discussion of the various policy alternatives, incorporating our comparative experience from practicing in different jurisdictions. We believe this question would necessarily require due process, in coordination with the SEC, to minimize unintended consequences across the multi-party financial reporting system in the US.

***Reasonable application of the extension of due professional care and professional skepticism***

We support in principle the extension of the need to exercise due professional care to all matters related to the audit. The Board should consider reasonable application of the extension of the concepts of due professional care and professional skepticism that takes into account the nature of the matter (including whether or not the matter is directly related to the auditor’s opinion). To this end, absent substantive changes in the performance standards to address inherent limitations, the PCAOB should retain language from existing standards that provides an accurate context, for example:

- paragraph .10 of AS 1015,<sup>11</sup> which notes that an audit conducted in accordance with PCAOB standards may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements;
- paragraph .11 of AS 1015, which notes that, even with good faith and integrity, mistakes and errors in judgment can be made; and
- paragraph .13 of AS 1015, which notes that the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with PCAOB standards.

We agree that professional skepticism is an important part of exercising due professional care in conducting an audit. However, it is unclear how the PCAOB envisages the auditor performing a “critical assessment” of information related to the audit. While the auditor can critically assess audit evidence using AS 1105,<sup>12</sup> there is not an overarching framework for critically assessing the totality of information related to the audit. Accordingly, we are concerned the proposed change is ambiguous and could extend further than is necessary to support the auditor’s overall responsibilities and the PCAOB’s objectives. We recommend the PCAOB retain the existing reference to a “critical assessment of audit evidence” in paragraph .10 of the proposed standard, as this is already supplemented by the requirement in paragraph .11 and the overarching responsibility to exercise due professional care in relation to all matters related to the audit (including the preparation of Form AP).

To the extent the Board believes it is important that that the auditor’s requirements related specifically to the preparation of Form AP go beyond exercising due professional care (as would be required under paragraph .09 of proposed AS 1000) and extend to performing a critical assessment of information used in

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things, the FRC expects preparers, those charged with governance, and auditors to provide additional disclosures when compliance with an accounting standard is insufficient to present a true and fair view, and to use the true and fair override where compliance with the standards does not result in the presentation of a true and fair view.

<sup>11</sup> AS 1015, *Due Professional Care in the Performance of Work*

<sup>12</sup> AS 1105, *Audit Evidence*



the preparation of Form AP and other reports to regulators, we suggest that the Board consider how best to address this through separate rulemaking. Doing so would also enable the Board to revisit whether it is appropriate that any error in Form AP, regardless of materiality, requires the form to be amended, unlike any other aspects of public company reporting. In our view, this position results in unnecessary costs without incremental value to investors and other stakeholders.

We are also concerned that paragraph .11 of the proposed standard sets out new and unclear obligations for auditors to consider their own potential biases and potentially seek contradictory evidence. The proposing release explains that, in exercising professional skepticism, the auditor would consider the auditor's own bias that could affect the auditor's own judgments. It states that the auditor could mitigate such bias by being aware of "confirmation bias," considering alternatives provided by others, and seeking contradictory information as evidence.<sup>13</sup> AS 1105 requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. However, extant PCAOB standards do not require the auditor to explicitly seek out contradictory information as evidence.

Rather than setting out new expectations in the text of the proposing release that auditors seek contradictory information as evidence, we believe the PCAOB could accomplish its same goals by looking to changes made to the AICPA standards as part of the AICPA's audit evidence project, for example:

- paragraph 8 of AU-C section 330,<sup>14</sup> which requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory; and
- paragraph A27 of AU-C section 200,<sup>15</sup> which provides guidance about how unconscious or conscious auditor biases may affect the auditor's professional skepticism and professional judgment. We believe this guidance is consistent with the various academic studies referred to in the proposing release, but that making that guidance more accessible to auditors would be beneficial. Additionally, we note that the firm's system of quality control may also establish quality responses designed to mitigate potential auditor biases.

### ***Application of the concept of due professional care to engagement partners***

The PCAOB's explanations of how the concept of due professional care applies to engagement partners is valuable for auditors. In places, however, we are concerned that the language in paragraph .09 of the proposed standard may be viewed as conflicting with other PCAOB standards or may be ambiguous as to how due professional care is expected to be exercised. For example, this paragraph notes that due professional care includes appropriately assigning responsibilities to, and supervising, engagement team members. However, paragraph .04 of AS 1201<sup>16</sup> permits the engagement partner to seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to that standard, including supervisory responsibilities. We recommend that the guidance explaining how due professional care

<sup>13</sup> PCAOB Release No. 2023-001, page 24

<sup>14</sup> AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

<sup>15</sup> AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

<sup>16</sup> AS 1201, *Supervision of the Audit Engagement*



relates to engagement partners in paragraph .09 of proposed AS 1000 be clarified to better align with AS 1201.

As another example, page 22 of the proposing release notes that, as part of exercising due professional care, the engagement partner assigns activities to engagement team members that adequately match their levels of competence. Neither AS 1201 nor AS 2101<sup>17</sup> explicitly require the engagement partner to do so. Rather, these standards are focused on taking into account the nature, timing, and extent of resources necessary to perform the engagement and the knowledge, skill, and ability of each engagement team member in determining the extent of supervision necessary.

We are therefore concerned that the proposing release sets out incremental expectations beyond what is expressly required by the professional standards and may not be practicable (for example, in the case of a multilocation audit). We do not believe changes to AS 1201 or AS 2101 are necessary or appropriately supported in the proposing release.

If the PCAOB believes that it is necessary to further specify and strengthen the responsibilities of engagement partners, we suggest that a separate project be undertaken and consideration be given to recent enhancements to International Auditing and Assurance Standards Board (IAASB) and AICPA standards,<sup>18</sup> which were intended to reinforce the need for quality management at the engagement level and complement their standards relating to firms' systems of quality management.

Finally, we support the inclusion of Note 2 to paragraph .05 (c) of AS 1201 to clarify that the engagement partner must review sufficient documentation as the individual primarily responsible for the engagement and its performance, and we believe this is consistent with current practice. The firm's policies and procedures assist the engagement partner in exercising professional judgment in determining the nature and extent of documentation to review, including when the audit is a multilocation audit.

### ***Consideration of professional judgment***

We support in principle the Board's intention to describe professional judgment in proposed AS 1000, as we also recognize that it is a "general principle and responsibility" of auditors, who exercise professional judgment throughout the audit. We also support the Board's stated intention that, by including a reference to applicable professional and legal requirements in the proposed definition of professional judgment, the Board "is not intend[ing] to create a new requirement."<sup>19</sup> Nonetheless, the PCAOB's proposed definition of professional judgment, by including the clause "such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements," could be interpreted to do just that, by imposing a new strict liability requirement in PCAOB auditing standards. In other words, paragraph .12 of proposed AS 1000 would consider any deficiency in an auditor's compliance with applicable professional and legal requirements to be, by default, a failure to exercise appropriate professional judgment. But evaluation of professional judgments requires an assessment of the reasonableness of an auditor's determinations, analyses, and evaluations to be considered contemporaneously with the information available at that time. An auditor's judgment should not be susceptible to future challenge based simply on whether a factfinder later determines that applicable professional or legal requirements were not met. Reasonable observers may disagree regarding whether

<sup>17</sup> AS 2101, *Audit Planning*

<sup>18</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, and SAS 146, *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*

<sup>19</sup> PCAOB Release No. 2023-001, page 26



applicable standards were complied with while agreeing that the matter in question was within the purview of the auditor's professional judgment.<sup>20</sup>

We therefore recommend the Board consider the following revisions to paragraph .12 of proposed AS 1000, which retains certain concepts of the existing definition of "professional judgment" in paragraph .05 of AS 1001<sup>21</sup> (language to be deleted is ~~struck through~~; language to be added is underlined):

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience in determining which auditing procedures are necessary in the circumstances to make informed decisions and reach well-reasoned conclusions and afford a reasonable basis for the issuance of the auditor's report about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.

### ***Relevant guidance applicable to the audit***

We appreciate the PCAOB clarifying that auditors should take into account relevant guidance applicable to the audit, including releases accompanying the standards and rules of the Board. As part of its standard-setting process, the Board may issue multiple documents over a period of time setting out its intent in relation to proposed standards, including concept releases and proposing releases. The Board's view may evolve based on public comment, the passage of time, or for other reasons, making it impractical to suggest that release text in proposals should necessarily be considered relevant guidance.

Accordingly, to facilitate auditors' appropriate consideration, it would be helpful for the PCAOB to codify and clearly delineate all relevant guidance in the accompanying release to the final standards, as previous discussions may have been superseded as a result of cumulative changes made to the proposed standards. We recommend the Board amend the proposed requirement in footnote 26 of proposed AS 1000 to describe that "Relevant guidance includes PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the final standards and rules of the Board" (language to be added is underlined).

For example, the material in the *Discussion of Proposal* section of the proposing release could be restructured in a manner similar to the application and other explanatory material as presented in the AICPA and IAASB standards. Revising the manner in which relevant guidance is presented would also afford stakeholders a better opportunity to comment on this guidance during the rulemaking process. In contrast, we would not consider matters discussed in the *Economic Analysis* section of the proposing release to represent relevant guidance applicable to the audit that auditors would need to take into account.

### ***Effective date***

While a number of changes in the proposed standard are intended to clarify but not change the auditor's responsibilities, the proposal to accelerate the documentation completion date would likely require changes to firms' methodologies, electronic audit tools, and audit software. If the SEC approves the final

<sup>20</sup> See paragraphs .A27-.A31 of AU-C section 200 (describing "professional judgment" and noting in particular that "[t]he exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm . . . assists the auditor in making informed and reasonable judgments.").

<sup>21</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*



standard before the end of calendar year 2023, we recommend a final standard be effective for audits of financial statements for periods beginning on or after December 15, 2024, to allow ample time for this transition.

\* \* \* \* \*

We appreciate the opportunity to provide input and would be pleased to continue a dialogue with the Board and its staff. Please contact Brian Croteau at [brian.t.croteau@pwc.com](mailto:brian.t.croteau@pwc.com) regarding our submission.

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP





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

June 26, 2023

**Re: General Responsibilities of the Auditor in Conducting an Audit**

Dear Chair Williams,

On behalf of Public Citizen and Americans for Financial Reform Education Fund, we welcome the opportunity to respond to the Public Company Accounting Oversight Board’s request for comment on General Responsibilities of the Auditor in Conducting an Audit (AS 1000).<sup>1</sup> The fundamental obligation of auditors in reviewing financial statements is to assure the “fair presentation” of a company’s financial position that is not misleading to investors. We commend the PCAOB for proposing to extend an auditor’s evaluation of fairness in AS 2810 beyond “mere technical compliance with the applicable financial reporting framework,” to more broadly “prohibit the financial statements and company disclosures from being materially misleading.”<sup>2</sup>

This proposed update is a crucial step to align PCAOB standards with over 60 years of judicial precedent holding that fair presentation requires more than adherence to generally accepted accounting principles (GAAP). The landmark case *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969), decided by the Second Circuit, established the legal liability of accountants under Section 11(a) of the Securities Act of 1933.<sup>3</sup> It clarified that accountants are liable not only for compliance with GAAP but also for the “fair presentation” of financial statements.<sup>4</sup> The court held that adherence to accounting rules, while persuasive, is not necessarily conclusive evidence of good faith and absence of material falsehood or misleading statements. Since then, courts have upheld auditors’ responsibility to provide assurance of “fair presentation,” not merely technical compliance with GAAP.<sup>5</sup>

<sup>1</sup> Public Company Accounting Oversight Board (PCAOB). 2023. “Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards.”

<sup>2</sup> *Id.* at 30.

<sup>3</sup> *United States v. Simon*, 425 F.2d 796 (1969).

<sup>4</sup> Mark, DeFond et al. 2018. “The Primacy of Fair Presentation: Evidence from PCAOB Standards, Federal Legislation, and the Courts.” *American Accounting Association*.

<https://publications.aaahq.org/accounting-horizons/article-abstract/32/3/91/2361/The-Primacy-of-Fair-Presentation-Evidence-from>.

<sup>5</sup> The Second Circuit reaffirmed that fair presentation holds primacy over GAAP compliance in *United States v. Ebbers*, 458 F.3d 110 (2d Cir. 2006). There, the court upheld that under securities law the government is not required to prove that accounting standards were violated, only that financial reports were intentionally materially misleading

In practice, accountants can easily conceal the true financial health of a company while complying with GAAP. Creative accounting lies at the core of many financial scandals. Arthur Andersen's sole focus on GAAP-compliance led to rubber-stamping Enron's fraudulent financial statements, which used loopholes in GAAP to mislead investors.<sup>6</sup> At the PCAOB's recent investor advisory group meeting, former Enron CFO Andy Fastow, who was convicted for his central role in the most notorious accounting scandal, stated the following:

I'd like to talk about a distinct type of fraud, the type of fraud that occurs when companies aren't simply putting in the wrong numbers intentionally, but when companies are exploiting the rules to make their financial statements look different than reality. When this occurs, very often the government enforcement agencies will make the case look as if the company has simply been committing black and white fraud, putting in the wrong numbers.

But in reality, many of these cases, where you have fraud occur—especially in large companies—[it is] because these companies are exploiting accounting rules, accounting assumptions and they're using structured finance in order to make their financial statements look healthier than they really are. ***I would emphasize again the importance of creating a distinction in the minds of auditors between what is accurate according to the rules and what is accurate in reality.***

My experience in talking to a variety of auditors is that their standard is that the company is following the rules. There's an entire industry of bankers, accountants, and attorneys who do nothing but help these large companies exploit rules.<sup>7</sup>

To combat fraud, the PCAOB must adopt fair presentation standards for auditors that do not solely rely on technical compliance with accounting rules. Recent events have underscored the need to strengthen auditing standards to protect investors and the public. Silicon Valley Bank's collapse exemplifies how accounting choices, such as stating securities as held-to-maturity rather than presenting mark-to-market values, can hide material losses in plain sight, leading to grave harm when a firm is forced to sell assets at a fair market value for a loss.<sup>8</sup>

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to investors. Additionally, *United States v. Rigas*, 490 F.3d 208 (2d Cir. 2007) concluded that financial statements can be materially misleading even if a defendant complies with GAAP.

<sup>6</sup> Congressional Research Service (CRS). 2004. "The Enron Collapse: An Overview of Financial Issues" at 3. [https://www.everycrsreport.com/files/20040812\\_RS21135\\_d3ccc53ec06a45476370a0cd5255b99c69afea08.pdf](https://www.everycrsreport.com/files/20040812_RS21135_d3ccc53ec06a45476370a0cd5255b99c69afea08.pdf) ("Enron's auditor, Arthur Andersen, not only turned a blind eye to improper accounting practices, but was actively involved in devising complex financial structures and transactions that facilitated deception.")

<sup>7</sup> Public Company Accounting Oversight Board - PCAOB, *3/9/23 Investor Advisory Group Meeting (Part 1 of 2)*, YouTube (Mar. 13, 2023), <https://www.youtube.com/watch?v=3eFSFNtdYz0>.

<sup>8</sup> Eaglesham, Jean. 2023. "Auditors Didn't Flag Risks Building Up in Banks." *Wall Street Journal*, April 10, 2023. <https://www.wsj.com/articles/auditors-didnt-flag-risks-building-up-in-banks-6506585c>; Lugo, Denise. 2023. "Silicon Valley Bank's Failure Sparks Speculation that FASB Accounting Rules for Held-to-Maturity Debt



The ubiquitous gaming of GAAP obscures and distorts financial reporting and has contributed to past systemic financial crises.<sup>9</sup> At present, these practices are obscuring the growth of climate-related financial risks associated with stranded assets that are systematically and materially misrepresented in financial statements. Consequently, coal, oil, and gas companies are able to mask the risks associated with stranded assets, the systematic overvaluation of which is commonly referred to as the “carbon bubble.” A global study indicated that the carbon bubble will result in \$1.4 trillion in assets becoming worthless in a low-carbon economy.<sup>10</sup> Regrettably, auditors have been slow to identify and disclose corporate climate-related financial risks and raise critical audit matters.<sup>11</sup>

The climate crisis and the economy-wide decarbonization transition are creating new incentives and opportunities for companies to misrepresent their financial position while remaining GAAP compliant. For example, many companies today are making net-zero commitments that they opine on in their 10-Ks but fail to substantiate in their financial statements. To address this misleading conduct, the PCAOB must bridge the existing gap between “accuracy according to the rules” and “accuracy in reality” by charging auditors with an explicit responsibility to look beyond mere compliance with GAAP, and to assure the fair presentation of climate-related financial risk. In addition, the PCAOB should direct auditors to look more closely at the alignment between climate commitments and actual financial statements. The adoption of fair presentation auditing standards, with greater enforcement by the PCAOB, is essential to help auditors avoid past mistakes and stop facilitating what amounts to financial fraud. For instance, existing accounting standards permit potentially misleading climate-related accounting estimates and assumptions to determine future cash flows and valuations of carbon-intensive assets. In addition, accounting norms allow energy companies to hide significant off-balance-sheet liabilities: asset retirement obligations and environmental liabilities.

### **Accounting estimates and assumptions are obscuring climate-related financial risks.**

Unsound climate-related accounting estimates and assumptions pose a significant risk to the fair presentation of financial statements. Overly rosy accounting assumptions and estimates in

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Securities Should be Revised” *Reuters*, March 12, 2023, sec. Tax & Accounting. <https://tax.thomsonreuters.com/news/silicon-valley-banks-failure-sparks-speculation-that-fasb-accounting-rules-for-held-to-maturity-debt-securities-should-be-revised/>.

<sup>9</sup> U.S. Securities and Exchange Commission (SEC). 2011. “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis.” <https://www.sec.gov/news/testimony/2011/ts040611jlk.htm>

<sup>10</sup> Semieniuk, Gregor, et al. 2022. “Stranded Fossil-Fuel Assets Translate to Major Losses for Investors in Advanced Economies.” *Nature Climate Change*. <https://www.nature.com/articles/s41558-022-01356-y>; Herren Lee, Allison. 2020. “Big Business’s Undisclosed Climate Crisis Plans.” *New York Times*, September 27, 2020, sec. Opinion. <https://www.nytimes.com/2020/09/27/opinion/climate-change-us-companies.html>.

<sup>11</sup> Carbon Tracker Initiative. 2021. *Flying Blind: The Glaring Absence of Climate Risks in Financial Reporting*. London: Carbon Tracker Initiative. <https://carbontracker.org/reports/flying-blind-the-glaring-absence-of-climate-risks-in-financial-reporting/>.

financial statements fail to reflect the future viability and valuation of carbon-intensive assets. Certain line items in the financial statements are calculated using estimates and assumptions about the future. To determine these estimates and assumptions, accounting rules sometimes allow backwards looking assessments—historical assumptions of carbon pricing and fossil fuel use that may overestimate future cash flows and underestimate stranded asset risk.<sup>12</sup>

Relying on historical cost or conservative models does not adequately account for the potential devaluation of assets resulting from energy transition risks. Several factors will lead to shorter estimated useful lives for productive assets or changes to the assumptions used to determine expected future cash flows for impairment testing, including declining demand for oil and gas, the switch to renewable energy, regulations to limit emissions, and the phase out of internal combustion engines.<sup>13</sup> By relying on unsound assumptions, companies are ignoring transition risk, and this can result in overstating assets and understating liabilities. For example, in 2020, BP wrote off \$17.5 billion in oil and gas assets due to its forecasts of an accelerating transition away from fossil fuels, a material impact to a fossil fuel company’s projected valuations.<sup>14</sup> This highlights the fact that fossil fuel companies often significantly overvalue their assets in their financial statements.

Unreasonable assumptions and estimates significantly change asset valuations and impairment tests in financial statements, effectively concealing the stranded asset risk faced by energy companies. In a recent SEC enforcement action, auditors at KPMG were fined \$1 million for rubber-stamping Miller Energy Corporation's inaccurate estimates that served to overvalue its oil and gas reserves by \$400 million.<sup>15</sup> A 2013 survey showed that 74% of KPMG employees in the energy and natural resources department had knowledge of misconduct in the industry.<sup>16</sup> The failure of KPMG highlights the need for increased guidance from the PCAOB on fair presentation to prevent auditors from becoming complicit in fossil fuel misrepresentations and fraud. Auditors’ duty of fair presentation should extend to assessing the sensitivity of

<sup>12</sup> Ross, Samantha. 2021. *Lifting the Veil: Investor Expectations for Paris-Aligned Financial Reporting at Oil and Gas Companies*. Boston, MA: Ceres.

<https://www.ceres.org/sites/default/files/reports/2021-05/Ceres%20Lifting%20the%20Veil%20Oil%20and%20Gas%205.18.pdf>, at 20.

<sup>13</sup>Jenkins, J.D., et al. 2022. *Preliminary Report: The Climate and Energy Impacts of the Inflation Reduction Act of 2022*. Princeton, NJ: REPEAT Project.

[https://repeatproject.org/docs/REPEAT\\_IRA\\_Preliminary\\_Report\\_2022-08-04.pdf](https://repeatproject.org/docs/REPEAT_IRA_Preliminary_Report_2022-08-04.pdf). The REPEAT Project estimates that a decrease in U.S. consumption of petroleum products and natural gas could lead to a reduction of roughly 5% in crude oil prices and a decrease of approximately 10-20% in U.S. natural gas prices by 2035.

<sup>14</sup> Reuters Staff. “BP to write off up to \$17.5 bln after reduced oil price forecast.” *Reuters*, June 15, 2020, sec. Integrated Oil & Gas.

<https://www.reuters.com/article/bp-writeoffs/bp-to-write-off-up-to-17-5-bln-after-reduced-oil-price-forecast-idUSL8N2DS0VA>

<sup>15</sup> National Whistleblower Center. 2020. *Exposing a Ticking Time Bomb: How Fossil Fuel Industry Fraud is Setting Us Up for a Financial Implosion – and What Whistleblowers Can Do About It*. Washington: National Whistleblower Center at 25.

<https://www.whistleblowers.org/wp-content/uploads/2020/07/NWC-Climate-Risk-Disclosure-Report.pdf>.

<sup>16</sup> *Id.* at 26.

climate-related estimates and assumptions in a companies' financial statements, in a manner free from management's biased risk assumptions, and verifying that companies are in alignment with their own climate-related commitments.

In response to Enron-era accounting fraud, the SEC issued guidance to reduce the use of unreasonable estimates, including a requirement that companies disclose significant estimates and assumptions that affect their financial statements. An SEC memo clarifies as follows:

A company should address material implications of uncertainties associated with the methods, assumptions and estimates underlying the company's critical accounting measurements... When preparing disclosure under the current requirements, companies should consider whether they have made accounting estimates or assumptions where:

- the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on financial condition or operating performance is material.<sup>17</sup>

Accounting measurements, as the SEC notes, could reflect material errors due to the uncertainties associated with estimates or assumptions or due to difficult to accurately measure value. The SEC requires that a company clearly explain the reasons for its accounting estimates or assumptions, which includes “analyzing factors such as the methodology used to arrive at the estimate, the historical accuracy of the estimate/assumption, the extent of past changes to the estimate/assumption, and the likelihood of future changes.”<sup>18</sup>

Under these existing requirements, auditors' lack of disclosure surrounding misleading climate-related estimates and the sensitivity of assumptions associated with carbon-intensive assets and liabilities constitutes a failure to fairly present financial statements to investors. Climate-related risks are material and should be integrated into their financial statements. The following are instances where auditors should assess how climate-related matters are relevant to estimates and assumptions:

- Sources of estimation uncertainty, such as estimates of future cash flows when testing an asset for impairment or estimates of expenditures required to settle decommissioning obligations.

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<sup>17</sup> U.S. Securities and Exchange Commission (SEC). 2003. “Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations.”

<https://www.sec.gov/rules/interp/33-8350.htm>.

<sup>18</sup> *Id.*

- Any material uncertainties related to events or conditions that cast doubt on a company's ability to continue as a going concern, as well as any significant judgments involved in concluding that no such doubt exists.
- The obsolescence of inventory, its selling price, or costs of completion, as well as how those factors inform the net realizable value of inventory.
- The estimated residual value and expected useful lives of assets, because of obsolescence, legal restrictions, or inaccessibility.
- Exposure to credit losses caused by severe weather or transition activities' effects on the value of collateral or a borrower's ability to meet debt obligations.

To reasonably assure fair presentation, auditors should aid in disclosing and providing transparency around the sensitivity and accuracy of climate-related estimates and assumptions. A study from Carbon Tracker found that few companies that use GAAP disclose the effect of climate-related risks on their assumptions and estimates, which raises concerns about the extent to which companies are truly integrating climate-related risks into their estimation practices.<sup>19</sup>

**Carbon-intensive companies' are using creative accounting to conceal environmental liabilities and asset retirement obligations.**

Asset retirement obligations (AROs) are legal and financial obligations associated with the retirement of long-lived assets, such as wells, pipelines, mines, power plants, or other carbon-intensive infrastructure. These obligations can include, but are not limited to, oil well plugging and underground storage tank removal. AROs are a significant cost for oil and gas companies. In 2006, Standard & Poor's estimated that 50% of European fossil fuel companies' debt obligations were AROs.<sup>20</sup> Yet these costs are largely hidden. Fossil fuel companies fail to disclose their environmental decommissioning liabilities to remove or remediate pollution or contamination, and asset retirement obligations in their financial statements by using accounting practices that are unreasonable but technically GAAP-compliant.<sup>21</sup>

Auditors should disclose these liabilities to fairly present an energy company's financials, but PCAOB-compliant audits rarely question the lack of disclosures of oil and gas companies' AROs. Instead, most auditors rubber stamp companies' misrepresentation of fossil fuel liabilities, keeping investors in the dark over significant and material asset retirement obligations and environmental remediation liabilities.

<sup>19</sup> Flying Blind, *supra* note 8 at 23.

<sup>20</sup> Carbon Tracker Initiative. 2020. *Flip Side: How Stranded Assets Will Give Rise to Stranded Liabilities*. London: Carbon Tracker Initiative. [https://carbontracker.org/wp-content/uploads/2020/02/Decommissioning-Analyst-Note\\_vwebsite-1.pdf?lang=ja](https://carbontracker.org/wp-content/uploads/2020/02/Decommissioning-Analyst-Note_vwebsite-1.pdf?lang=ja), at 2.

<sup>21</sup> Ross, Samantha. 2021. *The Role of Accounting and Auditing in Addressing Climate Change*. Washington: Center for American Progress, <https://www.americanprogress.org/article/role-accounting-auditing-addressing-climate-change/>.

One such misleading technique entails discounting AROs over the span of 60 to 80 years, a timeline unrealistic for net-zero goals. Some companies, like Valero Energy Corporation, provide no disclosure of AROs by claiming that it has no ability to estimate the retirement of its fossil fuel assets. In Valero’s annual report, it claims: “It is our practice and current intent to maintain all our assets and continue making improvements to those assets based on technological advances. As a result, we believe that assets at our refineries and plants have indeterminate lives for purposes of estimating asset retirement obligations because dates or ranges of dates upon which we would retire such assets cannot reasonably be estimated at this time.”<sup>22</sup> Energy companies use spurious claims of indeterminate life to keep massive ARO liabilities off their balance sheets. Some auditing firms, such as Deloitte, are starting to signal that the concept of “indeterminate life” should only be used in rare circumstances. But in practice, most auditors permit fossil fuel companies’ use of misleading accounting.<sup>23</sup>

As the energy transition speeds up, companies will increasingly need to recognize asset retirement obligations previously thought to have indefinite or unrealistically long lifespans. Carbon Tracker estimates that premature asset retirements for the seven super oil majors alone (BP, Chevron, ENI, Exxon, Shell, Total, and ConocoPhillips) could cause costs and commitments to soar from a reported \$87 billion to a staggering \$294 billion.<sup>24</sup> This is a clear instance of companies misleading investors about their financial health by failing to disclose liabilities they will face due to the energy transition. Many carbon-intensive assets will require earlier retirement than anticipated in previous audited financial statements. Consequently, auditors will need to accelerate the recognition of decommissioning costs and asset retirement obligations, leading to a sudden increase in reported liabilities.<sup>25</sup> For now, energy companies are pushing AROs off their balance sheets and delaying recognizing the cost of these liabilities due to accounting and audit failures. PCAOB fair presentation standards should spur auditors to recognize that AROs are often unreasonably—and misleadingly—minimized in statements that technically comply with GAAP.

Investors at Exxon have already put forth a shareholder resolution to request a full disclosure of the quantitative impact of off-balance-sheet asset retirement obligations in a net-zero by 2050 scenario.<sup>26</sup> Investors—and more scrupulous accounting firms—recognize this information is financially material. Unfortunately, a study from the Government Accountability Office determined that without access to company records, it is extremely difficult to evaluate an oil and

<sup>22</sup> Valero, 2022. “Form 10-K.”

<https://www.sec.gov/ix?doc=/Archives/edgar/data/0001035002/000103500223000027/vlo-20221231.htm>.

<sup>23</sup> Deloitte, 2022. “Environmental Obligations and Asset Retirement Obligations” at 83.

<https://dart.deloitte.com/USDART/pdf/b702f3de-7b0f-11e8-85b9-f5946165e692>

<sup>24</sup> Flip Side, *supra* note 16 at 1.

<sup>25</sup> The Role of Accounting and Auditing in Addressing Climate Change, *supra* note 17.

<sup>26</sup> Carbon Tracker Initiative. 2023. *Carbon Tracker Initiative’s Response to Exxon’s 14A filing*. London: Carbon Tracker Initiative. <https://carbontracker.org/response-to-exxons-14a-filing/>.

gas company’s environmental remediation liabilities and asset retirement obligations.<sup>27</sup> Auditors have access to company information and can require transparent disclosure of liabilities. But auditors rarely question oil and gas companies’ ARO disclosures when adhering solely to compliance standards. Without auditors flagging undisclosed liabilities, financial statements do not fairly present a company’s financial health.

## Conclusion

PCAOB auditors have a responsibility to be independent and skeptical of management’s financial statements. This begins with addressing GAAP-compliant mispricing of assets and liabilities, including those associated with climate-related estimates and hidden or understated AROs. To foster a more transparent, sustainable, and resilient financial system, auditors must bridge the gap between companies’ climate-related commitments, many of which are discussed in SEC filings, and how they represent climate-related financial risks in their financial statements. Auditors must disrupt this pattern of overvaluing assets and understating liabilities that misleads investors by giving them an inaccurate understanding of the financial viability of fossil fuel companies. Without strong PCAOB fair presentation standards that go beyond technical GAAP compliance, auditors are enabling greenwashing, and in some instances, accounting fraud. The PCAOB’s guidance on the responsibilities of auditors should codify the spirit of the law by directing auditors to opine on fair presentation of climate risks in financial statements, beyond just GAAP compliance.

For questions, please contact Mekedas Belayneh at [mbelayneh@citizen.org](mailto:mbelayneh@citizen.org) and Clara Vondrich at [cvondrich@citizen.org](mailto:cvondrich@citizen.org).

Sincerely,

Public Citizen  
Americans for Financial Reform Education Fund

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<sup>27</sup> Government Accountability Office (GAO). 2004. “Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information, United States Government Accountability Office: Report to Congressional Requesters.”

**From:** Salty <saulroe@yahoo.com>  
**Sent:** Tuesday, April 18, 2023 5:13 AM  
**To:** Comments  
**Subject:** [EXT]: Comment on Proposed Standard Addressing Core Auditing Principles and Responsibilities

A companies engagement with a CPA firm should be limited to 4 years. After which a new CPA firm must be engaged. We have seen over the decades that relationship between companies and their CPA firms have become incestuous where the CPA firm reports a clean audit in order to keep the company as a client. This has resulted in the public an investors not being informed of significant audit issues and risks. By limiting the number of years that a CPA firm me have a client, the CPA firm will have to disclose risks and significant audit items, because the successor CPA company will find them and report on them. Further requirements for transferring audit data to successor companies should be implemented.

After working for Arthur Young & Co., seeing what happened to Arthur Anderson and now KPMG with SVB, I believe it is clear that CPA firms audit opinions can be bought, in order for the CPA firms to keep the client. I have been frustrated by the lack of notice from Boeing's auditors of problems resulting in executive management's change of philosophy that led to the 737max crisis and then other problems that have depressed my stock price.

saul roe  
MBA 1978





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May 25, 2023

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, D.C. 20006

**Re: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards**

Dear Office of the Secretary:

RSM US LLP (RSM, “we”) values the opportunity to offer our comments on the Public Company Accounting Oversight Board’s (PCAOB) Proposed Auditing Standard, *General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (the proposed standard). RSM is a registered public accounting firm serving middle-market issuers, brokers, and dealers.

**Overall Comments on the Proposed Standard**

We are generally supportive of the proposal, recognizing the importance of the standard to audit quality and investor protection, and believe the reorganization of the standards is warranted. We recognize the benefit of creating a new standard that combines general principles and responsibilities from existing standards and introduces updates to reflect developments in the auditing environment.

Although we believe combining existing standards into one new standard is effective in condensing and streamlining the standard, we believe there are areas of concern where revisions or additional clarity in the new standard are necessary. Most notably:

- The proposed standard introduces several new, undefined terms and phrases which would constitute a fundamental change in the role of the auditor, would require interpretation either through inspection or by a court, and could be applied variably across the public accounting profession. The proposed standard elevates the responsibility of the auditor, despite the Board’s statement on page 50 of the release that, “The proposed changes to modernize the foundational standards do not impose new requirements on auditors or significantly change the requirements of PCAOB standards.”
- Certain aspects of the proposed standard de-emphasize auditor judgment and indicate that hindsight may be used to determine the appropriateness of the auditor’s conclusions on unpredictable matters. This would be harmful to the profession, which would ultimately be harmful to issuers, capital markets, and investors.
- The proposed standard introduces the concept of the auditor’s evaluation of fairness of the financial statements extending beyond compliance with the applicable financial reporting framework. We believe this is a dangerous proposal that would create confusion in the profession and capital markets.
- The proposed amendments regarding the auditor’s competency do not appropriately take into consideration the collective competency of the engagement team and are not sufficiently clear on the expected competency of various members of the engagement team.

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Office of the Secretary  
 Public Company Accounting Oversight Board  
 May 25, 2023  
 Page 2

- The proposed standard establishes Board-issued guidance as authoritative guidance. We have many concerns on this topic, which are detailed in our response to Question 9 below. We strongly request the Board seriously consider the various implications this would have.

We provide further detail on these areas, as well as other comments, in our responses to the specific questions set out below. In certain areas, we propose specific revisions to the proposed standards. Language recommended for deletion is ~~struck through~~. Language recommended for addition is underlined.

### Comments on Specific Questions Posed by the Board

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?

While we generally believe the principles and responsibilities described in the proposal are appropriate, we are concerned the proposed standard gives investors false confidence that they can solely rely on an auditor's report as investment advice, when in fact there are many other factors investors should consider. As auditors, we are proud to play a role in protecting investors' interests through the preparation and issuance of informative, accurate, and independent auditor's reports. Having access to informative, accurate, and independent auditor's reports empowers investors to make informed investment decisions according to their own individual investment goals and risk appetites. However, the auditor's report is only one fundamental piece of information on which investors should rely. Other parties, including management, audit committees, and regulatory bodies, also play a fundamental role in the protection of investors. We believe the proposed standard may mislead investors by implying that investor protection is the sole responsibility of the auditor, and we therefore recommend the PCAOB revise the language in proposed Auditing Standard (AS) 1000.01 as shown below. Alternative options to the language below include replacing the word "protect" with the word "inform" or the phrase "play a role in protecting." If the word "protect" is retained in the final standard, we believe the PCAOB should define the term, clarifying the extent to which an auditor is obliged and able to protect investors. See related comments in our response to Question 7.

Further, as used in proposed paragraph .01, the term "A properly conducted audit" is a new term that is not sufficiently defined. To avoid differing interpretations or confusion, we suggest aligning this phrase with the language used in the auditor's report by replacing "A properly conducted audit" with "An audit conducted in accordance with the standards of the PCAOB."

Additionally, we suggest adding "in all material respects" to proposed paragraph .01 to have a clear, consistent meaning with the remaining paragraphs in the standard.

Lastly, it is unclear what is meant by the word "all" in proposed paragraph .02. To avoid confusion, we suggest removing the word "all."

Our proposed revisions to address these concerns are as follows:

.01 Auditors have a fundamental obligation to ~~protect investors through the preparation and issuance of informative, accurate, and independent auditor's reports, and that obligation governs the auditor's work under~~ conduct an audit in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB"). An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company's financial statements are presented fairly, in all material respects, and, if applicable, on the effectiveness of

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the company's internal control over financial reporting. An audit conducted in accordance with the standards of the PCAOB ~~A properly conducted audit~~ and the related auditor's report enhance the confidence of investors and other market participants in the company's financial statements and, if applicable, internal control over financial reporting.

.02 This standard describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the ~~Public Company Accounting Oversight Board~~ ("PCAOB"). This standard sets out the objectives of the auditor, establishes requirements for the auditor's professional qualifications and the auditor's general responsibilities applicable in ~~all audits of financial statements and internal control over financial reporting~~, and describes auditing principles relevant to conducting the audit.

2. Is the approach to reorganize and consolidate the general principles and responsibilities appropriate? If not, why not?

We believe the PCAOB's approach to reorganizing and consolidating the general principles and responsibilities is appropriate.

3. Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?

We believe the first two objectives of the auditor in the proposed standard are appropriate. The third objective refers to "applicable professional and legal requirements," and Footnote 1 indicates this term has the same meaning as defined in Appendix A of proposed QC 1000, *A Firm's System of Quality Control*. We believe it is difficult to comment on the appropriateness of an objective which includes a term with a definition that is subject to change. The footnote also describes what is included in that definition, which could be interpreted differently from what was proposed in QC 1000. We provided the following response regarding the definition of "applicable professional and legal requirements" in our February 1, 2023 comment letter on the *PCAOB Proposals on A Firm's System of Quality Control*:

*While we agree with the definition generally, it appears to be overly broad and may inadvertently scope into the QC system professional and legal requirements or other matters that are beyond the remit of the PCAOB. We recommend that the scope of the standard is more clearly ring-fenced, for example, by providing descriptions of what is intended to be covered by the firm's system of quality control.*

We stand by that comment as it relates to this proposal, and we further emphasize the need for the phrase "legal requirements" to be more narrowly defined. As it is currently defined in the proposal, it includes unidentified legal requirements outside of state public accountancy laws and regulations and federal securities laws and regulations. We believe this applies to all uses of the phrase "applicable professional and legal requirements" throughout the proposal.

4. Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not?

We believe the proposed requirements related to auditor independence are clear and comprehensive.

5. Are the proposed requirements related to ethics clear and comprehensive? If not, why not?

We believe it is difficult to comment on the appropriateness of requirements which are subject to change. In our February 1, 2023 comment letter on the *PCAOB Proposals on A Firm's System of Quality Control*,

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we responded to questions regarding proposed standards on ethics, including EI 1000, *Integrity and Objectivity*. Assuming those comments are appropriately addressed, we believe proposed AS 1000.06 is clear and comprehensive, and we support the auditing standards referring to the specific requirements.

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

We recognize and value the importance of the auditor's competence in performing high quality audits, and therefore we recommend several changes to these paragraphs to achieve the intended objectives. Specific recommended changes or clarifications to these paragraphs are noted below.

1. **An audit is performed by a group of competent individuals, not just one auditor.** Each engagement team member brings a unique skillset and perspective to the engagement, and the combination of the varying backgrounds determines whether the engagement team (including any specialists) collectively possesses the necessary competence to effectively perform an audit in accordance with applicable professional and legal requirements. Therefore, we highly recommend the following revision to proposed AS 1000.07:

The audit must be performed by an auditor or auditors who, collectively, have an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements.<sup>6</sup>

Depending on the PCAOB's intentions, this could alternatively say "individuals who have" or "an engagement team who has."

2. **Related to our comments above regarding the competence of the engagement team as a whole, we believe paragraphs .07 and .08 of the proposed standard do not clearly define who should have, develop, and maintain competence.** It is unclear whether each individual assigned to the engagement is required to demonstrate the same level of competence regardless of their role, extent of involvement, or extent of supervision. Public accounting firms are structured in an apprenticeship model whereby staff auditors gain competence, experience, and expertise through close supervision and on-the-job training. In practice, the level of competence, experience, and expertise of the lead engagement partner differs from that of the staff auditor. This concept is explicitly described in extant AS 1010.03 but is de-emphasized in the proposed standard. Footnote 7 of the proposed standard refers to AS 1201.05–.06 as amended, which requires reviewers to take into account the knowledge, skill, and ability of preparers. While this is helpful, we have additional recommendations to address these concerns. First, we recommend the following sentence from extant AS 1015.06 be incorporated into AS 1201:

Engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability.

We further recommend the PCAOB clarify that the competence of individual engagement team members differs based on a variety of factors. While proposed AS 1000.07 indicates an auditor needs the competence to "perform the assigned activities," which we believe is a critical phrase to retain in the final standard, we encourage the PCAOB to further emphasize or elaborate on this concept. This could be accomplished by adding the following note to proposed AS 1000.07:

Note: An individual's competence is measured against the assigned activities, including the type of activities, the extent of the individual's involvement, and the extent of supervision of the individual.

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In addition to various levels of experience, there are various roles within in an engagement team (including auditors and non-auditors) as well as other individuals who are not part of the engagement team but have assigned roles on the engagement (such as subject matter experts and engagement quality reviewers). We are unsure how requirements in paragraphs .07 and .08 are intended to apply to these individuals.

We recommend the PCAOB clarify paragraphs .07 and .08 of the proposed standard to more clearly define the individuals intended to be covered by these paragraphs. This could be accomplished by replacing "the auditor" with a more specific term(s) and (or) adding an explanatory note.

3. **We oppose the PCAOB's assertion that the measure of competence is only qualitative rather than both quantitative and qualitative.** Page 20 of the release gives an example whereby "an engagement partner with significant experience in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee the audit of a financial institution." We strongly agree that experience in a company's industry is one factor of an individual's competence. However, we believe this is simply one qualitative factor. Quantitative factors should also be considered in the measurement of one's competence. Further, as noted above, competence should be evaluated holistically and collectively (i.e., qualitative and quantitative factors should be considered for both individuals and the entire engagement team, including any specialists, as a whole). Therefore, we recommend the following revisions to proposed AS 1000.07:

The measure of competence is both qualitative and ~~rather than~~ quantitative, ~~because q~~  
Quantitative measurement alone may not accurately reflect the relevant experience gained over time.

4. **Proposed AS 1215.11 states, "...competence and training...may be documented in a central repository..." We believe this statement causes confusion because training is one of the three modes by which auditors develop and maintain competence according to proposed AS 1000.08.** Therefore, it is unclear whether the other modes of developing and maintaining competence (i.e., academic education and professional experience) may be documented in a central repository for the firm in accordance with proposed AS 1215.11. We recommend removing "and training" from proposed AS 1215.11 or revising it as follows:

.11 Certain matters, such as auditor independence, ~~staff competence and training, and~~ client acceptance and retention, and auditor competence, including training, may be documented in a central repository for the public accounting firm ("firm") or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

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?

### Reasonable assurance

We believe the proposed definition of "reasonable assurance" lacks vital language in comparison to extant AS 1015.10–.13, which specifies the difference between reasonable assurance and absolute assurance. There are inherent limitations to reasonable assurance (e.g., due to fraud), which we believe are important to describe for the sake of transparency, clarity, consistency in practice, and investor

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protection. As discussed in recent open meetings of the Investor Advisory Group (IAG), there appears to be an expectation gap between what the investor and the auditor each believe to be the level of assurance provided by the auditor's report. We believe the revised definition of reasonable assurance would exacerbate this disconnect. We believe it is imperative to bridge this gap for the safety of capital markets and, in doing so, it is important to strike the right balance in the language and tone used in the standards and auditor's opinion to achieve both consistency in auditor practice and an appropriate level of reliance that investors place on auditor's reports. To clearly demonstrate the role auditors play in the protection of investors, we believe the standards and the auditor's opinion should inform investors of the limitations of reasonable assurance. Likewise, and equally important, the standards should not devalue the audit by providing overly cautious statements. To protect capital markets, investors need confidence in the worthiness of the auditor's report while understanding the inherent limitations thereof. Therefore, we recommend incorporating language derived from extant AS 1015.10–.13 into proposed AS 1000 as follows:

.14 Reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence.<sup>25</sup> The auditor is able to obtain reasonable, but not absolute, assurance that (1) in an audit of financial statements, misstatements, whether caused by error or fraud, are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected.

Note: An audit conducted in accordance with these standards may not detect a material misstatement in the financial statements, whether caused by error or fraud, or a material weakness in internal control over financial reporting. The auditor's report does not constitute a guarantee or insure against a material misstatement or a material weakness in internal control over financial reporting.

Note: The subsequent discovery of either a material misstatement, whether from error or fraud, in the financial statements or a material weakness in internal control over financial reporting does not, in and of itself, evidence a failure to comply with the standards.

Additionally, we recommend revising the auditor's opinion in AS 3101 Appendix B as follows, with corresponding edits to AS 3101.09:

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence. Reasonable assurance is not absolute assurance and does not guarantee that the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

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### **Due professional care**

As described in our response to Question 11, we recommend separating the engagement partner's responsibilities related to due professional care into a separate paragraph.

### **Professional skepticism**

Significant updates have been made by other audit standard-setting bodies (i.e., the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB)) related to the guidance and application material on the concept of professional skepticism, yet "the proposed standard retains the concept of professional skepticism in substantially the same form as it is described in AS 1015." We encourage the PCAOB to update the guidance around professional skepticism to align with improvements made by other standard-setting bodies.

Additionally, paragraph .10 of the proposed standard has potential redundancies and causes some confusion. We recommend removing the first sentence of paragraph .10, as we believe it is redundant with paragraph .09. We recommend relocating the second sentence of paragraph .10 to be the first sentence of paragraph .11, as paragraph .11 would then comprehensively define professional skepticism. These revisions are summarized as follows:

~~.10 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit.~~

.11 Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. The auditor's exercise of professional skepticism includes:

- a. Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;<sup>20</sup>
- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not relying on evidence that is less than persuasive;
- d. Not assuming that management is honest or dishonest; and
- e. Consideration of potential bias on the part of management and the auditor.

Lastly, we understand the PCAOB's position to use "information related to the audit" rather than "audit evidence" (as described in AS 1015) to emphasize that application of professional skepticism extends beyond the information used as audit evidence in arriving at conclusions on which the auditor's opinion is based. However, the difference between "*critical assessment* of information related to the audit" and "*objective evaluation* of evidence obtained in an audit" is unclear. It is also unclear why the former is a component of the "attitude" while the latter describes one way in which an auditor exercises professional skepticism. We encourage the PCAOB to consider the relation between these two phrases to determine whether there are any unintended redundancies, and if not, to provide further guidance on this topic.

### **Professional judgment**

The release states that, "The description of professional judgment is similar to the definition in the IAASB and [American Institute of Certified Public Accountants] AICPA standards." However, we believe there are notable differences which require clarification. The IAASB and AICPA define professional judgment as:

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“The application of relevant training, knowledge, and experience, within the context provided by auditing, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.” Proposed AS 1000 introduces the concept of “well-reasoned conclusions,” which is not defined or explained. If the PCAOB’s intention is for “professional judgment” to have the same meaning as in the standards of the IAASB and AICPA, we highly recommend using the same definition. However, if the PCAOB’s intention is for this term to have a different or added meaning, we request the PCAOB explain those differences so that firms can adhere to the definition. For example, two different auditors with the appropriate competency and the same set of facts who exercise due professional care, professional skepticism, and all other requirements of PCAOB standards could use professional judgment and reach two different conclusions on the same matter. We believe that introducing the term “well-reasoned conclusions” without appropriate explanation in the authoritative standards could be used inappropriately to retrospectively evaluate an auditor’s judgment using hindsight.

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?

We agree that relevant Board-issued guidance is beneficial for interpreting the PCAOB’s intended meaning of approved standards. However, if there are details within adopting releases and other relevant guidance that are important enough to merit the auditor considering them in the conduct of the audit, we believe those details should be directly incorporated into the final standards. Our specific concerns and recommended revisions or clarifications are outlined below.

1. We suggest defining “take into account.” If the Board intends to retain this proposal in the final standard, we suggest stating what evidence the PCAOB would expect when determining compliance with the standards. While this term is used throughout PCAOB auditing standards, we would appreciate further clarity on how this differs from the terminology “should consider” or “should evaluate.” This could be accomplished by revising PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, to include expectations around “take into account” and “should evaluate.” Clarifying the definition of this term may alleviate some, but not all, of our other concerns below.
2. The proposed standard does not clearly specify the scope of relevant Board-issued guidance and the information therein that auditors would be expected to consider. The PCAOB’s website contains thousands of pages of releases, rule filings, and supplemental materials spanning the past two decades. For firms to effectively comply with the proposed standard, we believe it is crucial for the standard to explicitly state the scope and be organized in a manner by which all authoritative guidance is readily discoverable. We recommend the PCAOB specify the scope of the following:
  - Types of Board-issued guidance (e.g., Releases and Rule Filings, including Concept Releases, Proposed Rules, Final Rules, and Overviews; Supplemental Materials, including Transcripts and Transcript Excerpts, White Papers, Statements, Marked Text Illustrations, Briefing Papers, and Updates on Status)
  - Types of content within those documents (e.g., Background, Economic Analysis)
  - Superseded content (e.g., Proposed Rules)
  - Already-existing Board-issued guidance (i.e., effective retrospectively or prospectively)
  - Comments not codified through rule making (e.g., one commenter’s view on an exposure draft repeated in a Release, but not incorporated into the final rule)

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Further, the PCAOB would need to have a clear process for identifying superseded information and communicating it as such. For example:

- *Docket 028: Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* includes a concept release, two proposed rules, and 14 documents classified as supplemental materials, dating back to 2009. We request the Board clarify which information within these documents, if any, should be taken into account upon the adoption of proposed AS 1000 and (or) proposed AS 2310.
  - *Docket 044: Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* includes a final rule, a proposed rule, and 16 documents classified as supplemental materials, dating back to 2015. We request that the Board clarify whether information within this proposed rule should be taken into account, even if the Board's intention is for proposed rules to be superseded by final rules, due to the final rule referencing the proposed rule.
3. The PCAOB would need to develop a clear timeline for when these types of guidance are required to be taken into account, and this timeline would need to include sufficient time to allow for audit firms to develop their policies, tools, and resources; test them for quality control; and release them to the audit practice.
  4. If the Board intends to retain this proposal in the final standard, we highly encourage the Board to write the relevant guidance styled as application guidance.
  5. We appreciate the opportunity to comment on proposed standards during the standard proposal and approval process. Due to potential unintended consequences, we believe it may be detrimental for guidance which has not undergone a comment process to become authoritative. If the PCAOB appreciates the due process afforded by the comment process and feedback received from various parties—including audit firms, issuers, and investors—we believe the PCAOB should remove this note from the proposed standard.
  6. If the Board intends to retain this proposal in the final standard, we highly encourage both the PCAOB and the SEC to review the historical Board-issued guidance documents covered by the Board's intended scope with the same level of scrutiny that is given to proposed standards, as these would effectively become authoritative guidance. We question whether previously issued Board guidance was released with the notion that it would become authoritative in the future and subjected to the same scrutiny afforded to final standards.
  7. Related to number 5 above, we believe the same level of scrutiny would need to be given to future Board-issued guidance, which could cause delays in the proposal and adoption processes because the Board-issued guidance would hold the same weight as the final standard.
  8. The cost burden of implementing this change on a retrospective basis would outweigh the benefits. We analyze authoritative guidance with a very high level of scrutiny. While we read through the Board-issued guidance, we do so in a holistic way and do not analyze minute details to the same extent we do with authoritative guidance. Going back through the historical Board-issued guidance would take a significant amount of time given the sheer volume of information. This is especially concerning given the Board's current standard-setting agenda. Resources are limited, especially for smaller firms, and rehashing thousands of pages of guidance from the past two decades would undoubtedly take valuable resources away from the implementation of new standards.
  9. If this concept is retained in the final standard, we believe it is imperative for PCAOB staff guidance to be explicitly excluded, as proposed. First, as noted in the release, staff guidance represents the views of PCAOB staff and not necessarily those of the Board. Second, as mentioned above and in our response to Question 25 below, sufficient time between when authoritative guidance is adopted by the Board and approved by the SEC and when the authoritative guidance is implemented by auditors is necessary to ensure proper implementation.



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10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not?

No, we believe the proposed amendments do not clarify the meaning of “present fairly” appropriately, but rather create an unclear and unachievable performance standard.

First, the standard introduces new undefined terms. For example, the undefined phrase “informative and not misleading to a reasonable investor” is subjective and fundamentally different from existing standards. The financial statements, including disclosures, provide information to investors which is then used to make investment decisions. Investors may use information contained in the financial statements in different manners and for varying purposes. Determining whether information contained within the financial statements, including disclosures, is informative and not misleading would depend on the various, and potentially conflicting, views of different investors. Additionally, it is unclear how auditors would be evaluated by the PCAOB, the SEC, judicial courts, and potentially other authoritative bodies on their compliance with this standard given the lack of definition or applicable framework underpinning the phrase.

Second, we believe it is imperative for professional judgment to be exercised in the evaluation of whether financial statements are presented fairly in accordance with the applicable financial reporting framework. We recommend the proposed standards more explicitly refer to the concept of professional judgment as it relates to the “present fairly” evaluation. For example:

.30A When evaluating whether the financial statements present fairly the financial position, results of operations, cash flows, and disclosures, in all material respects, in conformity with the applicable financial reporting framework, the auditor should exercise professional judgment and evaluate whether:<sup>17C</sup>

- a. The information in the financial statements is presented and classified appropriately and in an informative and reasonable manner ~~that would be informative and not misleading to a reasonable investor;~~

Third, we disagree with the Board’s statements on page 30 of the release that, “...the auditor’s [existing] obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework.” On the contrary, extant AS 2815.03 states, “The independent auditor’s judgment concerning the “fairness” of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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.” Having auditors evaluate financial statements beyond their compliance with applicable financial reporting frameworks would essentially allow auditors to overwrite such frameworks, which could create an avenue for inconsistent accounting treatment and cause confusion among issuers and investors alike.

If the Board is concerned that certain financial reporting frameworks may be misleading, we urge the Board to voice these concerns with the respective accounting standard-setting bodies. We believe in proper separation of power. It is the accounting standard-setting bodies’ duty to establish the accounting rules; it is management’s duty to apply the accounting rules; and it is the auditor’s duty to evaluate whether the entity properly applied the accounting rules, in all material respects. It is in the best interests of the capital markets that the segregation of duties remains intact and clearly understandable to investors.

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Fourth, we believe the proposed standard should be clarified to further emphasize the importance of the notes (at times referred to as “disclosures”) in the financial statements, which are critical in the evaluation of whether the financial statements are presented fairly. We recommend that the standard clearly define the term “financial statements” to be inclusive of the financial statements and disclosures.

Fifth, proposed paragraph .31 has redundancies which we believe create unnecessary confusion and should be simplified. We suggest revising proposed AS 2810.31 as follows:

~~.31 As part of the evaluation of the presentation of the financial statements, the~~ The auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>18</sup> Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

Note: The auditor should also evaluate whether the substance of transactions or events differs materially from their form.

Lastly, we also believe proposed AS 2810.30A.c could inappropriately require the auditor to evaluate whether all company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements. Extant AS 2815.04(e) clarifies that not every account or transaction is evaluated by including the phrase “within a range of acceptable limits.” If the Board wishes to remove this language, we suggest revising proposed 2810.30A to include a footnote referencing AS 2110 or a note describing the relationship between 2810.30A and AS 2110 and adding “in all material respects” as follows:

- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements, in all material respects.

|   |
|---|
| 11. Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not? |
|---|

We agree the engagement partner plays a critical role on the engagement team, with heightened responsibility compared to other engagement team members. To emphasize this, we believe the engagement partner’s responsibilities warrant their own paragraphs. There are overlapping themes between proposed AS 1201.04 and 1201.05’s Note 2. We recommend relocating the substance of 1201.05 Note 2 to its own paragraph under the *Responsibility of the Engagement Partner for Supervision* heading. Similarly, proposed AS 1000.09 highlights the engagement partner’s responsibilities in relation to due care—to be consistent, we recommend putting this in its own paragraph.

Despite the engagement partner’s heightened responsibility, as noted in our response to Question 6, an audit is performed by a group of individuals, not just one auditor. There is a shared responsibility among the engagement team, and there are areas of an audit which require the need to involve other experts when necessary. We believe the proposed notes in AS 1201.04–.05 and 2101.03 inappropriately diminish the responsibility and value of other engagement team members and experts by indicating their reviews do not reduce the engagement partner’s responsibility. We agree that the engagement partner’s *responsibility* should not be reduced; however, we believe engagement partners should tailor the extent of their supervision based on a variety of factors as described in AS 1201.06. We encourage the PCAOB to add additional emphasis to this notion, perhaps by referring to AS 1201.06 specifically in these three notes.

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In addition, we believe the term “timely evaluate” is not sufficiently defined. While we agree that significant findings and issues should be evaluated timely, we would appreciate clarification on this term so that auditors are enabled to adhere to the expectations of this new authoritative standard and demonstrate compliance. Is there a specific time frame that would be considered by the PCAOB to be “timely,” or would this be left to auditor judgment?

Lastly, we believe the term “sufficient documentation” as used in proposed AS 1201.05 Note 2 is not sufficiently defined and may result in inconsistencies in the profession.

12. Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?

We agree with the amendments to AS 1215.15 in that reviews of audit documentation should be completed prior to the report release date, and we support this being formally specified in the standard. There may be inconsistencies in practice as to what this new language entails. For example, we request the PCAOB further clarify whether this would include ensuring all review notes have been sufficiently addressed prior to the report release date.

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 believe the proposed amendment to accelerate the documentation completion date to 14 days is beneficial and appropriate. However, one of the potential benefits noted in the release was that the PCAOB’s inspection process could potentially begin sooner. We believe beginning the inspection process earlier could be detrimental to audit quality, as it would cause auditors to reallocate their time to the inspection process rather than focusing on audits of financial statements not yet issued during a time in which issuers have regulatory requirements to file their financial statements. We would have concerns with our ability to support the inspection process if it began earlier in the year.

14. Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?

We believe this would create technological and process challenges for firms. Currently, support for Form AP is retained as part of the audit engagement file documentation, which is enabled by the filing of Form AP prior to the lock-down of the engagement file. Firms may need to establish a separate system of record and processes and controls for maintaining information related to Form AP that is acquired subsequent to the lock-down of the audit engagement file or create a process whereby the audit files could be re-opened for such information to be added, while ensuring no existing information in the file could be changed. While we believe finding solutions for this inconsistency would be less burdensome than accelerating Form AP filings for all issuers, we believe sufficient time should be allowed for implementation of the standard and technological changes needed.

16. Are the amendments to the general principles and responsibilities described in the PCAOB’s attestation standards appropriate? Should other relevant amendments be made to the PCAOB’s attestation standards? If so, what are they?

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The proposed amendments to the attestation (AT) standards refer to the auditing standards in numerous instances. We suggest limiting the references to the auditing standards such that the attestation standards can stand alone and be fit for purpose. Certain references may be necessary, but we believe certain references are inappropriate. For example, several footnotes in the attestation standards (AT No. 1's footnote 11A, AT No. 2's footnote 8B, and AT 101's footnote 7A) refer to AS 1000.10–.11, which discuss the concept of professional skepticism specifically in the context of an audit. Instead of this reference, which then requires interpretation of the content in the context of an attestation engagement, the content on professional skepticism should be incorporated directly into the attestation standards and tailored to an attestation engagement to enhance consistent operability.

Additionally, we believe it is inappropriate to remove paragraph .41 from AT 101. We believe this is relevant case law. If the PCAOB desires to remove this paragraph, we suggest that revision be included in the anticipated Attestation Standards Update proposal rather than this General Responsibilities of the Auditor in Conducting an Audit proposal.

Finally, we believe footnote 9A needs to be updated to state “review engagements” rather than “examination engagements.”

21. We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?

Please see our response to Question 9.

22. Are there any other economic impacts we did not describe above that are relevant for consideration? If so, please specify.

Please see responses to Questions 9 and 14 regarding certain costs we expect to incur if this standard is finalized as proposed.

24. The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.

We believe the proposal should apply to emerging growth companies (EGCs).

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?

Requiring compliance on June 30 the year after approval would present administrative, technological, and training challenges. First, we would need time to update our methodology, tools, and resources; test them for quality control; release them to the audit practice; and develop and deliver training sessions on these changes. The most significant time constraints would be the challenges we discussed in our responses to Questions 9 and 14. We would need at least one full audit cycle to implement the changes as proposed. Depending on the Board's intentions for our concerns in response to Question 9, we may need additional time (e.g., if the Board intends to retrospectively require auditors to take into account Board-issued guidance from the past two decades). Second, because the majority of our firm's audits are December 31 year-ends, we believe a December 15 effective date is a more natural timeline to implement changes to

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methodology and tools. Internally, we strive to implement methodology and tool changes effective in December each year to reduce confusion and administrative burden.

Many firms who perform audits in accordance with PCAOB standards use purchased audit methodologies and software tools and rely on these updates to implement and train on changes. The PCAOB should consult directly with the methodology providers to understand the timeline needed for them to implement the changes into their tools as well as then distribute and train auditors on the changes. This can inform the PCAOB on the needed timeline for implementation.

### Other Comments

We additionally suggest the following minor revisions to proposed AS 1000:

.17 The auditor's report must contain:

- a. In an audit of financial statements, an An expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed;<sup>30</sup> and
- b. In an audit of internal control over financial reporting, an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed

.19 When the auditor conducts an audit in accordance with the standards of the PCAOB, some circumstances require that the auditor express a qualified opinion, adverse opinion, or disclaimer of opinion on the company's financial statements or ~~the company's~~ internal control over financial reporting, and state the reasons for the departure from the unqualified opinion.<sup>34</sup>

Finally, we suggest the following revision to footnote 17A in proposed AS 2810 to align with the language in the SEC rule quoted:

<sup>17A</sup> For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20 17, C.F.R. § 240.12b-20 (requiring issuers to disclose "in a statement or report ... such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.").

\* \* \* \* \*

We would be pleased to respond to any questions the PCAOB or its staff may have about our comments. Please direct any questions to Adam Hallemeier, Deputy Chief Auditor, at 619.641.7318, or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

*RSM US LLP*

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February 1, 2023

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, DC 20006By e-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)**Re: Public Company Accounting Oversight Board (PCAOB) Proposals on A Firm's System of Quality Control**

Dear Office of the Secretary:

RSM US LLP (RSM) values the opportunity to offer our comments on the Public Company Accounting Oversight Board's (PCAOB or Board) proposed new quality control standard, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (the 'proposed standard' or 'QC 1000'). RSM is a registered public accounting firm serving middle-market issuers, brokers and dealers.

We appreciate the opportunity to comment on the proposed standard developed by the PCAOB. Overall, we are supportive of an updated standard for quality control (QC) and see many of the proposals in the proposed standard as a key step in the continuous improvement of a firm's QC system, and ultimately in higher-quality engagements.

**Overall Comments on the Proposed Standard**

While we support the revision of the QC standard by the PCAOB, we would like to encourage that additional consideration be given to further aligning the proposed standard with similar standards recently issued by jurisdictional or global standard setting bodies (including International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Review of Financial Statements, or Other Assurance or Related Services Engagements* (ISQM 1) and Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management* (SQMS 1), adopted by the American Institute of Certified Public Accountants (AICPA)) (hereafter also referred together as 'other jurisdictional and international quality control/management standards'). RSM US LLP has recently implemented ISQM 1 and SQMS 1, which has taken dedicated effort and time to change the QC mechanisms by which we proactively manage our QC system. We support the notion that the QC standard should be sufficiently principles-based and scalable, with an objective of enhancing engagement quality (in particular for audits), however there are some specific aspects in QC 1000 we believe should be aligned to other jurisdictional and international quality control/management standards to enhance the effectiveness and efficiency of the firm's QC systems overall, and have detailed these areas in the responses to specific questions within this letter.

We strongly support a QC standard that has a quality management approach that is focused on the firm's quality objectives, quality risks and responses, as this allows firms to uniquely tailor their QC system to

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their own circumstances. Such a risk-based approach is fundamental to the scalability and ultimately the effectiveness of the proposed standard. We believe that there are some aspects of the proposed standard that need to be reconsidered to accomplish this result:

- **Principles-based requirements** – Not all of the specified responses are presented as objective-driven and risk-based. This contradicts the firm’s risk assessment process component, resulting in some components or aspects of some components being compliance-driven rather than driven by the firm’s response to its unique circumstances.
- **Scalability** – Principles-based requirements allow for the scalability of the standard based on size, complexity and the unique circumstances of each firm. In addition to the concerns about principles-based requirements (or deficiency thereof) for scalability of the standard, there are other areas where we believe scalability is also impacted, including:
  - Definition of ‘quality control deficiency’ – as this includes all engagement deficiencies by default. We do not believe scalability is achieved as there may be engagement deficiencies that are not necessarily QC deficiencies.
- **Quality Risks Definition** – The inclusion of intentional acts within the definition of ‘quality risks’ fundamentally changes the scope of what would be included in a quality risk as compared to other jurisdictional and international quality control/management standards. This would require a firm to identify different quality risks and thus different responses in relation to QC 1000 than other jurisdictional and international quality control/management standards, which would be incredibly challenging and confusing. In addition to the lack of comparability across standards, the inclusion of the consideration of all intentional acts may lead to an effort that is not commensurate with the benefit to audit quality.
- **Evaluation date** – We also have significant concerns about the specific evaluation date of November 30 as set out in the proposed standard.

We provide further detail on these broader points and other comments related to the specific questions in our comments to the specific questions as set out below. We have responded to questions in the context of the circumstances of our firm. We have not responded to questions we believe do not apply to our firm.

### Comments on Specific Aspects of the Proposals

1. Is the proposed definition of “applicable professional and legal requirements” appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?

While we agree with the definition generally, it appears to be overly broad and may inadvertently scope into the QC system professional and legal requirements or other matters that are beyond the remit of the PCAOB. We recommend that the scope of the standard is more clearly ring-fenced, for example, by providing descriptions of what is intended to be covered by the firm’s system of quality control.

2. Is the proposed definition of “engagement” clear and appropriate? If not, why not? Should the definition be narrower (e.g., limited to engagements required to be performed under PCAOB standards) or broader? If so, how?

In our view, the proposed definition of ‘engagement’ is clear, and appropriate. We agree that a firm’s system of quality control should apply to any audit, attestation or review or other engagement performed under PCAOB standards or when the firm is playing a substantial role in the preparation or furnishing of an audit report.

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3. Are the proposed definitions of “firm personnel,” “other participants,” and “third-party providers” sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.

We agree that the definitions of “firm personnel” and “third-party providers” are clear and comprehensive. However, we believe that the definition of “other participants” is too broad as it includes groups that are by nature different and may be subject to more distinguishable elements of the firm’s system of quality control. By including these all together as “other participants” the standard may not sufficiently distinguish the requirements that are appropriately applicable to each group. We recommend that further consideration be given to how this definition can be more explicit between those that would be directly involved in the engagement versus those that may only be involved in quality control.

4. Is the other terminology used in QC 1000 clear and appropriate? Are there other terms that should be defined?

With the exception of “reasonable assurance” as detailed in our comments in this letter, the other terminology used in the proposed standard is clear and appropriate.

The objective of the firm’s QC system is to provide reasonable assurance as to compliance with the professional and legal requirements that apply to the firm’s engagements. In paragraph .10 of the proposed standard, it is acknowledged that reasonable assurance is a high, but not absolute, level of assurance. While we agree that this is consistent with current QC standards, as well as ISQM 1 and SQMS 1, we believe certain aspects of the proposed standard do not support a risk-based approach and would therefore result in an expectation of an ‘absolute assurance’ level rather than ‘reasonable assurance.’ We, therefore, encourage that the PCAOB further consider those specific areas that are more prescriptive in nature (and that would therefore drive activities or expectations towards absolute assurance) as set out in our comments in this letter.

6. Is the proposed distinction between the obligation to design a QC system and the obligation to implement and operate a QC system appropriate? Is the proposed threshold for full applicability of QC 1000—having obligations under applicable professional and legal requirements with respect to a firm engagement—appropriate?

We agree that it is appropriate to limit the application of the requirements of QC 1000 for firms that have no obligations under applicable professional and legal requirements with respect to the firm’s engagements.

7. Is it clear how a firm’s responsibilities under QC 1000 may change depending on the extent of “applicable professional and legal requirements” to which the firm is subject at a particular time? Please explain what additional direction may be necessary.

We believe it is clear how a firm’s responsibilities under QC 1000 may change depending on the extent of “applicable professional and legal requirements” to which the firm is subject at a particular time. It is our view that the example provided helps explain this and encourage that this example is included in the final standard.

8. Are there other provisions of QC 1000 that should apply to all firms? If so, which other provisions should we consider?



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We do not believe that there are any other provisions that should apply to all firms except as detailed in the proposed standard.

9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?

Scalability is broadly achieved through the ability to apply the requirements of a proposed standard to a wide variety of firms with differing natures and circumstances. In our view, this scalability in the proposed standard is achieved (in most instances) for firms below the 100-audit threshold through principles-based requirements that allow flexibility in how the requirement is applied for different circumstances. In addition, the risk-based approach also supports the scalability of the standard. However, there are instances within the proposed standard where the requirements are more prescriptive in nature and would, therefore not be scalable – we have detailed these within our responses in this letter. As noted in our response to question 16, we do not believe that including risks of intentional misconduct within the definition of quality risks as currently drafted in the proposed standard results in a standard that is scalable and risk-based.

10. Is the reasonable assurance objective described in the proposed standard appropriate? If not, why not? Are there additional objectives that a QC system should achieve? If so, what are they?

We agree with the reasonable assurance objective as this is consistent with other jurisdictional and international systems of quality control/management. However, we do have significant concerns with the interaction of deficiencies (i.e., how they have been defined in the proposed standard) and the objective of reasonable assurance (see our comment to question 4).

We do not believe any other objectives are needed for a QC system.

11. Are the proposed requirements regarding design of the QC system appropriate? Are there other aspects of QC 1000 that should be required as part of the design of the QC system? If so, what are they?

We agree with the aspects of the design of the QC system in paragraph .06 of QC 1000, and do not believe that there is anything further to add with regard to the design of a QC system.

12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?

We believe the requirements setting out the roles and responsibilities described in the proposed standard are clear. As noted in our response to question 53, we believe the definition of QC findings should be modified. As currently drafted, we believe the roles and responsibilities related to the individuals assigned operational responsibilities are overly expansive based on the inclusion of the inappropriate definition of QC findings and QC deficiencies and inclusion of engagement deficiencies.

13. Would firms have difficulty filling the specified roles in light of the proposed requirements?

We have concerns related to the ability to fill the role of the oversight function (see our response to question 23).

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14. Are the proposed definitions of “quality risks,” “quality objectives,” and “quality responses” sufficiently clear and comprehensive? If not, why not?

We agree with the proposed definitions of “quality objectives” and “quality responses.” However, we have concerns about the extensive impact of including ‘intentional acts’ within the definition of quality risks (See response to question 16).

15. Is the threshold of “adversely affecting” set out in the proposed definition of quality risk clear, or would more guidance and examples be helpful?

As this is consistent with other jurisdictional and international quality control/management standards, we believe it is clear and have no more specific requests for more guidance on this.

16. Should the proposed definition of “quality risks” explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?

We have significant concerns about the inclusion of intentional acts within the definition of “quality risks,” particularly without giving consideration to the reasonable possibility of occurrence or impact on the firm’s achievement of quality objectives of such acts. The risk of intentional acts by individuals is always present, and requiring consideration of all possible illegal acts would contradict a risk-based approach, which is foundational to the scalability of the standard. Identifying quality risks for all possible intentional acts would result in an unrealistic increase in the number of quality risks identified and, therefore, the required responses for those identified risks even where the likelihood of the risk occurring or adversely affecting the achievement of quality objectives is low. This would result in different quality risks and responses to what is required under other jurisdictional and international quality control/management standards, which have been widely adopted by firms in the US and globally. Therefore, we believe the definition of ‘quality risks’ should be aligned with other jurisdictional and international quality control/management standards.

In further considering the definition of ‘quality risks,’ our highest preference would be to fully align the definition of quality risks with the definition included in both ISQM 1 and SQMS 1, which is:

*“Quality risk – A risk that has a reasonable possibility of:*

- (i) Occurring; and*
- (ii) Individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.”*

A direct alignment of the words in the standards would omit any confusion, whether or not they were intended to be applied in the same way.

Alternatively, the following edits could be made to modify the existing style of the definition as included in the proposed standard, resulting in a definition that conforms to the same principles as the other jurisdictional and international quality control/management standards (deletions in ~~strike through~~, additions in **bold**), such as:

Quality risks – Risks **that have a reasonable possibility of occurring and** that, individually or in combination with other risks, have a reasonable possibility of adversely affecting the firm’s achievement of one or more quality objectives if the risks were to occur., ~~and are either:~~

- ~~(1) Risks that have a reasonable possibility of occurring; or~~

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~~(2) Risks of intentional acts by firm personnel and other participants to deceive or to violate applicable professional and legal requirements.~~

With either of these alternatives, the focus on risks of intentional acts could be retained within the standard in the performance requirements in paragraph .20, rather than within the definition of ‘quality risks.’ This could further heighten the firm’s focus on consideration of such risks, while doing so within the appropriate overall framework. We believe this could retain the concept of reminding firms to consider intentional acts without requiring a fundamentally different approach to the determination of quality risks and responses and would also result in a system of quality control that complies with the concepts of reasonable, not absolute assurance. This could be accomplished with the following edits to paragraph .20 (deletions in ~~strike through~~, additions in **bold**):

20. Annually, the firm must identify and assess *quality risks* to achieving each of the *quality objectives* established by the firm. The firm should:

a. Obtain an understanding of the conditions, events, and activities that may adversely affect the achievement of its *quality objectives*, which includes an understanding of the following:

(1) The nature and circumstances of the firm, including:

- (a) The complexity and operating characteristics of the firm;
- (b) The firm’s business processes and strategic and operational decisions and actions;
- (c) The characteristics and management style of leadership;
- (d) The resources of the firm;
- (e) The environment in which the firm operates, including *applicable professional and legal requirements*;
- (f) If the firm belongs to a network, the characteristics of the network and the network’s resources and services and the nature and extent of such resources and services used by the firm;
- (g) If the firm uses *other participants*, the nature and extent of their involvement;
- (h) If the firm participates in other firms’ *engagements*, the nature and extent of the firm’s participation; and
- (i) If the firm uses resources or services obtained from *third-party providers*, the nature and extent of those resources or services.  
 (See Appendix B for specific examples.)

(2) The nature and circumstances of the firm’s *engagements* (see Appendix B for specific examples).

(3) Other relevant information, including information from the firm’s monitoring and remediation activities, external inspections or reviews, and other oversight activities by regulators.

Note: The firm might identify conditions, events, and activities that may adversely affect the achievement of its *quality objectives* by asking “what could go wrong?” in relation to the achievement of a given *quality objective*.

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- b. Identify and assess *quality risks* based on the understanding obtained pursuant to paragraph .20a. and taking into account whether, how, and the degree to which the achievement of the *quality objectives* may be adversely affected.

Note: The assessment of *quality risks* is based on inherent risk (i.e., without regard to the effect of any related *quality responses*). **The assessment of quality risks includes the consideration of risks of intentional acts by firm personnel and other participants to deceive or to violate applicable professional and legal requirements.**

17. In the proposed definition of “quality risks” should the threshold of “reasonable possibility of occurring” also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?

We believe the threshold of “reasonable possibility of occurring” should apply to all quality risks. As explained in question 16 above, if there is no threshold for intentional misconduct, this will impact the scalability of the standard and may impact the achievement of quality objectives because the threshold for quality risk identification is too low and requires consideration of risks that would have no reasonable possibility of occurring or adversely impacting the achievement of quality objectives. This would result in deviations from other jurisdictional and international quality control/ management standards that are administrative burdens and not true enhancements to the system of quality control. It could detract from the firm’s ability to do a proper risk assessment and tailor quality responses to truly heightened risks. If the PCAOB decides to maintain intentional acts explicitly within the final standard, they should be included with all risks and subject to the “reasonable possibility” clause.

18. Are the proposed requirements for the firm’s risk assessment process appropriate? Are changes to the requirements necessary for this process? If so, what changes?

Subject to our concerns about the inclusion of intentional acts with no threshold and the impact on the risk assessment process, as explained in questions 16 and 17 above, we believe that the proposed risk assessment process is appropriate as set out in the proposed standard because the risk assessment process is consistent with other jurisdictional and international quality control/management standards that have recently been implemented.

19. Are the proposed requirements sufficient to prompt firms to appropriately identify, assess, and respond to quality risks, or is supplemental direction needed? If supplemental direction is needed, what would assist firms in identifying, assessing, and responding to quality risks?

Subject to our concerns about the inclusion of intentional acts with no threshold and the impact on the risk assessment process, as explained in questions 16 and 17 above, because the proposed requirements are consistent with other jurisdictional and international quality control/management standards, we believe they would sufficiently prompt firms to identify, assess, and respond to quality risks.

20. Are the specific examples included in Appendix B helpful in assisting the firm in identifying and assessing quality risks? Should additional examples or guidance be provided? If so, what additional examples or guidance would be helpful?

We agree that the examples provided in Appendix B are helpful.

21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

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As the proposed quality objectives for governance and leadership are broadly consistent with other jurisdictional and international quality control/management standards, we believe they are appropriate. Consistency between different sets of standards, where appropriate, and the elimination of unnecessary differences, will help firms focus their resources on those areas of higher risk.

22. For the proposed specified quality response related to the firm's governance structure, is the threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, what is an appropriate threshold?

No, please see our response to question 23.

23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?

We are concerned that there is a lack of linkage between the specified response of having an oversight function with the required quality objectives. It is not explained in the proposed standard or background materials, which quality objective or objectives this oversight function is intended to be a quality response to. As such we find it difficult to conclude that this quality response is appropriate.

Additionally, we encourage the PCAOB to further clarify the role of this individual with respect to the oversight function. We acknowledge that pages 97-98 of the Release state that the role was intentionally undefined; however, we are concerned that the lack of definition of what is expected by this "oversight function," coupled with the lack of clarity of what quality objectives are intended to be addressed by the "oversight function" will require significant guessing by firms on how to incorporate this required response effectively into their system of quality control. We are also concerned that the lack of clarity will make this role challenging for firms to attract suitably qualified individuals to fulfill the role.

If a specific threshold of 100 audit reports is retained, we encourage the PCAOB to consider the requirement for determining whether the threshold of 100 audit reports has been benchmarked to a more specific date and linking that date to the date of evaluation of the QC system. In determining a specific date, sufficient time for firms to hire an individual and for that individual to commence the oversight function should be allowed. All timings for the appointment of the individual and the commencement of their related activities should be explicit and sufficiently clear within the final standard.

24. Is the proposed specified quality response related to the firm's policies and procedures on receiving and investigating complaints and allegations appropriate? Are there any other specified quality responses in this area that we should consider, and if so, what are they?

While the specified quality responses in QC 1000 related to the firm's policies and procedures on receiving and investigating complaints and allegations are more specific to this component than other jurisdictional and international quality control/management standards, we believe that they are appropriate for the firm's engagements. However, we are concerned that they are overly prescriptive for 'other participants,' which may not all be individually subject to QC 1000.

25. Are there any other specified quality responses for the governance and leadership component that we should consider? If so, what are they?

We do not believe other specified quality responses should be added.

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26. Are the proposed quality objectives for ethics and independence requirements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

As the proposed quality objectives for ethics and independence requirements are broadly consistent with other jurisdictional and international quality control/management standards, we believe that they are appropriate, and that no further changes are needed.

27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?

Please see our responses to questions 28, 29 and 30.

28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?

We have such a system in place and therefore do not have further concerns with regard to the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests in regards to our firm.

However, we do recognize that for those without such a system that the implementation of such a system within the timeframe set out in the proposed standard may be challenging, and such implementation is costly. We would recommend that the requirement in paragraph 34(a)(1) and the threshold of 100 issuers be removed, and the consideration in paragraph 34(a)(2) be applied to all firms. As is noted in the Release, all firms that audit more than 500 SEC registrants currently have such a system in place. It is highly unlikely that any audit firms that currently have an automated system in place would determine such process is not needed taking into account the quality risks and nature and circumstances of the firm. In contrast, requiring such a system for all firms that audit 100 issuers obviates a firm's risk assessment process and ignores the reality that firms may have a very different risk profile related to direct or material indirect financial interests based on the ownership structures of the issuers they audit. We believe requiring all firms to consider automating this process will result in the appropriate application of automation to meet the individual firms' quality objectives within the application of the risk assessment process without the introduction of an artificial numerical threshold.

29. Is the proposed specified quality response related to communication of changes to the list of restricted entities at least monthly (and more frequently, if appropriate) to firm personnel and others performing work on behalf of the firm who are subject to independence requirements appropriate? Could communication to a more limited group accomplish the goal of alerting all individuals whose actions and relationships are relevant to independence? If so, to whom should changes be communicated?

We are unsure why a required communication is relevant for a firm that has an automated process for identifying direct and material indirect financial interests. While we agree that ongoing and timely maintenance of the firm's list of restricted entities is a prerequisite for such an automated system, we are unclear whether the requirement of communication is aligned with an automated system. We are also unclear whether communication is intended to mean a distributed communication (e.g., e-mail of the updated list) or communication can be simply made available (e.g., a website that hosts such list and is readily available to access).

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Additionally, we encourage that further consideration be given to how this requirement for a quality response is applied for 'other participants' (also see response to question 3) to make the quality response more relevant to those individuals. For example, as 2101, *Audit Planning (amended for fiscal year ends on or after December 15, 2024)*, paragraph .06D ('other auditor's compliance with independence and ethics requirements') already contains specific requirements for 'other participants' that are appropriate to the circumstances, including requiring a "written description of all relationships between the other auditor and the audit client or persons in financial oversight roles at the audit client that may reasonably be thought to bear on independence pursuant to the requirements of..." We, therefore, do not believe that the proposed QC standard needs to specifically address certain communications to 'other participants' where this is required more specifically by another standard and is aligned to the nature of the engagement (and would thus be appropriate to the 'other participant' in those circumstances).

30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?

We support the requirement to obtain an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures.

31. Are the proposed quality objectives for acceptance and continuance of client relationships and specific engagements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

We agree with the proposed quality objectives for acceptance and continuance of client relationships and specific engagements as they are broadly consistent with other jurisdictional and international quality control/management standards.

32. Are the proposed specified quality responses for acceptance and continuance of client relationships and specific engagements appropriate? If not, what changes to the specified quality responses are necessary for this component?

While the specified quality responses in QC 1000 for acceptance and continuance of client relationships and specific engagements are more specific to this component than other jurisdictional and international quality control/management standards we believe that they are appropriate, and that no further changes are needed.

However, we recommend clarifying the timing of when the firm becomes aware of information subsequent to accepting or continuing a client relationship, or specific engagement that could have caused the firm to decline such relationship or engagement had that information been known prior to acceptance or continuance' as set out in paragraph .40 of the proposed standard. In the Release, it is noted that "for purposes of the proposed standard, the firm is 'aware' of information if any partner, shareholder, member, or other principal of the firm is aware of such information" and that this is consistent with Form 3 (footnote 202). The note in Form 3 refers to the deemed date that the firm becomes aware (i.e., the deemed date that the 'firm' becomes aware is the date "any partner, shareholder, principal, owner, or member of the Firm first becomes aware of the facts." In our view we believe that this timing should be clarified within the standard so that it is consistent. The following changes could be made to footnote 27 of the standard for consistency (deletions in ~~strikethrough~~, additions in **bold**):

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Footnote 27 - For purposes of this standard, the firm is **deemed** "aware" of information **if when** any partner, shareholder, member, or other principal of the firm **is first becomes** aware of such information.

33. Are the proposed quality objectives for engagement performance appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

We agree with the quality objectives for engagement performance as they are broadly consistent with other jurisdictional and international quality control/management standards, with noted exceptions already existing in PCAOB standards (i.e., responsibilities for reporting and other communications). However, it is not clear why some of the concepts from the PCAOB standards have been included as an objective while others have not (for example, with respect to dividing responsibility for the audit with another accounting firm or using the work of an auditor engagement specialist).

34. Should we include specified quality responses for the engagement performance component? If so, what should they be?

No. We support the proposal to not include specific quality responses for the engagement performance component within the proposed standard as any quality responses would be firm-specific based on the identified risks of their clients and the nature and circumstances of their engagements.

36. Are the proposed quality objectives for resources appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

As the proposed quality objectives for resources are broadly consistent with other jurisdictional and international quality control/management standards we believe that they are appropriate, and that no further changes are needed.

37. Does the proposed quality objective and specified quality response related to technological resources provide sufficient direction to enable the appropriate use of emerging technologies? If not, what additional direction is necessary?

While the specified quality responses in QC 1000 related to technological resources are more specific to this component than other jurisdictional and international quality control/management standards, we believe that they are appropriate, and that no further direction is needed.

38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?

While the specified quality responses in QC 1000 for resources are more specific to this component than other jurisdictional and international quality control/management standards, we believe they are appropriate, and that no further changes are needed.

39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients? If yes, what should the requirement be?

We do not believe that the standard should include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients because this may not always be relevant. If it is relevant and is a risk in terms of QC 1000, it should be identified as a risk by firms as part of their risk assessment process.



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40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

As the proposed specified quality objectives for information and communication are broadly consistent with other jurisdictional and international quality control/management standards, we believe that they are appropriate and no further changes are needed.

41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?

We broadly support the quality objectives addressing the firm's external communications about firm-level and engagement-level information. However, we believe that further clarity is needed with regard to the scope of external communications – these should be limited to communications externally about audit quality, but not extend to other external information issued by the firm that is not specifically related to audit quality such as marketing communications or recruiting information. This limitation on scope to only audit quality related external communications should also be applied to the communication of how metrics are determined and explanations of year-on-year changes.

42. Are the proposed quality objective and specified quality response addressing information and communication related to other participants appropriate? If not, why not, and what changes are necessary?

The proposed quality objective and specified quality response addressing information and communication related to other participants are appropriate, and subject to our response above in question 41, we believe that no further changes are needed.

43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.

If information is required to be shared at the deficiency level, we do believe this would violate the confidentiality provision in Sarbanes-Oxley Section 105(b)(5)(A). However, if the information were not reported at that level but rather the system level (see our response regarding deficiencies at question 53) we would not have concerns.

44. Are the proposed specified quality responses for information and communication appropriate? If not, what changes to the specified quality responses are necessary for this component?

While the specified quality responses in QC 1000 related to information and communication are more specific to this component than other jurisdictional and international quality control/management standards, we believe they are appropriate with the exception of the requirements regarding "other participants" as addressed in our response to Question 3.

45. Are the proposed requirements for the monitoring and remediation process appropriate? Are changes to the requirements necessary for this process? If so, what changes should be made and why?

We believe that the elements of the monitoring and remediation process set out in paragraph .60 of QC 1000 are appropriate, with the exception of the individual elements that are explained below.

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46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?

We believe that the proposed requirement to inspect engagements for each engagement partner on a cyclical basis is appropriate.

47. Is it appropriate to require monitoring of in-process engagements by firms that issue audit reports with respect to more than 100 issuers during a calendar year? If not, is there a more appropriate threshold?

While we support the notion of monitoring in-process engagements as a highly effective quality response. However, as outlined in our response to question 28, we would recommend all firms be required to consider monitoring in-process engagements as outlined in paragraph .63(b) without a requirement based on the 100 issuer threshold. We believe that more clarity is needed about what such monitoring entails. More specificity and clear guidance about the nature, timing and extent of the required monitoring are needed to determine whether the proposed monitoring requirements are appropriate (or not).

48. Are the purposes of in-process monitoring (as proposed within this standard) clear and appropriate, including how in-process monitoring differs from the requirements of engagement quality reviews under AS 1220? If not, what additional direction is needed?

Subject to our answer about more specificity about the nature and scope of the in-process monitoring in the final standard, as explained in question 47 above, we believe that the purposes of in-process monitoring are clear and appropriate. Such specificity will also help distinguish such monitoring from the engagement quality review under AS 1220.

49. Is it appropriate to require firms to consider performing monitoring activities on work they perform on other firms' engagements? If not, why not?

Subject to our answer about more specificity about the nature and scope of the in-process monitoring in the final standard, as explained in question 47 above, we believe that the purposes of in-process monitoring are clear and appropriate.

50. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which engagements to select, appropriate? If not, what other factors should be specified?

As the factors are similar to other jurisdictional and international quality control/management standards we believe that they are appropriate, and that there are no other factors that should be considered.

51. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of QC system-level monitoring activities appropriate? If not, what other factors should be specified?

As the factors are similar to other jurisdictional and international quality control/management standards we believe that they are appropriate, and that there are no other factors that should be considered.

52. Are the proposed requirements for firms that belong to a network that performs monitoring activities appropriate? If not, what changes should be made?

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As the proposed requirements are broadly consistent with other jurisdictional and international quality control/management standards, we believe that they are appropriate, and that there are no other changes that are needed.

53. Are the proposed definitions for “engagement deficiency,” “QC finding,” and “QC deficiency” sufficiently clear and appropriate? If not, what changes should be made and why?

*Engagement deficiency* – we agree with the definition as proposed.

*QC finding* – we generally agree with the definition as proposed except where it states that “all engagement deficiencies would be a QC finding.” We have the view that all engagement deficiencies should be considered before determining that it is a QC finding, as there may be some engagement deficiencies that are not a QC finding (for example, where an engagement deficiency is unique to that engagement and not indicative of a finding that could be applicable to the whole population). We, therefore, recommend that this part of the definition be removed.

*QC deficiency* – as this definition is different from how other jurisdictional and international quality control/management standards have defined a ‘QC deficiency,’ we do not agree with this definition. A different definition of QC deficiency would result in different deficiencies being identified, relating to the same (or broadly similar) quality objectives, quality risks and quality responses, which may result in unnecessary confusion where firms are applying QC 1000 and other jurisdictional and international quality control/ management standards. In addition, it is unclear what the threshold for identifying deficiencies is – the definition states that it is “the reduced likelihood of achieving reasonable assurance objectives or one or more quality objectives.” If the definition is not made consistent with ISQM 1 and SQMS 1, we encourage the PCAOB to clarify the threshold more appropriately by providing more specificity than “reduced likelihood.”

54. What, if any, additional direction is needed regarding:
- a. Evaluating information to determine whether QC findings exist;
  - b. Evaluating QC findings to determine whether QC deficiencies exist; or
  - c. Responding to engagement and QC deficiencies?

It is not clear how the definition of ‘QC deficiencies’ interacts with how it is determined when a QC finding is a QC deficiency (as illustrated in the diagram on page 190 of the Release). Using the ‘nature, severity and pervasiveness/likelihood of a QC finding to determine whether that finding is a QC deficiency is clear, however when considering the definition of a QC deficiency, it is unclear how the former (which is a judgment) is taken into account. We encourage the PCAOB to be clear on how a QC deficiency is determined.

56. Are the proposed requirements related to monitoring and remediation sufficiently scalable for smaller firms? Are there aspects of the proposed requirements that could be further scaled?

The requirements within the monitoring and remediation section are written in a more prescriptive way which reduces the scalability of the requirements. While we acknowledge the importance of this component of a firm’s QC system, we do believe that quality objectives should be included and that the firm should assess their own quality risks, with mandated responses only for those areas where the PCAOB believes specific responses are required.

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57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?

While we support an annual evaluation of the effectiveness of the firm's QC system, we do not agree with a prescribed date within the standard. Rather, we believe that each firm should be allowed to determine their own date for their own circumstances. The date of November 30 is not necessarily ideal for all firms because:

- Many firms have already adopted ISQM 1 and SQMS 1 and have selected an evaluation date for their QC system that may be different from November 30 (for example firms may have selected a date that coincides with its fiscal year-end). In such circumstances, and if the November 30 date is maintained for the evaluation, firms would be required to undertake two evaluations in the year. This difference could lead to unnecessary work without a commensurate benefit to audit quality.
- November 30 is not the fiscal year-end for many firms. A firm's business cycle, with corresponding structures and processes, are often aligned to its fiscal year-end. Using a date that is different from the firm's fiscal year-end may create unnecessary complexities that may impact the effective operation of the firm's QC system. For example, firms may evaluate employees and adjust compensation to align with the firm's fiscal year-end. Part of the evaluation would relate to the quality of the individual's engagements, and therefore it seems nonsensical to evaluate similar quality-related information at two different dates where the firm's fiscal year-end is not November 30 (as this would not have a commensurate benefit to engagement quality).
- The reporting date would fall over a very busy period for firms – see our comments regarding the reporting date in question 63 below.

We, therefore, strongly encourage the PCAOB to allow a flexible date to be selected for the evaluation.

58. Is the proposed definition of "major QC deficiency" clear and appropriate? If not, what changes should be made and why?

While we agree with the concept of a 'major deficiency' to help a firm determine whether its QC system is operating effectively, we have concerns regarding the definition of 'a major QC deficiency.' In particular, the phrase that describes the likelihood of not achieving the objective of the QC system (i.e., a QC deficiency or combination of unremediated deficiencies '*severely reduces the likelihood*' of the firm achieving the reasonable assurance objective or one or more quality objectives) is indistinct and should be more clearly described within the definition.

We also have concerns about a 'presumed' major deficiency relating to deficiencies identified in the firm's governance and leadership, as explained in question 59 below.

59. Is it appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist? Are the circumstances described in the proposed definition appropriate? Should there be other circumstances that give rise to such a presumption? If so, what are they?

We do not agree that there should be any presumed risks that automatically result in a major QC deficiency as such a presumed risk would not align with a risk-based approach. While we recognize the importance of the firm's governance and leadership and the overarching nature of the component, we believe that not every deficiency within this component would necessarily rise to the level of a major

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deficiency, and that any deficiencies identified in this component, like the other components, should be judged on its pervasiveness and severity.

60. Are the proposed factors for determining whether an unremediated QC deficiency is a major QC deficiency appropriate? If not, what other factors should be specified?

Although we agree with the factors for determining whether an unremediated QC deficiency is a major QC deficiency set out in the proposed standard, we have concerns about how some of the factors could be considered if a root cause had not yet been undertaken, for example the impact of the deficiency on other components.

61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

We support reporting on the evaluation of the QC system to the PCAOB and that it is non-public. However, we encourage the PCAOB to further consider the deficiencies that are reported that are engagement deficiencies. Currently, the proposal would require all deficiencies that are not remediated to be reported, however we had significant concerns about the definition of 'deficiency' (see our answer to question 53 above). If the definition of deficiency is not changed, we recommend with respect to engagement deficiencies that are reported, that they are constrained to a delimiter. For example, in AS 1220, *Engagement Quality Review*, the standard sets out a definition for when a deficiency is determined to be a 'significant engagement deficiency,' and such a concept could be used to describe the deficiencies that are reported. We believe that such an approach would be consistent with the underlying premise of a risk-based approach and would not result in the reporting of individual engagement deficiencies that may be of much lower risk.

62. Should we require individual certifications of the evaluation of the QC system? Is the language in Appendix 2 regarding the certifications appropriate? If not, why not?

Subject to our answer to what the evaluation details in question 61 above, we support the individual certifications of the evaluation of the QC system.

63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?

Although we support reporting within a specific time after the firm's evaluation date, we do not agree with:

- A reporting date of January 15 – we believe that the evaluation date should not be fixed by the proposed standard but rather left to the firm's determination (see our response to question 57 above). Accordingly, although the reporting date should correspond to the evaluation date, we also believe that this should not be fixed but should rather be a set number of days after the firm-selected evaluation date.
- A time period of 45 days – we believe that this period should be longer to allow sufficient time to undertake the work effort related to the evaluation, and we would recommend 90 days after the evaluation date.

64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?

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Our preference is for firms to determine their own evaluation date, with the reporting date to correspond to that date (see questions 57 and 63 above), thus the fixed reporting date for Form 2 would not coincide with this approach.

65. Is the information required on proposed Form QC in Appendix 2 appropriate? Why or why not?

We do not have issues with the content of the form as set out in Form QC in Appendix 2 other than as related to the specific comments regarding the content as set out in questions 57-62 above. We would like to encourage that the web-based system for submitting the information is navigable and easy to use.

66. Are proposed Rule 2203A, Report on the Evaluation of the Firm's System of Quality Control, and the proposed Form QC instructions included in Appendix 2, clear and appropriate? If not, why not?

Subject to our comments about deficiencies (see question 53) and what should be reported in the Form QC (see question 61 above), we agree that the report and its instructions are clear and appropriate.

69. In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?

We do not support public reporting on QC matters outside what is required under Sarbanes-Oxley. Firms should retain flexibility to publicly report information on QC matters as they see fit.

70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?

We generally believe that the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system is appropriate as this will help to enhance a more robust two-way dialogue between the auditor and the audit committee. However, we are concerned that the communication of unremediated QC deficiencies that are not major QC deficiencies could be confusing to audit committees based on the overly broad definition of QC deficiencies (see our responses to questions 53, 60 and 61 above).

71. Are the proposed documentation requirements appropriate? If not, what changes should be made?

While we do not believe that further changes are needed to the documentation requirements, we have concerns about the proposed lockdown period. Analogous to an audit, the completion of the assembly of the documentation to support the QC report issued is an administrative process that does not involve the generation of new information or changing conclusions within the QC report. We, therefore, encourage the PCAOB to change the lockdown period to allow for such document assembly, and we recommend that this lockdown date is 45 days after the date of reporting.

72. Is the "experienced auditor QC threshold" set out in the in the proposed documentation requirement appropriate? If not, what threshold is appropriate?

Yes, the "experienced auditor QC threshold" set out in the proposed documentation requirement appropriate as it is a familiar concept to what is in the auditing standards.

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73. Are there additional specific matters that the firm should be required to document about its QC system? If so, what are they?

We do not believe that there are any other specific matters that should be documented.

74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?

Subject to our comments regarding what constitutes a deficiency in question 53 above, we believe it is appropriate to include engagement deficiencies on ICFR audits.

75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported? If not, why not?

Subject to our comments about what constitutes a deficiency in question 53 above, we believe it is appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported as this would contribute to improving audit quality.

77. Are the terms used in EI 1000 clear? Should additional terms be defined or additional guidance provided?

We do not believe the definitions are clear for the terms 'being... candid' in paragraph.02(a) and 'being intellectually honest' in paragraph .03(b). We recommend that the PCOAB clarify its expectations needed for these behaviors.

93. Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

Challenges with effectively implementing the proposed standard by the effective date as set out in the exposure draft could arise. Notwithstanding many concepts are similar to other quality control /management systems recently implemented by firms, there are significant differences (as detailed in our responses to this letter) that would require time to work through thoroughly and thoughtfully. We, therefore, do not believe that the effective date as proposed is appropriate. We recommend aligning with the effective date of SQMS 1, which is December 15, 2025, as this would allow firms time to effectively implement the requirements of the proposed standard. Experience in implementing ISQM 1 has also shown that firms need time to carefully identify and evaluate their quality risks, and implement appropriate responses to those risks, therefore necessitating a longer time period for implementation.

We would be pleased to respond to any questions the Board or its staff may have about our comments. Please direct any questions to Jamie Klenieski, Audit Quality and Risk Leader, at 215.648.3014 or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

*RSM US LLP*

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April 27, 2023

Answers to Questions in the Proposed Rulemaking – the following are comments in response to questions listed in P.C.A.O.B. Rulemaking Docket Matter No. 049, AS 1000, "Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit, and Proposed Amendments to P.C.A.O.B. Standards". This single commenter has read the text of this guidance, also known as P.C.A.O.B. Release No. 2023 – 01 (March 28, 2023), and P.C.A.O.B. Rulemaking Docket Matter No. 049. This proposed standard would reorganize and consolidate an older group of standards adopted by the Board in April 2003. The proposed standard addresses the general responsibilities of the auditor, as narrated in the guidance and reviewed below, in the conduct of an audit in accordance with the standards of the P.C.A.O.B. This commenter considers it a great privilege to comment on the proposed standard and to provide feedback hereby. Questions and answers are as follows :

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? **Answer :** This commenter believes the principles and responsibilities described in the proposal for audits performed under PCAOB standards are appropriate insofar as the objectives of the auditor are concerned along with auditor qualifications. On the subject of competence, due professional care, professional skepticism and the evaluation and sufficiency of audit evidence, the PCAOB should additionally consider addressing in this proposed standard the relevance and reliability of audit evidence and information per AS 1105. At present concerning relevance of audit information with respect to financial statement assertions, and the reliability of such information and evidence, proper care, evaluation and judgment are needed to determine what constitutes quality, material audit evidence and the requirements for such evidence starting with designing, planning and performing audit procedures. Audit evidence must be appropriate and sufficient, and of a quality that is relevant and reliable in order to support financial statement assertions and the auditor's opinion. Relevance as a concept is the relation between the financial statement assertion and the control being tested, and reliability has to do with the source of the audit evidence and the way or ways in which it is obtained. In audit testing, an internal control must be relevant to the related assertion and the information being tested must be preferably from an independent and knowledgeable, reliable source. As much should be included in this proposed auditing standard if the Board decides to examine these additional considerations.

2. Is the approach to reorganize and consolidate the general principles and responsibilities appropriate? If not, why not? **Answer:** The approach of the Board to reorganize and consolidate the general



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principles and responsibilities of the auditor is entirely appropriate provided that, as intended, the reorganization of the general principles and responsibilities coordinates properly with its underlying assumptions, with the audit assertions, overall financial accounting concepts such as accrual, periodicity, matching and conservatism, etc.; and the basic principles of internal control and the assessed risks of the audit.

3. Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why? **Answer:** The objectives of the auditor in the proposed standard are appropriate as documented for reasonable assurance about whether the financial statements are free of material misstatement, reasonable assurance as to the existence of material weaknesses in internal control, and communication and conformity with applicable and professional legal requirements.

4. Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not? **Answer:** The proposed requirements related to auditor independence are clear and comprehensive including the independence considerations set out by the S.E.C. that emphasize independence overall in fact and appearance throughout the audit and the professional engagement period.

5. Are the proposed requirements related to ethics clear and comprehensive? If not, why not? **Answer:** The proposed requirements related to ethics are clear and comprehensive including the ethics rules and requirements of the PCAOB. These include Part 5 of the PCAOB Auditing and Related Professional Practice Standards and Section 3 thereof.

6. Are the proposed requirements related to the auditor's competence clear and comprehensive? If not, why not? **Answer:** The proposed requirements related to the auditor's competence are clear and comprehensive insofar as these encompass adequate training and experience; knowledge, skill and ability that enable the auditor to perform assigned activities in conformity with professional and legal requirements and the firm's procedures. That this is a qualitative measure reflects the consideration of the Board of the overall experience of the auditor.

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? **Answer:** The proposed requirements and related descriptions of the general principles are clear and comprehensive. The narrative on the general principles is in understandable standard American English.

8. Are the general principles and responsibilities appropriate in light of the availability of electronic audit tools and the use of audit software by both larger and smaller firms? If not, what changes should be made? **Answer:** The general principles and responsibilities are appropriate given the availability of electronic audit tools and the use of audit software by both large and small firms. These are clear insofar as the general principles and responsibilities of the auditor are addressed in the foundational standards – AS 1001, AS 1005, AS 1010, and AS 1015, as these include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment that are necessary to the audit regardless of electronic tools and audit software.

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? **Answer:** The proposed requirement for the auditor to take into account relevant guidance such as PCAOB auditing documentation as it accompanies standards, amendments, and rules is appropriate. PCAOB documentation and guidance over the course of an audit will increase auditor effectiveness and efficiency as an authoritative resource.

10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not? **Answer:** The proposed amendments to clarify the meaning of “present fairly” are appropriate, especially insofar as “present fairly” means the financial statements are appropriately stated with the right information (not misleading), the financial statements adhere to a proper accounting framework in their disclosures, and there is proper recognition and measurement of transactions in the disclosures. “Present fairly” in this proposed standard also includes appropriate materiality considerations.

11. Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not. **Answer:** The proposed clarifying amendments related to engagement partner responsibilities that include supervision and engagement review are appropriate. This is especially important as the proposed standard aligns supervision and review responsibilities with due professional care, competence, proper judgment, audit planning, communication; significant findings, judgments and conclusions, engagement review and others that add up to the engagement partner’s final responsibility for the audit.

12. Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not? **Answer:** The proposed clarification in the proposed standard related to audit documentation is appropriate. Audit documentation is the basis for the review of the audit work product, and provides the engagement partner and other reviewers with a record of the planning and performance, and other aspects of the audit. This is especially important in the evaluation of judgments and conclusions made and documented during the audit and concerning other matters such as staff training and competence, audit procedures, and client retention.

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? **Answer:** The proposed amendment to accelerate the audit 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 is appropriate insofar as financial statement preparers, users, investors and other stakeholders have an interest in audit efficiencies and in as timely a completion of the audit as possible including the more timely release of the financial statements for review by end users and investors, and other financial stakeholders. The proposed amendment also invites the responsibilities of the audit supervisor to further exercise due professional care related to supervision and review of audit materials and work product, and further clarifies the role of the auditor in evaluating whether the

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financial statements “present fairly” the financial condition, revenues and expenses and cash flows of the examined entity. This change will also enable P.C.A.O.B. inspection of the work product of the audit in a more timely manner, result in earlier issue of audit inspection reports, and would reduce the possibility of improper alteration or inappropriate changes to the audit documentation. Less time to assemble the audit work product also allows for cost efficiencies in the completion of the audit field work, document assembly, review and so on, that is time – dependent insofar as audit costs are concerned. Less time to assemble and complete the audit work product will also result in cost and time efficiencies of the firms’ audit software and other utilities. These narrative points in the proposed standard indicate there are greater benefits, including enhancing audit quality and protecting investors, in shortening the time required to complete the audit work papers and work product than in allowing for as much as a month longer than is presently called for in the audit completion process.

14. Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them? **Answer:** Presumably, audit information, details, and documentation added after the audit completion date is of lesser quality than the work product assembled and reviewed, etc., before or at the date of audit completion. Audit documentation and work product that is material to the audit and that is added after the completion date can undermine the objectivity and integrity of the a priori completed audit work product. Information or details submitted related to Form AP after the issuance of the auditor’s report, if significant or materially negative to the audit can undermine the integrity of the completed work product. [This is also dependent] upon obligations of due professional care and due diligence. The Form AP deadline is important in this situation as the completion of the audit is thirty – five days officially before Form AP is due. The Board should use its discretion and judgment in evaluating the nature and quality of the audit papers submitted for accuracy, consistency and completeness, timeliness and given other related considerations; and evaluate as well the timeliness and completeness of Form AP as submitted.

15. Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required? **Answer:** This commenter believes overall that the size of the firm or type of engagement will typically not affect the time necessary to assemble a complete and final set of audit documentation. This commenter believes the financial condition of the entity under examination, the tone of management, the general competence of the audit team, and the condition of internal controls over financial reporting are more determinative of the amount of time needed, if additional time is needed, to complete the audit and finalize the audit documentation. If an entity is in a shoddy financial position or the tone of management is un – cooperative in the audit, and in other situations adverse to the proper and timely completion of the audit work product, especially if the entity is comparatively large in size, e.g., in measuring its assets, the engagement may need additional time for completion, and the additional period of time necessary under the circumstances should be at the discretion of the Board.

16. Are the amendments to the general principles and responsibilities described in the PCAOB’s attestation standards appropriate? Should other relevant amendments be made to the PCAOB’s

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attestation standards? If so, what are they? **Answer:** This proposed standard reaffirms as appropriate the general principles and responsibilities (reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment) to ensure a proper foundation for audit work and audit quality. The general principles and responsibilities as narrated in four separate standards, AS 1001, AS 1005, AS 1010, and AS 1015, will be integrated into and superseded by a single standard, AS 1000. This provides a single source of reference for the audit team and engagement partner insofar as their fundamental responsibilities in the conduct of the audit are concerned. These changes in guidance reflect changes in the overall audit environment (now reflecting additional independence requirements, changes to audit requirements, and changes in audit technologies), eliminate outdated and specious language in the standards, and are consistent with Board – issued standards to streamline and to clarify audit standards in alignment with Board – issued guidance; and to make the standards more logical, more understandable and easier to read and to apply.

17. Are the amendments to the general principles and responsibilities described in AS 4105, Reviews of Interim Financial Information, appropriate? Should other relevant amendments be made to AS 4105? If so, what are they? **Answer:** This commenter believes the general principles and responsibilities as described in AS 4105 are appropriate as these establish standards and objectives, and provide guidance on the nature, timing and extent of audit procedures to be performed by an accountant in the review of interim, selected quarterly and financial information of an entity. The preceding should be conducted as a financial statement examination by an independent accountant that includes certain quarterly certifications of internal control over financial reporting.

18. We request comment generally on the baseline for evaluating the economic impacts of the proposed standard. Are there additional factors we should consider? If so, what are they? Is there any evidence that auditors are failing to understand their obligations under today's standards, or that the standards set insufficiently robust expectations and obligations associated with the performance of an audit? If so, please explain. **Answer:** An audit in accordance with P.C.A.O.B. foundational standards and the general principles and responsibilities as outlined in this proposed standard will increase the overall quality and transparency of the financial statement audit. The general principles and responsibilities will be integrated into the audit firms' methodologies, published guidance and other technical tools : There is no evidence that audit personnel at audit firms are unclear or uncertain about the meaning of the proposed guidance (AS 1000.) The role of the proposed guidance is to simplify and to make the principles and responsibilities more easily understood and applied, resulting in audits that are of higher quality, more robust, more transparent, effective and efficient. Studies show that audited financial statements that are more transparent and readable, among other positive traits, result in higher valuations for stock companies. This commenter is aware of the financial and operational scale and scope of different audits and knows that while some financial statement audits with microeconomic considerations are more monetarily expensive and require a greater degree of examination than others, the overall time and effort required to conform with this proposed standard will not weigh down the expenses of the entity in a comparative sense, nor will conformity with the proposed standard in these matters prove arduous for audit firms.

19. We request comment generally on the analysis provided above regarding the need for the proposal. Should we consider any additional arguments, academic studies, or sources related to the need for

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standard setting? If so, please specify. **Answer:** This commenter, given the analysis provided above regarding the need for the proposed standard, is not aware of any additional arguments, academic studies, or sources related to the need for the proposed AS 1000. The guidance proposed in AS 1000 in fact and appearance does improve the audit quality, effectiveness and efficiency, robustness, transparency, and other positive traits highlighted in the proposed standard that should be required in an audit environment as changed as it is at present. AS 1000 by nature will assumedly not tangibly increase the scale of audit work, but will integrate in a proper compliance narrative the needed guidance for the general principles and responsibilities and other rules for necessary conformity with auditing standards in an audit environment that has markedly changed in its use of methodologies, firm processes and new technologies.

20. Are there additional potential benefits and costs that should be considered? If so, what are they? Please provide relevant data or other reference information. **Answer:** This commenter is not aware of any additional benefits to the proposed standard, nor any additional costs. This commenter views the proposed standard as potentially greatly increasing audit quality given its simplicity, comprehensibility and transparency.

21. We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered? **Answer:** This proposed guidance could indeed increase audit costs due to its emphasis on independence considerations. These might include additional documentation and narrative in the audit work product that would otherwise be marginal in the time and effort expended on independence questions and related documentation. This commenter does not view the proposed standard as having potential unintended consequences for auditors and audit firms given its coherent and comprehensive, understandable narrative and format.

22. Are there any other economic impacts we did not describe above that are relevant for consideration? If so, please specify. **Answer:** There might be some measures of economic utility of the conduct of the audit that could show themselves in the implementation of this proposed standard, such as time and effort given the various facets of the new guidance and lack of familiarity of audit teams with the proposed guidance, though this cannot be significant overall. It is also entirely possible that audit efficiencies will increase given the audit team competence requirements and the transparency [and simplicity] of the proposed guidance.

23. What academic studies or data should the Board consider in evaluating the potential benefits and costs of the proposed requirements? Please provide citations and other reference information for such studies and data. **Answer:** This commenter is not aware of any present or proposed studies nor research the Board should consider in evaluating the potential benefits and costs of the proposed requirements. Some constructive research might have a place in examining whether or not the nature of the Board's examinations of audit firms and the Boards enforcement actions will change as the result of the new requirements.

24. The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be

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made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify. **Answer:** This commenter is aware that the nature of EGC's and the microeconomics of EGC's are different from other entities. This commenter believes the annual audit standards should be the same for EGC's and for other entities, though in the publication of interim information, the disclosures of EGC's, per the discretion of the Board, should be derivative probably more of selected financial information than the requirements for interim information from larger entities. The reason for this is the scale of EGC's is many times much less than even many small issuers under P.C.A.O.B. requirements and the relative costs of audited financial statements are greater than at other, larger entities.

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? **Answer:** A uniform deadline for the required compliance on June 30 the year after approval by the SEC might invite uniform operational and methodological, technical changes from a number of audit firms. This presents a marginal monetary and human capital challenge of keeping up with standards as faced by audit firms and the related expenditures for new compliance measures in the conduct of audits themselves. This challenge probably can best be addressed by the audit firms internally.

By,

*Thomas H. Spitters, C.P.A.*

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May 26, 2023

PCAOB  
Office of the Secretary  
1666 K Street, NW  
Washington, DC 20006-2803

Email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

RE: Request for Comments on PCAOB's Release No. 2023-001 (No. 49) – Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards

PCAOB Board:

The views expressed herein are written on behalf of the Professional Standards Committee (PSC) of the Texas Society of CPAs. The committee has been authorized by the Texas Society of CPAs' Leadership Council to submit comments on matters of interest to the membership. The views expressed in this document have not been approved by the Texas Society of CPAs' Leadership Council or Board of Directors and, therefore, should not be construed as representing the views or policy of the Texas Society of CPAs. Please find our responses below to the requests for comment in the above-referenced Release No. 2023-001.

We support the PCAOB's project to update and streamline interim audit standards to ensure consistency with other standards. However, we do have concerns that this proposed standard significantly expands the auditors' responsibilities, which is inconsistent with the stated objectives of this proposal.

Response to Question 1: The PSC believes that the summary of general principles and responsibilities included in the proposal is appropriate, except for our response to questions 10 and 11.

Response to Question 2: As a general standard guiding principle, the PSC reiterates its view that it would be helpful if the PCAOB's auditing standards were not divergent from AICPA auditing standards to the extent appropriate and would assist in clarification of requirements.

Response to Question 9: The proposed AS 1000 paragraph .15 and FN 26 are overly broad and would be impractical to implement as worded. The PSC recommends that any specific "relevant guidance" be listed in the accompanying final standard. This will also allow PCAOB guidance to be included in a firm's quality control processes.

Response to Question 10: The PSC has several concerns regarding the amendments to clarify "present fairly." The proposed amendments to AS 2810 and proposed rescission of AS 2815 are not mere "clarification" and in fact, expand the meaning of "presents fairly" beyond current auditor



responsibility inconsistent with the Board's stated intentions. The PSC believes that the Board should include the current standard wording for the auditor's fundamental responsibility as found in AS 3101, par. .08e. The proposed amendments delete extant section 2815.03 relating to auditor's judgment concerning fairness grounded within the framework of generally accepted accounting principles. The PSC believes that portions of AS 2815, especially AS 2815.03, should be retained.

The PSC believes that clarification and expanded discussion are needed for the Board's language in amended AS 2810, par. 30A b relating to the proposed change requiring the auditor to determine that "The accounting principles selected and applied by the company's management are in conformity with the applicable financial reporting framework *and are appropriate under the circumstances.*"

Additionally, clarification is needed on the purpose of the Board's proposed change in wording in AS 2810 par..31 to the requirement that the auditor "consider" whether the substance of transactions or events differ from their form to an "evaluate" standard, and whether any new procedures and documentation relating to the evaluation are intended by the Board.

Response to Question 11: The PSC is concerned that the optics of the proposed amendments create an incorrect perception that the responsibility for all phases of the audit is almost exclusively limited to the engagement partner and does not adequately recognize that the performance of the audit is a firm and engagement team shared responsibility. The PSC believes that the Note added to proposed AS 1201.04, Note 2 to AS 1201.05 and the Note added to AS 2101.03 are unnecessary and recommends that they be deleted from the proposed standard.

Response to Question 13 and 15: The PSC is generally in agreement with the proposed amendment to accelerate the documentation completion date by reducing the maximum number of days to finalize audit documentation to 14 days. We do not believe this is a significant change or will result in expedited inspection schedules. However, the Board should consider if additional time should be provided for smaller firms to comply with the shortened documentation completion date.

Response to Question 25: The PSC believes that the implementation date of June 30 the year after SEC approval will present challenges depending on when the SEC approval is obtained. We think it would be simpler to use the language as presented in other PCOAB standards of "the fiscal year ending on or after December 15." Additional explanation of why the June 30 date was chosen would be helpful in understanding the Board's intent on the implementation date.

We appreciate the opportunity to provide feedback on the PCAOB's Release No. 2023-001.

Sincerely,



J. Ramsey Womack III, CPA  
Chair, Professional Standards Committee  
Texas Society of Certified Public Accountants





U.S. Chamber of Commerce

1615 H Street, NW  
Washington, DC 20062-2000  
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June 5, 2023

Ms. Phoebe W. Brown  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**Re: Proposed Auditing Standard – *General Responsibilities of the Auditor in Conducting an Audit* (PCAOB Release No. 2023-001, March 28, 2023; PCAOB Rulemaking Docket Matter No. 049)**

Dear Ms. Brown:

The U.S. Chamber of Commerce (“Chamber”) Center for Capital Markets Competitiveness appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB” or “Board”) Exposure Draft on *General Responsibilities of the Auditor in Conducting an Audit* (“Exposure Draft” or “Proposal”). The Proposal is part of the Board’s standard-setting agenda to update and modernize PCAOB Auditing Standards (“AS”). The Chamber supports the PCAOB’s goal to update its auditing standards with thoughtful consideration and due process.<sup>1</sup>

This standard-setting project focuses on the general principles and responsibilities of the auditor in conducting an audit. These principles and responsibilities are foundational and encompass extant PCAOB standards on reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment.<sup>2</sup>

According to the Executive Summary of the Proposal, the PCAOB is “reaffirming the general principles and responsibilities to ensure that the foundation continues to be solid and appropriate for maintaining high quality audits.”<sup>3</sup> The proposed standard (“AS 1000”) and amendments would modernize PCAOB standards to “[r]eflect changes in the auditing environment; [e]liminate outdated and inconsistent language; and [a]chieve consistency with Board-issued standards.”<sup>4</sup> These summarizations suggest that the Proposal is essentially a housekeeping exercise.

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<sup>1</sup> For example, see the letters to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB Concept Release on *Potential Approach to Revisions to PCAOB Quality Control Standards* dated March 16, 2020; the PCAOB Request for Comment on *Advisory Groups – Draft Governance Frameworks* dated February 28, 2022; and the PCAOB Request for Comment on the *Draft 2022-2026 Strategic Plan* dated August 16, 2022.

<sup>2</sup> See the Exposure Draft, page 4.

<sup>3</sup> See the Exposure Draft, page 4.

<sup>4</sup> See the Exposure Draft, page 5.

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However, considering the Exposure Draft in its entirety reveals that the proposed revisions belie these benign characterizations. The Chamber is challenged to interpret the Proposal as consistent with a reaffirmation or clarification of existing standards. Rather than reaffirm and clarify, the Proposal creates confusion about the role and responsibilities of auditors; mischaracterizes the application of generally accepted accounting principles (“U.S. GAAP”) as promulgated by the Financial Accounting Standards Board (“FASB”) – which provides the financial reporting framework in Securities and Exchange Commission (“SEC”) filings and bounds the auditor’s responsibilities; promotes an expectations gap with investors; has significant attendant consequences, which lack any meaningful economic analysis; and raises a number of other concerns.

In its current form, the Chamber cannot support the Proposal as fit for purpose. The Chamber strongly urges the PCAOB to withdraw it and substantially reconsider, recraft, and re-expose a revised proposed standard on the general responsibilities of the auditor in conducting an audit.

Following a background on the U.S. financial reporting structure and framework that provides context for our concerns and recommendations, we discuss them in more detail below.

### **Background**

It is widely recognized that reliable financial reporting is essential to well-functioning capital markets and our economy. In the U.S., market participants – regulators, standard-setters, management, boards and audit committees, internal auditors, independent auditors, securities lawyers, and the providers of capital, among others – all play a role and work together in support of reliable financial reporting.

However, it is also the case, that under the U.S. financial reporting structure, management is responsible for preparing and filing GAAP-compliant financial statements with footnote disclosures (for convenience, referred to as “the financial statements”) as required by the SEC. Management is likewise responsible for establishing and maintaining effective internal control over financial reporting (“ICFR”).

Management’s responsibility for adopting sound accounting policies, maintaining effective ICFR, and making fair representations in the financial statements contrasts with the auditor’s responsibility for verifying management’s representations.<sup>5</sup> An independent audit

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<sup>5</sup> For example, see *Auditing & Assurance Services: An Integrated Approach (15<sup>th</sup> Edition)* by A. A. Arens, R. J. Elder, and M. S. Beasley, page 143.

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increases the reliability of financial statements and ICFR information reported by management, thereby, enhancing the confidence of investors and creditors in this information.<sup>6</sup>

#### *U.S. GAAP*

GAAP as promulgated by FASB is the financial reporting framework for U.S. companies.<sup>7</sup> In the aftermath of the Sarbanes-Oxley Act of 2002 (“SOX”), the SEC formally reaffirmed FASB as the private-sector standard setter for U.S. GAAP under SOX Section 108. Thus, FASB’s financial accounting and reporting standards are recognized as “generally accepted” for the purposes of the federal securities laws.<sup>8</sup>

Registrants are required to comply with FASB standards in preparing financial statements filed with the Commission. SEC Regulation S-X Rule 4-01(a)(1) states:

*Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.*

The FASB Accounting Standards Codification (“Codification”) is the source of authoritative GAAP recognized by FASB for application by companies and auditors. Importantly, Topic 105-10-05-1 of the Codification explicitly provides that rules and interpretive releases of the SEC under authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. Topic 105-10-05-4 of the Codification explains that content in the SEC sections is designated by an “S” preceding the section number and provided for convenience, relates only to SEC registrants, and does not contain the entire population of current SEC rules, regulation, interpretive releases, and staff guidance.

#### *Effective ICFR*

SEC rules require management to base its evaluation of the effectiveness of ICFR on a suitable recognized control framework (also known as control criteria) established by a body or group that follows due process procedures, including the broad distribution of the framework

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<sup>6</sup> For example, see the Center for Audit Quality White Paper on “The Value of the Audit: A Brief History and the Path Forward” (“CAQ White Paper”) (June 2021); the “U.S. Financial Reporting Structure for Public Companies: A Blue Print” available on the SEC website under the Office of the Chief Accountant; and various statements by SEC Commissioners and staff such as the recent Statement on “Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors” by Paul Munter, SEC Chief Accountant (March 9, 2022).

<sup>7</sup> U.S. GAAP as promulgated by FASB is also used as the financial reporting framework by many Foreign Private Issuers (“FPIs”).

<sup>8</sup> See the SEC Policy Statement *Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter* (Release Nos. 33-8221; 34-47743; IC-26028; FR-70) (April 25, 2003).

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for public comment.<sup>9</sup> The control framework promulgated by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) is the most widely used framework for ICFR-related reporting in SEC filings.

### *Reasonableness*

Reasonableness is a core principle of the U.S. financial reporting framework. For example, management is responsible for maintaining books and records in reasonable detail and maintaining a system of ICFR that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.<sup>10</sup> “Reasonable detail” and “reasonable assurance” are defined as the level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.<sup>11</sup>

Financial statement audits and integrated audits of the financial statements and ICFR provide reasonable assurance. The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the GAAP financial statements are free of material misstatement, whether caused by error or fraud, (i.e., “fairly presented”) and, in an integrated audit, whether effective ICFR was maintained in all material respects. Reasonable assurance is a high level of assurance – it is not absolute assurance. The auditor is not an insurer or guarantor.

Reasonableness also applies to the judgments inherent in accounting and financial reporting in accordance with U.S. GAAP, the application of COSO to ICFR, and auditing in accordance with PCAOB rules and standards. For example, accounting and financial reporting judgments by management include selecting and implementing the accounting standards to account for transactions and events; estimating the amount to record; evaluating the sufficiency of evidence; and deciding on financial statement presentation and footnote disclosures.<sup>12</sup> Likewise, professional judgment is inherent in all phases of the audit – from deciding on client acceptance and retention; through planning and conducting the engagement, obtaining sufficient appropriate evidence, and rendering an opinion; to documenting the process and result.

### **Overarching Concern with the Proposal**

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<sup>9</sup> See AS 2201 on *The Audit of Internal Control Over Financial Reporting that is Integrated with An Audit of Financial Statements*, footnote 7.

<sup>10</sup> For example, see the Foreign Corrupt Practices Act (Sections 13(b)(2)(A) and (B) of the Exchange Act) and SEC *Guidance Regarding Management’s Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934* (“Management Guidance”) (June 27, 2007).

<sup>11</sup> For example, see the Exchange Act Section 13(b)(7).

<sup>12</sup> See the *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008), pages 89-91.

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This background provides context for discussing the Chamber’s concerns about the Proposal and how it undermines the U.S. financial reporting structure and framework. In addition, the current regulatory environment for auditors, including the Board’s focus on enforcement as a primary tool of the PCAOB,<sup>13</sup> helped inform our perspectives on the Proposal, as reflected in the subsequent discussion.

We also considered the Proposal in light of the goals and objectives for standard-setting in the PCAOB’s Strategic Plan (“Plan”). The Plan calls for modernizing PCAOB standards, not just to meaningfully improve audit quality, but to enhance the PCAOB’s ability to enforce standards and inspect for compliance.<sup>14</sup> Unfortunately, the Proposal will have very little practical effect on the former and primarily focuses on the latter.

Whether by accident or design, the proposed revisions and amendments in standards on the general responsibilities of the auditor – both individually and collectively – are not likely to improve audit quality. Rather, the Proposal will significantly increase the risks for audit firms and individual auditors, including engagement partners, of PCAOB inspection findings, PCAOB enforcement, SEC enforcement, and private securities litigation, along with attendant reputation effects.

Further, the Board’s focus on enhancing inspection findings and enforcement, including against engagement partners, may have additional unintended consequences that will have long-lasting adverse impacts on the profession. Attracting and retaining high quality talent has always been an important priority for the profession. But the challenges of doing so have been greater in the last few years. The Proposal may exacerbate these challenges. The Chamber is very concerned that the Proposal will contribute to undermining the attractiveness of the audit profession, which extends to the willingness of individuals to serve as engagement partners on issuer and broker-dealer audits.

These are a few of the important consequences that require robust economic analysis and full consideration by the Board. Such analyses and considerations are absent from the Proposal. Instead, the Proposal contains very limited economic analysis that concludes: “Overall, we expect that the economic impacts of the proposed changes, including both benefits and costs, would be relatively modest ...”<sup>15</sup> While the benefits of the Proposal are likely modest, the costs are not.

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<sup>13</sup> For example, see the PCAOB Media Advisory and video on Chair Williams Keynotes Baruch Conference on Financial Reporting (May 4, 2023).

<sup>14</sup> See the *PCAOB Strategic Plan 2022-2026*, page 10.

<sup>15</sup> See the Exposure Draft, page 45.

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The costs that have not been analyzed – either quantitatively or qualitatively – include the costs to audit firms from the new legal duties and auditor responsibilities created by the Proposal, as subsequently discussed. Moreover, the ensuing costs of the Proposal will impact issuers and broker-dealers through increased audit fees, which likewise have not been analyzed or considered.

The inadequacy of the economic analysis and consideration of consequences – both intended and unintended consequences – necessitates that the PCAOB withdraw and reconsider the Proposal.

We next address the PCAOB’s claim that the auditor’s responsibilities on financial statement audits are not bound by GAAP and that “mere” compliance with GAAP is not sufficient.

### **GAAP Bounds the Auditor’s Responsibility to Evaluate Fair Presentation of a Company’s Financial Statements**

The Chamber is very concerned that the PCAOB is using the Proposal as an attempt to remove the financial reporting framework of U.S. GAAP as the boundary for the auditor’s responsibilities in rendering opinions on financial statements. For example, the narrative (release) text of the Proposal states:

*[t]he amendments would clarify that the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework. U.S. federal securities laws prohibit the financial statements and company disclosures from being materially misleading, which is a broader concept than mere compliance with the applicable financial reporting framework. Presented fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework. However, the existing standards may not be sufficiently clear that the auditor’s obligation concerning the fairness of the financial statements extends beyond compliance with the applicable financial reporting framework.<sup>16</sup>*

Otherwise, the Proposal provides no additional discussion of this matter.

The Chamber is puzzled by the claim that “existing standards may not be sufficiently clear ...” Existing PCAOB standards appear to be a model of clarity. To illustrate, currently PCAOB AS 2815 on *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”* states:

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<sup>16</sup> See the Exposure Draft, page 30.

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*The independent auditor's judgment concerning the 'fairness' of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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.*<sup>17</sup>

The Proposal calls for deleting this provision from PCAOB auditing standards.<sup>18</sup>

Adding to the puzzle, the proposed revisions in the meaning of “fairly present” were stealth-like, as only Board Member Stein referred to them during the open Board meeting.<sup>19</sup> Otherwise, to discern the proposed revisions required reading the entire Exposure Draft. However, matters crystalized when the PCAOB issued an Investor Bulletin to market the Proposal to investors. The Bulletin said:

*The Board's proposal, if adopted, would ...clarify that the auditor's responsibility to evaluate the fair presentation of a company's financial statements is a broader concept than mere compliance with the applicable financial reporting framework (such as U.S. GAAP).*<sup>20</sup>

Unfortunately, “clarify” cannot be used to describe a core responsibility that does not now exist.

Perhaps this is why Board Member Stein referred to the proposed revisions as an “enhancement.” Even so, “enhancement” likewise understates the import of such a sea-change in the auditor’s responsibilities. Irrespective of semantics, such a proposal is conceptually flawed, practically unworkable, lacks any economic analysis by the PCAOB, and contributes to an expectation gap with investors.

To elaborate, the Proposal would also amend AS 2810 on *Evaluating Audit Results* to add a footnote to paragraph AS 2810.17 on the evaluation of the effect of uncorrected misstatements. The proposed footnote reads:

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<sup>17</sup> See the deleted text in the Exposure Draft, page A2-3.

<sup>18</sup> The Proposal deletes additional language in AS 2815 on the meaning of “present fairly” that should be retained. This includes language in paragraph AS 2815.04 such as “... within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.”

<sup>19</sup> Board Member Stein’s statement, posted on the PCAOB website, says: “The proposal enhances an auditor’s evaluation of the presentation of the financial statements. This includes requiring an auditor’s determination of whether additional information or disclosures, beyond those required by the financial reporting framework, may be necessary.” See “A Return to Roots: General Responsibilities of the Auditor in Conducting an Audit” by Kara M. Stein, Board Member, at the PCAOB Open Board Meeting (March 28, 2023).

<sup>20</sup> See the PCAOB Investor Bulletin on an *Opportunity to Comment on Proposed Standard Addressing Core Auditing Principles and Responsibilities* (April 17, 2023).

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*For additional considerations regarding the fairness of presentation of financial statements, see, e.g., SEC Rule 12b-20.17, C.F.R. [par.]240.12b-20 (requiring issuers to disclose “in a statement or report ... such further information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”).<sup>21</sup>*

It is instructive to recognize that Section 240 of the Code of Federal Regulation (“CFR”) involves the “General Rules and Regulations, Securities Exchange Act of 1934.” Paragraph 240.12b-20 (“Rule 12b-20”) is a longstanding provision on “Additional Information” that deals with material omissions in SEC filings. It states:

*In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.*

Rule 12b-20 applies to filings with the SEC (i.e., annual Form 10-Ks and quarterly Form 10-Qs) in their entirety. In applying to SEC filings broadly, Rule 12b-20 falls under the purview of the securities lawyers that advise management. Auditors are not expected to be experts in the securities laws.<sup>22</sup>

Moreover, PCAOB auditing standards distinguish between the auditor’s responsibilities related to the financial statements and the auditor’s responsibilities related to other information in documents containing audited financial statements such as 10-Ks and 10-Qs. The latter standard, which the PCAOB is not proposing to amend, states:

*The auditor’s responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document. However, he should read the other information and consider whether such information, or the manner of its presentation is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements.<sup>23</sup>*

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<sup>21</sup> See the Exposure Draft, page A2-2.

<sup>22</sup> It is noteworthy that the proposed changes would place auditors “in the shoes of management” (and the securities lawyers that advise management) to assess SEC 10-K and 10-Q filings in their entirety, as to whether additional information is necessary to make the filing not misleading. Such a move contravenes SEC and PCAOB auditor independence rules, too.

<sup>23</sup> See PCAOB AS 2710.04 on *Other Information in Documents Containing Audited Financial Statements*.



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However, the PCAOB's claims are flawed setting aside these considerations and the proposed footnote. SEC rules that involve GAAP reporting do not remove U.S. GAAP as the boundary for auditor responsibilities. As previously discussed, as an additional source of authoritative GAAP for SEC registrants, the FASB Accounting Standards Codification (i.e., U.S. GAAP) encompasses SEC rules, regulations, and interpretive releases for financial statement presentation and footnote disclosure. The PCAOB should not attempt to create auditor responsibilities out of an oxymoron.

Further reinforcing compliance with GAAP as the boundary for fair presentation of the financial statements, auditors cannot override GAAP under PCAOB rules and standards. To explain, Rule 203 (now Rule 2.320.030) of the Code of Professional Ethics of the American Institute of Certified Public Accountants ("AICPA") permits an unqualified opinion on financial statements that departs from GAAP under certain, very limited circumstances. While the use of this "GAAP override" rarely occurs in audits of private companies, it does not apply at all to audits overseen by the PCAOB – as the PCAOB has never adopted Rule 203 or an equivalent.<sup>24</sup> Compliance with U.S. GAAP is both necessary and sufficient for the auditor to render an unqualified opinion on financial statement audits of issuers and broker-dealers.<sup>25</sup>

To summarize, GAAP as promulgated by FASB is the financial reporting framework for U.S. companies. The auditor expresses an opinion about whether the financial statements comport with GAAP in all material respects – which is the meaning of "fairly present." The differing responsibilities of management and auditors under the U.S. financial reporting structure are, nonetheless, aligned based on GAAP as the framework for financial statement presentation and footnote disclosure. This alignment makes both conceptual and practical sense.

In this regard, the Proposal raises significant issues for companies (i.e., issuers and broker-dealers). It is essential to recognize that the PCAOB's proposed changes in the auditor's responsibilities, by extension, likewise eliminate U.S. GAAP as the boundary for management's responsibilities. Clearly the PCAOB does not have the authority to do so. The PCAOB is swimming outside its lane.

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<sup>24</sup> See PCAOB Auditing Standard 6 (AS 2820) on *Evaluating Consistency of Financial Statements and Conforming Amendments* (PCAOB Release No. 2008-001) (November 15, 2008), pages 14-15, which explains that, in 2003, when the Board adopted certain AICPA rules and Auditing Standard Board standards as interim Board standards, the Board did not adopt Rule 203.

<sup>25</sup> A proposed note to AS 2810.31 raises similar concerns, as it is untethered to GAAP, saying: "The auditor should also evaluate whether the substance of transactions or events differs materially from their form." (See the Exposure Draft, page A2-3.) The PCAOB should maintain the extant language in AS 2815.06, including the term "consider" rather than "evaluate," as follows: "Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form."

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Importantly, the Proposal fails to include any economic analysis of the proposed revisions and amendments to the meaning of “fairly present.” No evidence is provided to support the need for, or the costs and benefits of, the proposed revisions and amendments to remove GAAP as the boundary for the auditor’s responsibilities to evaluate fair presentation of a company’s financial statements. Regardless of whether the Proposal is described as a reaffirmation, a clarification, an enhancement, a sea-change, or simply misguided – it requires robust economic analysis.

In addition, by claiming that U.S. GAAP is not the boundary for auditor responsibilities on financial statement audits, the PCAOB is contributing to an expectation gap with investors. The PCAOB lacks the authority to overcome any investor perceptions of shortcomings in GAAP or to expect auditors do likewise – that authority resides with FASB and the SEC.

The Chamber strongly urges the PCAOB to eliminate the proposed amendment to AS 2810 (i.e., delete the proposed footnote to paragraph AS 2810.17) and maintain the substance of AS 2815.

### **Additional Concerns**

The Chamber has a number of additional concerns with the Proposal, including proposed revisions and amendments related to the objectives of an audit, reasonable assurance, the meaning of “the financial statements as a whole,” due professional care, professional skepticism, professional judgment, and competence in addition to other matters. These concerns are discussed in more detail below.

#### *Objectives of an Audit*

Independent audits have long been required for registrants in support of the SEC’s tri-part mission to protect investors, facilitate capital formation, and maintain fair, orderly, and efficient markets. The investor protection aspect of this mission was enhanced with SOX and the creation of the PCAOB (under SEC oversight). As provided in SOX Section 101(a), the PCAOB’s mission is to:

*[O]versee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.<sup>26</sup>*

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<sup>26</sup> SOX gives the PCAOB authority for registration, inspection, standard-setting, and enforcement of auditors and audits of issuers. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) added auditors of certain broker-dealers to the PCAOB’s inspection authority.

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The Chamber appreciates the essential role of independent audits in enhancing the confidence of investors and other market participants in a company's financial statements (and ICFR on integrated audits) that underpins the PCAOB's investor protection mission.<sup>27</sup> Auditors overseen by the PCAOB should and do recognize the purpose of an audit and that investors are the primary users of the financial statements. This is part of the culture of audit firms and is reflected in auditor independence requirements and other PCAOB rules and standards.

However, the PCAOB risks misleading investors and others by stating in an auditing standard on the general responsibilities of auditors that "[a]uditors have a fundamental obligation to protect investors" and "that obligation governs the auditor's work under the standards of the PCAOB."<sup>28</sup> Rather, PCAOB rules and standards govern (i.e., control and direct) the auditor's work. Moreover, the Proposal conflates the overall benefits from independent audits for investors in our capital markets with any potential legal duties in the context of the facts and circumstances of individual audit engagements.

Our concerns are reinforced by narrative (release) text in the Proposal such as "[a]uditors have a fundamental obligation to the public by serving as the protector of the public interest in the integrity of financial statements."<sup>29</sup> Again, such overarching statements run the risk of being interpreted as creating legal or fiduciary duties for auditors to an unknown cadre of investors or the public generally.<sup>30</sup>

The Chamber urges the PCAOB to delete proposed paragraph AS 1000.01. The proposed paragraph AS 1000.02 can serve as an appropriate introduction.<sup>31, 32</sup>

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<sup>27</sup> See the Exposure Draft, page A1-1.

<sup>28</sup> See the Exposure Draft, page A1-1.

<sup>29</sup> See the Exposure Draft, page 16.

<sup>30</sup> The PCAOB also cites a 1984 Supreme Court decision that the auditor functions as a "public watchdog" (see the Exposure Draft, page 16). However, this case arose out of an investigation of a corporation's tax returns by the Internal Revenue Service ("IRS"). And, the Exposure Draft mischaracterizes the decision, which is narrower than suggested and did not find or create any legal obligation of the nature suggested. Under provisions of the Internal Revenue Code of 1954, the IRS sought access to the tax accrual workpapers prepared by an independent audit firm, while routinely reviewing the corporation's financial statements. The corporation instructed the audit firm not to comply with an IRS summons – under some form of work-product immunity from disclosure – and the IRS sued for enforcement of the summons. The court rejected an analogy to the work-product protection available in the context of legal advice – contrasting the attorney's role as "confidential adviser and advocate" to the role of the independent auditor as a "disinterested analyst charged with public obligations" (*United States, Petitioner v. Arthur Young & Co.*, 465 U.S. 805 (1984) at 818).

<sup>31</sup> See the Exposure Draft, page A1-1.

<sup>32</sup> For the same reasons (along with others subsequently discussed), the proposed paragraph AS 1000.15 should also be deleted or reframed, as it states: "The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors." See the Exposure Draft, page A1-6.

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In addition, while we assume that it is a drafting oversight, the proposed paragraphs on the objectives of the auditor, AS 1000.03(a) and 1000.03(b), lack any reference to the relevant criteria – that is U.S. GAAP for (a) and COSO (or other suitable control criteria) for (b). As to the latter, references to ICFR throughout the Proposal likewise lack any tethering to COSO (or other suitable control criteria) and need to be reconsidered. Indeed, we could not find any mention anywhere in the Proposal of the control criteria for ICFR. Further, the Chamber suggests the PCAOB clarify that the audit of ICFR is integrated with a financial statement audit. Currently, the Proposal reads as if the PCAOB is referring to a standalone audit of ICFR.

#### *Reasonable Assurance*

As previously discussed, reasonableness is a core principle of the U.S. financial reporting framework. Consistent with this core principle, financial statement audits and integrated audits of the financial statements and ICFR provide reasonable assurance. Although the PCAOB is proposing to retain the concept of reasonable assurance,<sup>33</sup> the Proposal fails to include important language from existing PCAOB standards that provide transparency on the meaning of reasonable assurance – and the PCAOB fails to explain or justify this move.

The following examples of selected portions from PCAOB auditing standards that the Proposal deletes illustrate the breadth of the provisions being eliminated:

*(AS 1015.10) ... Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Although not absolute assurance, reasonable assurance is a high level of assurance. Therefore, an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements.*

*(AS 1015.11) ... As a result of these factors, in the great majority of cases the auditor has to rely on evidence that is persuasive rather than convincing.*

*(AS 1015.12) ... Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement. ...*

*(AS 1015.13) Since the auditor's opinion on the financial statements or internal control over financial reporting is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to*

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<sup>33</sup> See the Exposure Draft, pages 27, A1-1, and A1-6.

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*obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the Public Company Accounting Oversight Board (United States).*

The Chamber is concerned that failing to retain the longstanding explanatory language in AS 1015 will confuse investors about the nature of reasonable assurance. Investors may not appreciate or respect that the Proposal represents no change in the meaning of reasonable assurance. Indeed, quite the opposite, investors will likely assume that the deletions signal a change.

From an investor perspective, mentioning in the narrative (release) text of the Proposal – that reasonable assurance is attained by performing audit procedures and evaluating the resulting audit evidence in accordance with PCAOB standards – is not especially useful.<sup>34</sup> Irrespective of how it is attained, investors generally prefer that auditors provide absolute assurance or they expect a level of assurance higher than reasonable assurance.<sup>35</sup> The deleted language helps explain why these investor preferences and expectations are unrealistic and not attainable.

The Chamber strongly urges the PCAOB to restore the deleted language from AS 1015. Deleting the explanatory language also reinforces our concerns that the Proposal is focused on facilitating PCAOB inspections, regulatory enforcement, and litigation against auditors.

#### *Meaning of the Financial Statements as a Whole*

Consistent with the U.S. financial reporting framework, practice has long considered the meaning of “financial statements as a whole” to be just that – the financial statements (including footnotes) taken as a whole. It does not mean an individual line-item of a financial statement, an individual financial statement, or an individual footnote.

Nonetheless, among the many subtle revisions of existing PCAOB auditing standards, without due consideration and economic analysis, is a proposed change in the meaning of the phrase “taken as a whole.” The Proposal includes an amendment to AS 3101 on *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* stating: “‘Taken as a whole’ applies equally to a complete set of financial statements and to an individual financial statement with appropriate disclosures.”<sup>36</sup>

The Chamber strongly urges the PCAOB to delete this proposed amendment to the meaning of “taken as a whole.” Revising the long-standing meaning of “taken as a whole”

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<sup>34</sup> See the Exposure Draft, page 27.

<sup>35</sup> See the Exposure Draft, pages 39 and 40.

<sup>36</sup> See the Exposure Draft, page A4-22.

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represents another example of our concerns that the Proposal undermines the U.S. financial reporting framework and focuses on facilitating PCAOB inspections, regulatory enforcement, and litigation against auditors. And, yet again, by extension, the proposed amendment will impact companies (i.e., issuers and broker-dealers), too, as the meaning of “taken as a whole” applies to all.

### *Due Professional Care*

In consolidating the general principles and responsibilities of the auditor into a single standard (AS 1000), the Proposal eliminates four PCAOB Auditing Standards (AS 1001 on *Responsibilities and Functions of the Independent Auditor*, AS 1005 on *Independence*, AS 1010 on *Training and Proficiency of the Independent Auditor*, and AS 1015 on *Due Professional Care in the Performance of Work*) and significantly revises the provisions of the four standards in the process. The Chamber has concerns about these deletions and proposed revisions.

For example, AS 1000 does not include paragraphs AS 1015.03 and AS 1015.04 that describe the nature of auditor responsibilities for conducting audits with due professional care. This provision has been part of auditing standards for decades. Without this context, investors may be confused about the meaning of due professional care and/or assume the Proposal somehow alters the auditor’s responsibilities in this regard. The Chamber strongly recommends the PCAOB restore AS 1015.03 and AS 1015.04.

Throughout the Proposal, revisions related to auditor compliance with various core principles, including due professional care and professional judgment, tether auditor responsibilities for compliance to the “applicable professional and legal requirements.”<sup>37</sup> The Chamber understands that this term is included in the recently proposed quality control standard.<sup>38</sup> Nonetheless, we find the term problematic. It lacks clarity – it could mean anything or everything.<sup>39</sup>

Moreover, the term “applicable professional and legal requirements” appears to exceed the PCAOB’s authority. We note that in accordance with SOX Sections 104 and 105, PCAOB inspection and enforcement investigations assess compliance with SOX, the rules of the Board, rules of the Commission, or professional standards. Professional standards are defined to include auditing, attestation, quality control, ethical, competency, and independence standards as determined by the Board or Commission.<sup>40</sup>

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<sup>37</sup> For example, see the Exposure Draft, page A1-4 and the professional judgment paragraph on page A1-5.

<sup>38</sup> For example, see the Exposure Draft, page 17.

<sup>39</sup> For example, narrative (release) text in the Exposure Draft that a reference to professional and legal requirements in the paragraph on professional judgment is not intended to create a new requirement is not particularly helpful. See the Exposure Draft, page 26.

<sup>40</sup> See SOX Section 2(a)(10)(B). Accounting principles established by FASB or prescribed by the Commission would also be included in the definition of professional standards under SOX Section 2(a)(10). Indications of violations of

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The Chamber strongly urges the PCAOB to replace “applicable professional and legal requirements” with a more appropriate term throughout the Proposal. We recommend using the term “PCAOB rules and standards,” which include rules of the Commission and reflect the implement of SOX requirements. “PCAOB rules and standards” define the boundaries of the applicable professional and legal requirements on PCAOB audit engagements.

### *Professional Skepticism*

The Chamber appreciates that exercising due professional care includes exercising professional skepticism in conducting an audit. The current standard, AS 1015.07, defines professional skepticism as “an attitude that includes a questioning mind and critical assessment of audit evidence.” However, the Proposal defines professional skepticism as “an attitude that includes a questioning mind and a critical assessment of information related to the audit.”<sup>41</sup> “Information” is substituted for evidence in other proposed revisions and amendments, too.<sup>42</sup>

Unfortunately, information (or information related to the audit) is not a defined term in PCAOB Auditing Standards.<sup>43</sup> It lacks clarity – it could be anything – especially when viewed after the fact. However, evidence is defined and auditor responsibilities are described in AS 1105 on *Audit Evidence*. Audit evidence is obtained from performing audit procedures. Professional skepticism involves a critical assessment of audit evidence, including objective evaluation of evidence obtained in an audit that supports and corroborates and that contradicts management’s assertions that the financial statements are fairly presented in accordance with U.S. GAAP (or ICFR is effective in accordance with COSO). The Chamber strongly recommends the PCAOB use the term “evidence.”

The Proposal states that the exercise of professional skepticism includes “consideration of potential bias on the part of management and the auditor.”<sup>44</sup> The phrase “and the auditor” seems added as an afterthought. While the need to consider potential management bias is long recognized, a need to consider auditor bias is new to PCAOB Auditing Standards and introduced into the proposed standard on the auditor’s general responsibilities without explanation or guidance. The Chamber strongly recommends the PCAOB delete it. Rather than improve audit quality, this appears another attempt to facilitate PCAOB inspections and enforcement.

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accounting principles affect issuers and the PCAOB has no authority over issuers. However, such indications are reported to the Commission under PCAOB Rule 4004.

<sup>41</sup> See the Exposure Draft, page A1-4 paragraph 1000.10, along with paragraph 1000.11.

<sup>42</sup> For example, see the Exposure Draft, pages A4-16, A4-30, A4-31, and A4-32.

<sup>43</sup> Other standard-setters may use terms such as “information related to the audit.” Even so, this is not PCAOB defined terminology, although narrative (release) text includes a few examples of what the PCAOB considers to be “information.” See the Exposure Draft, page 24.

<sup>44</sup> See the Exposure Draft, page A1-5.

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### *Professional Judgment*

In addition to matters previously discussed related to professional judgment, the Proposal adds a paragraph on professional judgment to AS 1000.<sup>45</sup> However, the proposed provision does not include language from AS 2815 that “the concept of materiality is inherent in the auditor’s judgments.”<sup>46</sup> The Chamber strongly recommends that the concept of materiality be included in any provision on professional judgment.

### *Competence*

The Proposal includes provisions related to competence that do not appreciate audits are performed by teams and, therefore, the requirements should apply to teams as a whole.<sup>47</sup> Although engagement partners have overall responsibility, audits represent the collective effort of an engagement partner, EQR and other partners, professional staff and staff support, specialists, national office consultation staff, and others. In addition, auditors are not lawyers and should not be expected to have expertise in “SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.”<sup>48</sup> As to the latter, while auditors have industry knowledge, they are not industry experts, per se. The auditor’s competence is tethered to financial reporting and auditing related matters. The Chamber recommends the PCAOB recraft these provisions.

Further, proposed amendments to other standards (e.g., AS 1201 on *Supervision of the Audit Engagement*) add requirements for engagement partner responsibilities that are overly prescriptive. In addition, such requirements do not appreciate that the nature of project management and workflow require some flexibility and engagement-specific tailoring for effective audits, including flexibility related to engagement partner review of and sign-off on documentation. Auditing standards should not introduce a “one size fits all” approach. The Chamber strongly recommends that the PCAOB reconsider these provisions from this perspective. As it stands, the amendments appear largely intended to facilitate PCAOB inspection findings and enforcement actions targeted against engagement partners.

### *Other Matters*

The Proposal introduces the notion that relevant guidance includes PCAOB auditing interpretations, Board issued guidance, and releases accompanying the standards and rules of

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<sup>45</sup> See the Exposure Draft, page A1-5.

<sup>46</sup> See the Exposure Draft, page A1-5 and deleted language on A2-4.

<sup>47</sup> For example, see the proposed wording of AS 1000.07 in the Exposure Draft, pages A1-6 and A1-7.

<sup>48</sup> See the Exposure Draft, page A1-3.



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the Board.<sup>49</sup> As to the latter, it is unrealistic for the Board to designate as authoritative guidance the hundreds of pages of release (narrative) text and the variety of information contained in such text. Commentators may use release text to help understand the rationale and justification for a proposed rule or standard, along with its expected costs and benefits. However, commentators do not comprehensively consider release text in recommending revisions to PCAOB proposals. This point likewise extends to release text in final rules and standards adopted by the Board and subject to SEC due process, with notice and comment as part of the Commission's approval process.

In addition, the Chamber is unaware of any Board issued guidance and it does not appear to be explained or defined in the Proposal. Thus, we do not understand the distinction between rules and standards of the Board versus Board guidance. Importantly, to be authoritative, any Board issued guidance requires due process by both the PCAOB and SEC.

The Chamber strongly recommends that the PCAOB revise the definition of authoritative PCAOB guidance to exclude releases accompanying standards and rules. Any relevant authoritative guidance should be included in a PCAOB rule or standard itself. Further, any (all) PCAOB rules, standards, and guidance intended to be authoritative should be subject to due process by the PCAOB (with public notice and comment) and – after adoption by the Board – submitted to the SEC for approval by the Commission (after public notice and comment).

The Proposal would accelerate the documentation completion date by reducing the maximum time to assemble and complete a final set of audit documentation for retention from 45 days to 14 days from the report release date.<sup>50</sup> The rationale for this move is to support timelier inspections and provide the strongest incentives for firms to implement operating efficiencies.<sup>51</sup>

The Chamber questions whether this revision will have any meaningful impact on PCAOB inspection timelines and operating efficiencies are not the purview of the PCAOB. In addition, we question whether it is workable for smaller audit firms, who may not have the technology to implement this change. We are concerned that it will be another mechanism for generating Part IB deficiencies in audit firm inspection reports and enhancing PCAOB enforcement activities.

### **Transparency and Due Process**

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<sup>49</sup> See footnote 26 in the Exposure Draft, page A1-6, along with page 28.

<sup>50</sup> See the Exposure Draft, page A3-4.

<sup>51</sup> See the Exposure Draft, page 54.

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The Chamber is a strong advocate for transparency and due process in standard-setting and regulatory rule-making. A basic level of transparency is especially important with this Proposal to understand the nature and scope of the PCAOB's proposed revisions in the general responsibilities of the auditor.

Thus, the Chamber requests the PCAOB disclose those with whom it has consulted on this project. For example, the PCAOB should disclose the name of the former PCAOB chief auditor<sup>52</sup> and identify any consultants, advisers, or others that have assisted in crafting the Exposure Draft, provided feedback on it in non-public settings (including in non-public meetings of PCAOB advisory groups or committees), or otherwise influenced the development and drafting of it.

Given the nature of this Proposal and the potential for conflicts of interest, transparency is paramount for credibility. To illustrate, individuals or groups that engage in litigation against auditors, or provide expert support for plaintiff attorneys that do, will personally benefit from the Proposal. The Proposal is a dream come true for plaintiffs and plaintiffs' attorneys. The individuals and groups with this type of vested interest in the proposed revisions should not have any influence on the Proposal. If they have had, for this reason alone, the PCAOB should withdraw the Proposal.

### **Concluding Remarks**

In conclusion, the Chamber supports the PCAOB's goal to update its Auditing Standards. Nonetheless, we have deep concerns about this Proposal and strongly urge the PCAOB to withdraw it.

The Chamber also recognizes that setting standards takes time. Due process is essential. We encourage the Board to focus on crafting well informed, balanced, cost-effective standards that will improve audit quality and stand the test of time, rather than simply "rushing to revise" with a focus on enhancing PCAOB inspections and enforcement.

The Chamber hopes that the Board finds our comments and recommendations useful.

Thank you for your consideration and we stand ready to discuss these matters with you further.

Sincerely,

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<sup>52</sup> The Chamber notes that the current Chief Auditor disclosed, at the June 15, 2022 meeting of the PCAOB Standards and Emerging Issues Advisory Group ("SEIAG"), that an (unnamed) former PCAOB chief auditor was assisting her Office with the Board's ambitious standard-setting agenda.

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A handwritten signature in black ink, appearing to read 'TK' with a long horizontal flourish extending to the right.

Tom Quadman  
Executive Vice President  
Center for Capital Markets Competitiveness  
U.S. Chamber of Commerce

Via email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

May 29, 2023

Office of the Secretary  
PCAOB  
1666 K Street NW  
Washington, DC 20006-2803

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

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB):

The PCAOB's proposed changes to AS 1000 update verbiage throughout the standard, but the updates will be largely inconsequential to practice regarding professional skepticism (PS). Our view is that this proposal is a missed opportunity to critically assess the conceptualization of PS and PS expectations. We are concerned that since this standard has not been revised in 20 years, another 20 years may pass without improvement in auditor PS before the PCAOB examines this issue again.

As we discuss in detail below, skeptical judgments and skeptical actions are irrational and counterdispositional for nearly all people, including auditors. The trade-off between the costs of exercising PS for most people versus the ease of avoiding PS, particularly when the risk of material misstatement is perceived as low, presents immense challenges to achieving the depth of PS that the PCAOB appears to expect from auditors.

We are concerned that the depth of insight into PS among accountants remains mired in a simplistic conceptualization as an attitude or mindset, which is at best, lacking. Heretofore, the underlying assumption in both theory and practice is that all auditors have the ability to exercise PS consistently for the duration of the audit. Not only do we find no evidence from other disciplines to support this assumption, but the evidence strongly refutes it. In this comment letter, we highlight theories, advancements in medical diagnosis and treatment, and empirical results from multiple disciplines that challenge the simplicity of current PS views in accounting theory and practice.

Given the serious PS deficiencies that have been noted for decades,<sup>1</sup> PS demands immediate attention in AS 1000. To help affect meaningful progress on audit quality, we call upon the PCAOB to model PS by critically assessing research from diverse disciplines while avoiding confirmation biases and other judgment heuristics, suspending judgment until sufficient evidence is gathered, and providing a critical discussion of a broader perspective.

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<sup>1</sup> See, Beasley, M. S., Carcello, J. V., & Hermanson, D. R. (2001). Top 10 audit deficiencies: Lessons from fraud-related SEC cases. *Journal of Accountancy*, 191(4), 63–66.

Overall, this letter assists in providing an understanding of why existing views of PS are rudimentary and how the conceptualization of PS in AS 1000 is critically insufficient. We believe that a PS reconceptualization along the theoretical dimensions that we discuss is an important first step in making improvements to auditor PS and thereby improving overall audit quality.

### **Widespread Deficiencies in PS Persist Despite Extensive Emphasis during the PCAOB Era**

The origins of PS date back to at least 1940 when the SEC implored auditors to engage in “copious skepticism” when conducting audits.<sup>2</sup> The Cohen Commission (1978)<sup>3</sup> used the term “professional skepticism” in its report, which accelerated its use thereafter. Though the definition of PS has slightly evolved over the years, the underlying requirements (e.g., suspend judgment, gather sufficient evidence) remain unchanged for 45 years as well as the requirement that all auditors exercise PS throughout the duration of the audit.

The frauds of the early 2000s were blamed, in part, on a lack of PS exercised by the auditor.<sup>4</sup> These frauds led to the passage of the Sarbanes-Oxley Act (SOX) in 2002 followed by the formation of the PCAOB, which ushered in a new era of regulation including a renewed emphasis on PS. The profession enacted new auditing standards to try to detect fraud and increase PS.<sup>5</sup> Academics put forth models of PS,<sup>6</sup> developed a scale to measure PS traits,<sup>7</sup> and suggested interventions to help increase auditor PS.<sup>8</sup> Furthermore, there is no question that the PCAOB emphasized PS since its inception.<sup>9</sup>

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<sup>2</sup> See, “A Journal Roundtable Discussion: Frank Talk from Former SEC Chief Accountants.” *Journal of Accountancy*, 1988, December: 76–84.

<sup>3</sup> See, Cohen Commission, “The Commission on Auditors’ Responsibilities: Report, Conclusions, and Recommendations.” Available at [http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1978\\_0101\\_CohenAuditors.pdf](http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1978_0101_CohenAuditors.pdf)

<sup>4</sup> See, *Securities and Exchange Commission v. David B. Duncan*, United States District Court, Southern District of Texas, Case 4:08-cv-00314, 2008. Available at <https://www.sec.gov/litigation/complaints/2008/comp20441.pdf>.

<sup>5</sup> See, Statement on Auditing Standards (SAS) No. 99, “Consideration of Fraud in a Financial Statement Audit.”

<sup>6</sup> See, Nelson, M. W. (2009). A model and literature review of professional skepticism in auditing. *Auditing: A Journal of Practice and Theory*, 28(2), 1–34.

<sup>7</sup> See, Hurtt, R. K., (2010). Development of a scale to measure professional skepticism. *Auditing: A Journal of Practice and Theory*, 29(1): 149–171.

<sup>8</sup> See, Cross, J. M., Moroney, R., and Phang, S-Y. (2023). Is it all in the mind(fulness)? An exploratory study in assessing the impact of mindfulness on professional skepticism. *Accounting Horizons* 37(1): 25–41.

<sup>9</sup> For example, see Gillam, K. J., “Unconscious Human Nature Affecting Professional Skepticism,” Jan. 23, 2007, <https://pcaobus.org/news-events/speeches/speech-detail/unconscious-human-nature-affecting-professional-skepticism-37>

Despite 20 years of substantial resources devoted to increasing auditor PS, insufficient PS remains a significant concern just as it was 25 years ago (Carcello et al. 1998). Examples of corporate frauds or financial distress in recent years are abundant: FTX, Wirecard, SVB, Credit Suisse, etc. Inevitably, the auditors' actions are criticized when such failures occur, and a lack of PS is among the most frequent explicit or implicit criticisms. Every large audit failure jeopardizes the stability of the financial system and undermines the credibility of auditors and regulators, including the PCAOB. Thus, we assert that PS deficiencies need to be addressed by the PCAOB in a manner that dramatically exceeds minor tweaks to the wording in AS 1000.

### **PS Assumptions by Regulators, the Accounting Profession, and Academics are Fundamentally Flawed**

The PCAOB has reiterated in the proposal that the auditor must “exercise professional skepticism throughout the audit” (p.10), and this requirement is repeated throughout the Auditing Standards.<sup>10</sup> There are no caveats or exceptions. Stated differently, the standards require *all* auditors to exercise PS throughout the *entire* audit. Given this expectation, there is an implicit assumption that all auditors have the *capability* to exercise PS throughout the duration of the audit without exception or limitation. This assumption is fundamentally flawed. There has never been research to support this assumption, yet this assumption has been blindly accepted by auditors, academics, and regulators since the 1970s.

Not only is there no evidence to support the assumption that auditors *can* and *will* exercise PS following the standards, but there is also pervasive evidence that indicates that this assumption does not reflect reality. Though PS is an important requirement for auditors, the totality of scientific evidence related to skepticism does not reside within accounting. Human evolution, psychology, and physiology provide critical insights related to skepticism that have gone largely unnoticed by accounting regulators, academics, and professionals.

### **Psychologists View Skepticism as a Subclinical Personality Trait of Paranoia**

Psychology has long viewed skepticism and related behaviors (e.g., suspicion, curiosity) as stable personality traits that constitute pervasive predispositions and predict human behavior.<sup>11,12</sup> The view that skepticism is a trait dates to at least 1748 with the work of philosopher David Hume.<sup>13</sup>

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<sup>10</sup> For example, see AS 1015: Due Professional Care in the Performance of Work (as amended).

<sup>11</sup> In other contexts, such as morality (moral skepticism) or religion (religious skepticism, such as the belief in the divine), skepticism is characterized as a belief, attitude, or doubt related to putative knowledge or beliefs.

<sup>12</sup> See, Goldberg, L. R. (1993). The structure of phenotypic personality traits. *American Psychologist*, 48(1), 26–34; Tupes, E. C., & Christal, R. E. (1961). *Recurrent Personality Factors Based on Trait Ratings*. Technical Report ASD-TR-61-97, Lackland Air Force Base, TX: Personnel Laboratory, United States Air Force Systems Command.

<sup>13</sup> Hume, D. (1748). *An Enquiry Concerning Human Understanding*. Available at <http://www.earlymoderntexts.com/assets/pdfs/hume1748.pdf>

Skepticism is *not* an isolated trait. Rather, skepticism is a component of a broad personality trait with pervasive trust and clinical paranoia at opposing ends of a spectrum.<sup>14</sup> Just as introversion and extroversion are aspects of a common personality trait, trust, skepticism, and paranoia are likewise aspects of a common personality trait. Thus, discussions of introversion require the contrasting trait of extraversion, and likewise, skepticism requires the contrast of trust and paranoia to provide meaning.

Psychologists view skepticism as a subclinical, *dark* characteristic with attributes related to paranoia in that “high-skeptical individuals display behavior patterns that are similar to Paranooids but not at the level so debilitating to necessitate clinical intervention.”<sup>15</sup> Researchers have specifically investigated whether skepticism is a unique trait or part of the same trait and trust and paranoia. In a study of 2,874 participants including representation from the general, at-risk, and clinically diagnosed populations, researchers conclude that paranoia, subclinical paranoia, and non-clinical traits (i.e., trust) comprise the same symptom spectrum.<sup>16</sup>

Understanding personality traits is important because traits predict human behavior. Every person has a homeostasis (default position) on any given personality trait, including the trust-skepticism-paranoia (TSP) trait. While people can deviate from their homeostatic condition, such deviations are minimal and temporary, and individuals tend to quickly return to their homeostasis.<sup>17</sup>

What is the homeostasis for most people, including auditors, as it relates to the TSP trait? How come exercising PS throughout the duration of an audit is impossible for most auditors? We turn to the fields of human evolution, psychology, and physiology for these important answers.

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<sup>14</sup> See, Bebbington, P. E., McBride, O., Steel, C., Kuipers, E., Radovanovic, M., Brugha, T. Jenkins, R., Meltzer, H.L., & Freeman, D. (2013). The structure of paranoia in the general population. *British Journal of Psychiatry*, 202(6), 419–427; Freeman, D., Garety, P. A., Bebbington, P. E., Smith, B., Rollinson, R., Fowler, D., Kuipers, E., Ray, K., & Dunn, G. (2005). Psychological investigation of the structure of paranoia in a non-clinical population. *British Journal of Psychiatry*, 186(5), 427–435.

<sup>15</sup> See, Spain, S. M., Harms, P., & Lebreton, J. M. (2014). The dark side of personality at work. *Journal of Organizational Behavior*, 35(S1), S41–S60.

<sup>16</sup> See, Elahi, A., Perez Algorta, G., Varese, F., McIntyre, J. C., & Bentall, R. P. (2017). Do paranoid delusions exist on a continuum with subclinical paranoia? A multi-method taxometric study. *Schizophrenia Research*, 190(December), 77–81.

<sup>17</sup> See, Little, B. R., & Joseph, M. F. (2007). Personal projects and free traits: Mutable selves and well beings. In B. R. Little, K. Salmela-Aro, & S. D. Phillips (Eds.), *Personal project pursuit: Goals, action, and human flourishing* (pp. 375–400) Mahwah, NJ, Lawrence Erlbaum Associates Publishers; Zelenski, J. M., Santoro, M. S., & Whelan, D. C. (2012). Would introverts be better off if they acted more like extraverts? Exploring emotional and cognitive consequences of counterdispositional behavior. *Emotion*, 12(2), 290–303.

## Evolutionary Barriers to PS

The science of human evolution provides critical insights into the TSP trait. As humans evolved, most individuals developed a trait to trust for three primary reasons.

First, people inherently trust their initial judgments rather than suspend judgment. Research shows that *snap* decisions made during initial interactions between people, formed in milliseconds in the brain’s emotion-processing center, the amygdala, are used to evaluate the trustworthiness of a stranger.<sup>18</sup> Hume notes that humans trust their own senses and that most people have a strong disposition to follow this type of “powerful instinct” out of a sense of survival.<sup>19</sup>

Second, trust is an evolutionarily beneficial trait. As noted by evolutionary researchers,<sup>20</sup> “Trust and trustworthiness are essential characteristics of successful human societies.”<sup>21</sup> Prehistorically and contemporarily, trust provides societal benefits such as increased security and economic benefits.<sup>22</sup>

Third, humans have limited cognitive abilities and difficulty updating prior evaluations, especially if those evaluations include providing irrelevant or inaccurate information,<sup>23</sup> solving complex problems, or reasoning through complicated situations due to cognitive exhaustion.<sup>24</sup> When confronted with a social interaction, most individuals manage cognitive loads by defaulting to trust. Researchers note that trust provides individuals with a significant cognitive advantage while skepticism or distrust of another person requires “an enormous amount of time

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<sup>18</sup> See, Todorov, A. (2017). *Face value: The irresistible influence of first impressions*. Princeton, NJ., Princeton University Press.

<sup>19</sup> See, Hume (1748).

<sup>20</sup> See, Manapat, M. L., Nowak, M. A., & Rand, D. G. (2013, p.1). Information, irrationality, and the evolution of trust. *Journal of Economic and Behavior & Organization*, 90(Supplement): S57–S75.

<sup>21</sup> The evolutionary predisposition to trust manifests itself in social contexts and communal activities designed to achieve a specific outcome. The social interactions associated with the audit (Guenin-Paracini, Malsch, & Tremblay, 2014), along with the objective to achieve a desired outcome (i.e., finish the audit) are consistent with the evolutionary predisposition to trust. See, Guenin-Paracini, H., Malsch, B., & Tremblay, M. S. (2014). On the operational reality of auditors’ independence: Lessons from the field. *Auditing: A Journal of Practice & Theory*, 34(2), 201–236. One exception to the evolutionary predisposition to trust occurs in situations of potential physical harm, which is not applicable in an auditing context. See, Markova, I., Linell, P., & Gillespie, A. (2007). Trust and distrust in society, in I. Markova and A. Gillespie (Eds.), *Trust and Distrust: Sociocultural Perspectives*. Charlotte, NC, Information Age Publishing.

<sup>22</sup> See Markova et al. (2007).

<sup>23</sup> See, Shelton, S. W. (1999). The effect of experience on the use of irrelevant evidence in auditor judgment. *The Accounting Review*, 74(2), 217–224.

<sup>24</sup> See, Devine, D. J., & Philips, J. L. (2001). Do smarter teams do better: A meta-analysis of cognitive ability and team performance. *Small Group Research*, 32(5): 507–532.



and energy...in discovering the true nature of the other’s value system.”<sup>25</sup> Thus, evidence shows that humans have a strong evolutionary predisposition to trust, and trust yields many individual and societal benefits.

### **Physiological Barriers to PS**

Trust also produces physiological benefits associated with the release of the neuropeptide oxytocin, which results in a positive, *feel good* reaction in the body,<sup>26</sup> whereas skepticism does not yield that response. In an effort to maintain a polite society, people actively work to reciprocate trust and positive feelings when they interact. Conversely, distrust is associated with conflict and has the physiological effect of increasing dihydrotestosterone in men, which increases agitation, confrontation, and aggression.<sup>27</sup> Together, interactions between individuals (such as an auditor and client) can alter the brain chemistry in a positive manner via mutual trust or in a negative manner via distrust or skepticism.

### **Social, Professional, and Personal Barriers to PS**

Social, professional, and personal costs are also barriers to PS in auditor-client interactions. For example, requesting more audit evidence may result in the labeling of the skeptical auditor as confrontational, difficult, or unprofessional, along with implications of excessive work, excessive fees, and an adversarial relationship with the client.<sup>28</sup> Confronting a client is also uncomfortable for most auditors and socially costly. Research shows that exercising PS without finding a misstatement leads to lower performance evaluations from a supervisor.<sup>29</sup> Additionally, exercising PS includes costs to the auditor, such as reduced personal time and longer work hours. Recent research confirms that audit partner PS—in the form of issuing an adverse internal control opinion—increases the likelihood that the partner will be removed from that engagement.<sup>30</sup>

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<sup>25</sup> See, Jones, G. R., & George, J. M. (1998, p. 535). The experience and evolution of trust: Implications for cooperation and teamwork. *The Academy of Management Review*, 23(3), 531–546.

<sup>26</sup> See, Kosfeld, M., Heinrichs, M., Zak, P. J., Fischbacher, U., & Fehr, E. (2005). Oxytocin increases trust in humans. *Nature*, 435(2005), 673–676.

<sup>27</sup> See, Zak, P. J. (2008). The neurobiology of trust. *Scientific American*, 298(6), 88–93.

<sup>28</sup> See, Dodgson, M. K., Agoglia, C. P., & Bennett, G. B. (2019). The influence of “relationship” partners on client managers’ negotiation positions. *Working paper*, Northeastern University and University of Massachusetts, Amherst.

<sup>29</sup> See, Brazel, J. F., Jackson, S. B., Schaefer, T. J., & Stewart, B. W. (2016). The outcome effect and professional skepticism. *The Accounting Review*, 91(6), 1577–1599.

<sup>30</sup> See, Bakke, A., Cowle, E. N., Rowe, S. P., and Wilkins, M. S. (2023). How do audit firms treat partners who issue adverse internal control opinions? Working paper. Available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4383557](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4383557)

To prevent these cognitive, emotional, and professional costs, auditors may avoid confrontation and skeptical actions, especially if they perceive the risk of material misstatement as reasonably low. Auditors could also manage potential dissonance through motivated reasoning by seeking confirmatory information that allows the auditor to justify the avoidance of skeptical behavior.<sup>31</sup> Thus, social costs and professional costs provide significant disincentives and barriers for auditors to exercise PS.

### Counterdispositional Actions

Individuals, including auditors, *can* engage in actions inconsistent with their personalities. For example, introverts can act outgoing at times. Such trait-inconsistent actions are termed *counterdispositional*. Research involving counterdispositional behaviors further highlights the difficulty in enhancing consistent PS. Counterdispositional actions are cognitively exhausting, and people must then recuperate by experiencing “restorative niches.”<sup>32</sup> Research clearly shows that counterdispositional thoughts and actions *cannot* persist for extended periods of time.

Professional standards requiring the persistent exercise of PS are unrealistic for most auditors. Interventions to encourage the *normal*, trusting person to consistently act skeptically are counterdispositional, cognitively intensive, unsustainable, socially maladaptive, and generally ineffective.<sup>33</sup> Such interventions are akin to asking a quiet person to consistently act excitable or an introvert to consistently act as an extrovert.<sup>34</sup>

A professional standard mandating socially undesirable traits that are counterdispositional to most people—such as neuroticism, psychopathy, or Machiavellianism—seems absurd, yet the auditing profession mandates PS, which has many socially undesirable personality characteristics. In other words, a PS mandate is akin to an audit requirement to exercise “professional neuroticism” or “professional Machiavellianism.” Furthermore, psychological and

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<sup>31</sup> See, Hatfield, R. C., Jackson, S. B., & Vandervelde, S. D. (2011). The effects of prior auditor involvement and client pressure on proposed audit adjustments. *Behavioral Research in Accounting*, 23(2), 117–130.

<sup>32</sup> See, Little & Joseph (2007); Zelenski et al. (2012).

<sup>33</sup> Cognition and neuroscience research indicates the ineffectiveness in training to enhance overall general cognitive ability. See, Sala, G., & Gobet, F. (2019). Cognitive training does not enhance general cognition. *Trends in Cognitive Science*, 23(1), 9–20. Accounting research has examined adjustments to audit planning in response to fraud cues related to auditor experience and expertise (e.g., Bedard, 1989) and specific interventions (e.g., Hoffman & Zimbelman, 2009). See, Bedard, J. C. (1989). Archival investigation of audit program planning. *Auditing: A Journal of Practice & Theory*, 8(Fall), 57–71; Hoffman, V. B., & Zimbelman, M. (2009). Do Strategic Reasoning and Brainstorming Help Auditors Change Their Standard Audit Procedures in Response to Fraud Risk? *The Accounting Review*, 84(3), 811–837. Together, this research on the effectiveness of experience, expertise, and intentional interventions yields limited success in achieving expected PS outcomes within the general population of auditors.

<sup>34</sup> These analogies underestimate the difficulties for the non-clinical population to act counterdispositionally. Introverts receive social approval for behaving like an extrovert (see, Zelenski et al. 2012), but skepticism does not often produce social rewards, especially in light of outcome effects (e.g., see Brazel et al. 2016).

psychiatric treatments help individuals develop more socially acceptable attributes,<sup>35</sup> yet PS mandates are maladaptive for most people.

Consistent with introversion-extroversion behaviors,<sup>36</sup> counterdispositional behaviors are also asymmetrical; it is much easier for a homeostatic (natural) skeptic to respond to instructions to reduce skepticism and exhibit more trust than it is for a trusting individual to enhance skepticism. The social and cognitive costs of deviating toward trust are simply less intense than opposing deviations toward skepticism and paranoia.

Asking a *normal* auditor to switch to a skeptical mindset is counterdispositional, and except for audit tasks already labeled as high risk, asking auditors to switch mindsets likely has more costs than benefits. Researchers note that “mindset switching can be costly for subsequent decisions,” and “there are psychic costs to switching mindsets”<sup>37</sup> that result in depleted cognitive resources. In a series of five experiments, researchers find that mindset switching results in harmful effects for a variety of activities.<sup>38</sup> Thus, interventions designed to invoke a skeptical mindset pose the challenges of counterdispositional behaviors and mindset switching stated in prior research.

### **Can Interventions Facilitate Counterdispositional Actions Such as PS?**

Prior research suggests that behavioral interventions are *not* viable solutions toward consistent counterdispositional change as evident by the continued influence effect (CIE). CIE is a well-documented psychological phenomenon that highlights the insufficiency of behavioral interventions to change counterdispositional behaviors. CIE occurs when individuals are told that certain information is invalid or outdated, yet they still use that information in their decision making across various situations.<sup>39</sup> CIE is similar to other cognitive heuristics, such as anchoring and confirmation bias.

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<sup>35</sup> See, Zelenski et al. (2012).

<sup>36</sup> Whelan, D. C. (2014). *Extraversion and counter-dispositional behavior: Exploring consequences and the impact of situation-behaviour congruence*. Ottawa, Canada, Carlton University Press.  
<https://pdfs.semanticscholar.org/16da/553c8d8e9cc94a8d5db851ca5254446bb144.pdf>

<sup>37</sup> Hamilton, R., Vohs, K. D., Sellier, A-L., & Meyvis, T. (2011, p.13). Being of two minds: Switching mindsets exhausts self-regulatory resources. *Organizational Behavior and Human Decision Processes*, 115(1), 13–24.

<sup>38</sup> Ibid.

<sup>39</sup> See, Johnson, H. M., & Seifert, C. M. (1994). Sources of the continued influence effect: When misinformation affects later inferences. *Journal of Experimental Psychology: Learning, Memory, and Cognition*, 20(6), 1420–1436; Coronel, J. C., Poulsen, S., & Sweitzer, M. D. (2020). Investigating the generation and spread of numerical misinformation: A combined eye movement monitoring and social transmission approach. *Human Communication Research*, 46(1), 25–54; Wilkes, A. L., & Reynolds, D. J. (1999). On certain limitations accompanying readers’ interpretations of corrections in episodic text. *Quarterly Journal of Experimental Psychology*, 52(A), 165–183.

Researchers note numerous unsuccessful interventions aimed at helping individuals exclude false information and the effects of CIE.<sup>40</sup> Unsuccessful interventions include: 1) a direct, clear wording of the retraction;<sup>41</sup> 2) repetition of the retraction;<sup>42</sup> 3) explanations that accompany the retraction that describe the misinformation in more detail;<sup>43</sup> 4) instructions to carefully read the materials, including the retraction;<sup>44</sup> and 5) an immediate retraction following the misinformation.<sup>45</sup>

We note the significant parallels between facing outdated false information and information with unknown reliability. In fact, if individuals have difficulty ignoring information that they *know* is inaccurate (i.e., the CIE effect), then actively questioning information with *unknown* reliability (i.e., PS) is an even more monumental task for nearly all auditors.

### **How Common is the Skepticism Personality Trait Among Auditors?**

The most widely cited professional skepticism scale in accounting, the Hurtt Scale,<sup>46</sup> uses categorical classifications with six constructs that are *not* collectively consistent with attributes of subclinical paranoia along a dimensional spectrum. In fact, some items on the Hurtt Scale, such as self-esteem, may predict individuals who are trusting rather than skeptical.<sup>47</sup>

Because existing skepticism scales were not designed to identify traits from a broader spectrum, we note the frequency of other subclinical traits to provide preliminary insights into a possible range regarding the prevalence of homeostatic skeptics.<sup>48</sup> In a review of multiple studies,

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<sup>40</sup> See, Ecker, U. K. H., Lewandowsky, S., & Wang, D. T. W. (2010). Explicit warnings reduce but do not eliminate the continued influence of misinformation. *Memory & Cognition*, 38(8), 1087–1100.

<sup>41</sup> See, Johnson & Seifert (1994).

<sup>42</sup> See, van Oostendorp, H., & Bonebakker, C. (1999). Difficulties in updating mental representations during reading news reports. In H. van Oostendorp and S. R. Golden (Eds.), *The Construction of Mental Representations during Reading*. West Chester, PA, Hillsdale.

<sup>43</sup> See, Bush, J. G., Johnson, H. M., & Seifert, C. M. (1994). The implications of corrections: Then why did you mention it? In A. Ram and K. Eiselt (Eds.), *Proceedings of the Sixteenth Annual Conference of the Cognitive Science Society*, 112–117. Hillsdale, NJ: Erlbaum.

<sup>44</sup> See, van Oostendorp, H. (1996). Updating situation models derived from newspaper articles, *Medienpsychologie*, 8, 21–33.

<sup>45</sup> See, Wilkes & Reynolds (1999).

<sup>46</sup> See, Hurtt, R. K. (2010). Development of a scale to measure professional skepticism. *Auditing: A Journal of Practice & Theory*, 29(1), 149–171.

<sup>47</sup> See, Combs, D. R., & Penn, D. L. (2004). The role of subclinical paranoia on social perception of behavior. *Schizophrenia Research*, 69(1), 93–104.

<sup>48</sup> Researchers have examined the reliability of both the Hurtt Professional Skepticism Scale and Rotter Interpersonal Trust Scale in the context of audit experimental research. See, Boritz, J., Patterson, K. E.,

research finds that the prevalence of the paranoid clinical personality disorder varies between 0 percent and 4.4 percent of the population with a median estimate of 1.7 percent.<sup>49</sup> As a corollary, subclinical hoarding occurs at a rate of 1.6 times the clinical rate of hoarding.<sup>50</sup> Extrapolating these results to the TSP spectrum provides an estimated subclinical paranoia rate of 2.7 percent of the general population. Two other subclinical diagnoses that fall along established continua are subclinical depression and subclinical psychosis. The prevalence of subclinical psychosis is estimated at 7.2 percent of the population,<sup>51</sup> and based on a study released by the Centers for Disease Control and Prevention, the estimated rate of subclinical depression is 5 percent in the United States.<sup>52</sup>

To the extent that homeostatic skepticism is consistent with related examples of subclinical diagnoses, the prevalence of homeostatic skepticism among the general population likely falls in the range of 2.7 percent to 7.2 percent. We suspect that the prevalence of the skepticism trait among auditors falls within this range as well.

### **Implications for Regulators and the Accounting Profession**

PS challenges will persist indefinitely—just as they have for decades—until there is a more accurate understanding of PS among regulators, academics, and auditors. The implicit assumption that all auditors can exercise PS, in both judgments and actions, throughout the duration of the audit is unsustainable based upon substantial research in other disciplines.

We do not claim to have all the answers to improve auditor PS, but we do assert that there is overwhelming evidence that the current views of PS are grossly inaccurate and incomplete. We note the irony that there has been seemingly little skepticism among those in our profession about PS for decades.

We invite the PCAOB, academics, and auditors to think skeptically about their current views of PS. In other words, we invite all to exercise professional skepticism about professional skepticism. The PCAOB and other interested parties should “suspend judgment” and gather “sufficient evidence” while carefully avoiding confirmation bias and other heuristics.

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Rotaru, K., & Wilkin, C. L. (2018). How reliable are the Hurtt Professional Skepticism Scale and the Rotter Interpersonal Trust Scale for audit experimental research? *Working Paper*, University of Waterloo.

<sup>49</sup> See, Torgersen, S. (2009). The nature (and nurture) of personality disorders. *Scandinavian Journal of Psychology*, 50: 624–632.

<sup>50</sup> See, Spittlehouse, J. K., Vierck, E., Pearson, J. F., & Joyce, P. R. (2016). Personality, mental health and demographic correlates of hoarding behaviours in a midlife sample. *PeerJ*, 4(2826), 1–21.

<sup>51</sup> See, DeRosse, P., & Karlsgodt, K. H. (2015). Examining the psychosis continuum. *Current Behavioral Neuroscience Reports*, 2(2): 80–89.

<sup>52</sup> See, Prince, J., & Carson, S. (2013). *Almost depressed: Is my (or my loved one's) unhappiness a problem?* Center City, NJ. Hazelden.

Overall, we recommend that the PCAOB take a proactive approach while crafting AS 1000 to meaningfully address PS concerns, which includes acknowledging the vast research beyond accounting that directly relates to this issue. This is an opportunity for the PCAOB to increase its relevance and provide meaningful direction to firms. Absent action by the PCAOB, we predict that PS challenges will remain an ongoing concern and point of contention.

Below our signatures, we respond to various potential counterpoints. We are willing to be part of the solution to improving PS, and we welcome the opportunity to answer questions and discuss our views with any interested parties.

Respectfully,



Rick C. Warne, PhD, CPA, CFE  
Professor  
University of San Diego



Robert M. Cornell, PhD, CMA  
Associate Professor  
University of Nevada, Las Vegas

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Counterpoint 1: *Mindset literature suggests that auditors can utilize a skeptical mindset, and the mindset is more important than a personality trait.*

Mindsets allow people to view a situation from a different lens. For example, a person has a different mindset regarding the price of a hotdog at a professional sporting event compared to the grocery store. Likewise, auditors in a high-risk situation certainly *can* engage in a skeptical mindset and act counterdispositionally. However, we believe that viewing sustainable PS as a mindset is a mistake for the following reasons:

- a. The psychology literature is clear: personality traits are more explanatory of behavior than mindsets.<sup>53</sup> Fixed personality traits predict human behavior much more frequently than mindsets.
- b. A counterdispositional mindset is always a temporary state of mind.<sup>54</sup>
- c. Mindsets that lead to counterdispositional behaviors are subject to the same challenges described above (short-lived, exhausting, etc.).

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<sup>53</sup> For example, the DSM-5-TR defines personality traits as “enduring patterns of perceiving, relating to, and thinking about the environment and oneself that are exhibited in a wide range of social and personal contexts.” See, American Psychiatric Association. (2022, p. 735). *Diagnostic and Statistical Manual of Mental Disorders, Fifth Edition – Text Revision (DSM-5-TR)*. Arlington, VA.

<sup>54</sup> See, Little & Joseph (2007); Zelenski et al. (2012).

Counterpoint 2: *Even if auditors have difficulty exercising PS, they are smart enough and professional enough to invoke appropriate levels of PS in high-risk situations.*

We note the following in response to this counterpoint:

- a. Any inability to exercise PS is *not* a reflection of an auditor’s intelligence just as the inability for an introvert to consistently act like an extrovert does not relate to intelligence.
- b. We surmise that auditors exercise PS in obvious high-risk situations. When faced with a situation where there is a high likelihood of a material misstatement, auditors usually exercise appropriate PS. The problem with insufficient PS is *not* the obvious situations. In non-obvious situations, auditors have no way of knowing if a material misstatement exists, which is why the Auditing Standards call for PS throughout the audit. Thus, the suggestion that auditors can turn on and off PS depending on the risk is both illogical and inconsistent with professional standards.
- c. There are two possible reasons that cause insufficient auditor PS: either auditors are *unwilling* to exercise appropriate PS, or they are *unable* to do so. Given widespread agreement that insufficient PS is a problem, are auditors willfully neglecting their professional responsibilities, or are they unable to constantly exercise PS as expected by the PCAOB? We refuse to believe that widespread PS failures are due to auditors willfully abdicating their professional responsibilities. Thus, we take the position that the requirement that all auditors exercise sufficient PS for the duration of the audit is unobtainable and that other avenues to meet expectations should be considered.

Counterpoint 3: *The PCAOB and other regulators must require all auditors to exercise PS for the duration of the audit even if such a standard is unobtainable in order to protect the capital markets.*

The PCAOB has a history of acknowledging human limitations associated with auditors’ professional duties, such as confirmation bias.<sup>55</sup> Understanding judgment biases and heuristics is necessary to mitigate the associated consequences and risk to the audit. Ignoring human limitations prevents solutions to address those limitations. Thus, acknowledging that current views of PS are grossly inaccurate and that the current PS expectations are unattainable does not give auditors a *free pass* regarding PS. Rather, such acknowledgements are a critical step in mitigating the shortcomings of immutable personality characteristics for most auditors.

Counterpoint 4: *Most accounting academics have not embraced this view of PS.*

We readily acknowledge that our views of skepticism conflict with conventional wisdom held by accounting academics and professionals. However, history is replete with examples of fundamental paradigm shifts after widespread dismissal by those who subscribed to the

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<sup>55</sup> For example, see PCAOB Release No. 2018-005, Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards (2018).

conventional wisdom at the time.<sup>56</sup> Accounting professionals, regulators, and academics are not known for change, especially proactive changes. It took multiple frauds to occur before the accounting profession accepted some of the commonsense reforms required by SOX. The auditor's report was the same for many decades before recent changes,<sup>57</sup> such as the addition of critical audit matters. The acknowledgement by the PCAOB that many of its standards must be modernized is further evidence of the slowness of the profession to adapt to changing conditions. We remind the PCAOB and others that the lack of consensus has no bearing on the true state of the world, particularly on this intensely critical dimension of audit success.

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<sup>56</sup> See, "Mavericks and Heretics: Ideas Rejected, Later Proven Correct." <https://www.informationisbeautiful.net/visualizations/mavericks-and-heretics/>. Our intent is not to compare ourselves to the researchers on this list, but rather, to provide dozens of examples where new views were rejected and ridiculed before ultimately shown to be correct.

<sup>57</sup> See, Mock, T. J., Bedard, J., Coram, P. J., Davis, S.M., Espahbodi, R., and Warne, R. C. (2013). The Audit Reporting Model: Current Research Synthesis and Implications. *Auditing: A Journal of Practice and Theory*, 32 (Supplement 1): 323–351.



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**From:** Stephen A. Zeff <[sazeff@rice.edu](mailto:sazeff@rice.edu)>  
**Sent:** Tuesday, June 6, 2023 10:10 PM  
**To:** Vanich, Barbara <[VanichB@pcaobus.org](mailto:VanichB@pcaobus.org)>  
**Subject:** [EXT]: fair presentation

Dear Ms. Vanich,

In regard to the Board's proposal to clarify the meaning of "fair presentation," may I bring to your attention an article which I wrote in 1992, attached, which recounted the decision by Arthur Andersen & Co. between 1946 and 1962 to decouple the auditor's opinion on fair presentation into two opinions: one on fair presentation, and other on conformity with GAAP?

In another article which I published in 2007, "The Primacy of 'Present Fairly' in the Auditor's Report," also attached, the point is made that "fair presentation" and "not misleading" are not equivalent terms.

Kind regards,

Stephen Zeff

Keith Anderson Professor of Accounting  
Rice University  
Houston, Texas.

# Arthur Andersen & Co. and the two-part opinion in the auditor's report: 1946–1962\*

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*Abstract.* This paper constitutes a historical study of the roots of the decision by Arthur Andersen & Co. in 1946 to adopt a two-part auditor's opinion for all of its engagements, and of its eventual decision in 1962 to return to the standard form of the auditor's report. The essence of the two-part opinion was to decouple the auditor's opinion on fairness of presentation from the opinion on conformity with generally accepted accounting principles. The paper also treats the factors that prompted the Canadian Institute of Chartered Accountants to adopt a two-part opinion, and the reasons why it opted to return to the single-opinion format in 1976.

*Résumé.* L'auteur retrace l'histoire de la décision prise en 1946 par Arthur Andersen & Cie de présenter l'opinion du vérificateur en deux volets dans toutes ses missions, et de sa décision ultérieure, en 1962, de ramener le rapport du vérificateur à sa forme standard. Le choix de l'opinion en deux volets reposait sur l'intention de distinguer l'opinion du vérificateur quant à la fidélité avec laquelle est présentée l'information de l'opinion du vérificateur relative au respect des principes comptables généralement reconnus. L'auteur traite également des facteurs qui ont amené l'Institut Canadien des Comptables Agréés à adopter l'opinion en deux volets, et des raisons pour lesquelles il a choisi de rétablir l'opinion unique en 1976.

## Introduction

Since 1939 in the United States, the standard form of the auditor's report has contained the phrasing, "present fairly... in conformity with generally accepted accounting principles..." In the last 25 years, the role of "present fairly" in relation to "in conformity with generally accepted accounting principles" in the auditor's report has been a controversial topic in North America (see Carmichael, 1974; Rosenfield and Lorensen, 1974; and Johnston, 1979). The Auditing Stan-

\* The author appreciates the cooperation of Arthur Andersen & Co. in the preparation of this paper. The author gratefully acknowledges the helpful comments on earlier drafts by Timothy T. Griffy, Haim Falk, Douglas R. Carmichael, Frederick L. Neumann, Jack C. Robertson, Philip W. Bell, Ken Trotman, Stephen Taylor, Barbara D. Merino, Gary J. Previts, George R. Catlett, Leonard Spacek, Leonard G. Eckel, and Lee D. Parker, as well as by the anonymous reviewers. He also appreciates the historical insights into the Canadian experience provided by Ross Skinner, Doug Thomas, Rod Anderson, Stephen Elliott, David Selley, Kenneth Gunning, G. Kenneth Carr, and Gertrude Mulcahy. He is solely responsible for what remains.

dards Board of the American Institute of Certified Public Accountants (AICPA), seeking to implement a recommendation made by the Commission on Auditors' Responsibilities (1978, p. 14), proposed in 1980 that "fairly" be deleted altogether from the auditor's standard report because "the word is subjective and is interpreted differently by different users of the auditor's report" (AICPA, 1980, p. 6). The board's proposal provoked considerable debate and disagreement because it was not clear whether the deletion of "fairly" would contribute to, or lessen, the alleged confusion over the meaning of the auditor's report (see Carmichael and Winters, 1982, p. 18). In the end, the board's proposal was withdrawn.

In Canada, for a period in the 1960s and 1970s, the accounting profession supported a two-part opinion, in which separate opinions were to be given on "present fairly" and on "conformity with generally accepted accounting principles."

In addition, although it was not widely known, the accounting firm of Arthur Andersen & Co. used a two-part opinion in all of its engagements between 1946 and 1962.

It is the purpose of this article to suggest the reasons behind the firm's decision to adopt a dual-opinion format and, in the end, to return to the single-opinion format endorsed by the AICPA. In the first part of the paper, the Canadian experience with the two-part opinion will be reviewed because it may be instructive to compare the experience of a national accounting profession with that of a major accounting firm at odds with the leadership of its national accountancy body.

### **Canadian experience with the two-part opinion**

In Canada, the auditing pronouncements of the Canadian Institute of Chartered Accountants (CICA) called for a two-part opinion between 1968 and 1976 (some would say from 1959 to 1976). The auditor was expected to express two opinions, one on whether the financial statements present fairly, the other on whether they were prepared in accordance with generally accepted accounting principles (GAAP) (see Eckel, 1973; and Johnston, 1979).

The CICA's Accounting and Auditing Research Committee, evidently more through inadvertence than design, created the impression in *Bulletin No. 25* (CICA, 1967) that it was recommending a two-part opinion. In fact, it appears that the committee had no such intention.<sup>1</sup> The purpose of *Bulletin No. 25* was to

1 Eckel (1973, p. 41), a close student of these developments, finds language in *Bulletin No. 25* that supports the concept of a two-part opinion, although the language used by the committee was less than explicit. Moreover, in a communication with the author, Gertrude Mulcahy, who was CICA research associate, then associate research director, and (from 1969 onward) research director during the 1970s, maintains that the two-part opinion was first introduced in *Bulletin No. 17*, issued in 1959, and was reiterated and clarified in *Bulletin No. 25*. Yet, in other communications with the author, R.M. Skinner, a member of the committee that drafted *Bulletin No. 17*, and G.K. Carr, the deputy chairman of the committee that drafted *Bulletin No. 25*, both affirm that there was no intention by their respective committees to call for a two-part opinion. (Letter, 1990, from Gertrude Mulcahy; letter, 1988, and telephone conversation (1990) with R.M. Skinner; letter 1990, from G.K. Carr.)

add a reference to the funds statement in the auditor's report. It also restated the auditor's obligations set forth in *Bulletin No. 17* (CICA, 1959). The principal object of the latter was to recommend the inclusion in the auditor's report of a reference to conformity with GAAP and consistency in their application. Another aim of *Bulletin No. 17* was to recommend the use of "present fairly" in the opinion paragraph of the auditor's report unless a different wording was required by statute. Prior thereto, the opinion to be given in the auditor's report was confined to whether (1) the financial statements "present fairly" the financial position and results of operations (for Ontario corporations) or (2) the financial statements "exhibit a true and correct view" (for corporations subject to the companies legislation of other jurisdictions). The purport of *Bulletin No. 17* was to favor the American-style opinion paragraph in the auditor's report.

Since *Bulletin No. 17* had introduced the auditor's obligation to comment on conformity with GAAP and consistency in addition to the previous obligation that the auditor give an opinion on "true and correct view" or "present fairly," the committee found it necessary to discuss how the *two* obligations were related to one another. Some drew the inference from the committee's discussion that *two opinions* were required. A similar discussion appeared in *Bulletin No. 25*. In 1967-1968, when the Accounting and Auditing Research Committee codified the previous bulletins and compiled the new *CICA Handbook*, the committee used language that was construed as constituting an *explicit requirement* for a two-part opinion (Sec. 2500.06) (see, e.g., Eckel, 1973, p. 41), even though the committee may not have had that intention.<sup>2</sup>

Since the CICA had switched to the American-style opinion paragraph, there was keen interest in Canada in the decision rendered in the Continental Vending case in 1969 by the U.S. Second Court of Appeals in which the court said that the "critical test" for determining the adequacy of financial statements was fair presentation. Compliance with GAAP, the court said, was persuasive but not necessarily conclusive. The case attracted comment in the Canadian accounting literature (see, e.g., Eckel 1973, p. 43; and Anderson, 1977, p. 484), and the Second Circuit's establishment of the primacy of fairness may have emboldened the CICA's leaders to support a two-part opinion in the auditor's report.

Indeed, in May 1972, the CICA research director wrote a letter on behalf

2 G.K. Carr, who served as 1967-1968 chairman of the Accounting and Auditing Research Committee, advises the author that the issue of a two-part opinion "did not come to the fore" in the committee's discussions. (Telephone conversation, 1991.) When the *CICA Handbook* was unveiled in December 1968, the research director reported that the committee had "made a number of wording changes in recommendations to eliminate ambiguities" (Mulcahy, 1968, p. 433), but the changes were not identified.

Eckel (1973, p. 42) has pointed out that the CICA's Accounting and Auditing Research Committee never actually added an "and" between "present fairly" and "in accordance with generally accepted accounting principles" to signify, unequivocally, the intention to call for two separate opinions. As will be seen below, when Arthur Andersen & Co. decided in the 1940s to express two opinions instead of one, the firm believed it was necessary to insert "and were prepared" between "present fairly" and "in conformity with generally accepted accounting principles."

of the Accounting and Auditing Research Committee to all CICA members to remind them of the dual obligation imposed by the requirement of a two-part opinion (see Eckel, 1973, p. 43). The CICA's letter of clarification had been provoked by concern over the 1971 annual report of Trizec Corporation, a Montreal-based real estate development company, in which the company boosted its reported net income by 60 percent by means of a decision to account for deferred income taxes on a discounted basis. The company's auditor, one of Canada's best-known firms, did not qualify its opinion on conformity with GAAP even though there was little, if any, support for this discounting practice in Canada. After some discussion, the Ontario Securities Commission eventually accepted a filing of the company's prospectus that incorporated the financial statements reflecting the disputed practice. Eventually, in connection with the issuance of Trizec's 1972 financial statements, the 1971 statements were restated to eliminate the discounting of deferred taxes, and two partners of the audit firm were censured by their professional institute (see Elliott, 1974).

One consequence of the Trizec affair was that questions began to be raised about the criteria that auditors should be expected to use when deciding whether a client's practices are in conformity with GAAP. Companies and securities legislation were silent on the point. Although CICA members were required to base their judgments on the *CICA Handbook*, the Trizec affair drew attention to the auditor's responsibility to determine the content of GAAP when there was a departure from the *Handbook* or, as in the case of Trizec, where the *Handbook* was silent.

In December 1972, the Canadian Provincial Securities Administrators declared in a national policy statement that GAAP, for purposes of yearly and half-yearly financial statements filed with them, would be defined by reference to the recommendations in the *CICA Handbook*. This action was, without doubt, precipitated by the embarrassment surrounding the questionable judgment used by the Trizec auditors in deciding what practices qualified as GAAP. The securities administrators preferred an objective source of authority rather than reliance on the judgments of individual auditors that could be based on largely undefined criteria. A similar provision was included in the 1975 Canada Business Corporations Act Regulations. Hence, the legal status accorded to the CICA's accounting recommendations as the arbiter of GAAP suggested to the CICA's Auditing Standards Committee that they should constitute the sole framework for judging fair presentation. The decision taken in 1976 by the CICA's committee to revert to a one-part opinion was, therefore, taken mainly to establish a generally understood framework for use by auditors when making this judgment (see Thomas, 1976, pp. 57-58).

Another more subtle factor may also have been influential in the committee's 1976 decision. In the 1950s and early 1960s, when accounting pronouncements were issued relatively infrequently and were concerned, in the main, with broader and less contentious questions, auditors may have found themselves in easier agreement with one another, and with their client companies, on matters of

judgment in the application of accounting principles. As the standard setters began to pronounce upon specific and controversial questions in the late 1960s and early 1970s, auditors were increasingly likely to find themselves disagreeing with their peers, and with their client companies, on such judgments. Companies wishing to avoid the adverse effects of disagreeable pronouncements on touchy subjects were likely to be questioning the wisdom of their auditors' judgment. The level of tension in such relationships must have been rising. By the mid-1970s, therefore, auditors themselves may have preferred to substitute the *CICA Handbook* for the broader exercise of professional judgment.

It is interesting to note that the CICA's Auditing Standards Committee, as part of its decision in 1976 to revert to the one-part opinion, included the suggestion that "the auditor must exercise his professional judgment as to the appropriateness of the selection and application of principles to the particular circumstances of an enterprise and as to the overall effect on the financial statements of separate decisions made in their preparation." This passage prompted one commentator to remark, "In effect, we still have a two-part opinion!" (Johnston, 1979, p. 53). Johnston's dictum may have been premature since the committee's suggestion was made as background discussion, but not as part of the formal recommendation. Eight years later, in 1984, the CICA's Auditing Standards Committee converted the "appropriateness test" from a suggestion to a formal recommendation (*CICA Handbook* para. 5400.13), to increase the emphasis on professional judgment in the audit function (see Jeffreys, 1984; and Gibbins, 1983).

Hence, although the dual (or two-part) opinion was mandatory in Canada for almost a decade, the auditor's standard report in the United States has, since the 1930s, joined fair presentation and conformity with GAAP in a single opinion.

#### **Arthur Andersen & Co.: Rationale behind the decision in 1946**

In 1934 in the United States there was "almost instant and widespread acceptance" (Staub, 1942, p. 76) of the standard form of the auditor's report (or certificate, as it was then called) recommended by the American Institute's Special Committee on Co-operation with Stock Exchanges and endorsed by the Committee on Stock List of the New York Stock Exchange and by the Committee on Stock Exchange Relations of the Controllers Institute of America. The opinion paragraph was as follows:

In our opinion, based upon such examination, the accompanying balance-sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review, its position at December 31, 1933, and the results of its operations for the year (American Institute of Accountants, 1934, p. 47).

It was originally envisaged that "accepted principles of accounting" would be expressions of broad principles and would be few in number. The Special Committee suggested that a statement of such principles might be developed in consultation with "a small group of qualified persons, including corporate of-

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ficials, lawyers and accountants” (AIA, 1934, pp. 13–14). Within the limits of these broad principles, corporations were to be free to choose accounting and reporting methods, and were expected to file a public statement of these methods with the New York Stock Exchange. In its report, the Special Committee proposed five broad principles, which were, together with a sixth, approved by the membership of the American Institute of Accountants (as the AICPA was then known). Yet neither the New York Stock Exchange nor the Securities and Exchange Commission (SEC) acted to require corporations to provide a publicly available list of the accounting and reporting methods they used. Storey writes: “The failure to adopt the limitations recommended by the special committee to accompany the freedom given management in the choice of accounting methods sowed the seeds of the subsequent proliferation of accepted methods” (Storey, 1964, p. 27). In 1939, the Institute’s Committee on Auditing Procedure modified the opinion paragraph by transposing “present” and “fairly,” replacing “in accordance” with “in conformity,” and inserting “generally accepted accounting principles” in place of “accepted principles of accounting”: “. . . present fairly . . . , in conformity with generally accepted accounting principles . . .” (AIA, 1939, p. 12). The term *generally accepted accounting principles* came to refer not only to broad principles but also to accounting methods. In 1939, the Institute’s Committee on Accounting Procedure began issuing bulletins to provide the SEC with “substantial authoritative support” for the principles and methods comprehended by GAAP. In instances where alternative methods or practices commanded strong support within the Committee, the resulting bulletins allowed optional treatments, contributing to the proliferation cited by Storey.

As a firm, Arthur Andersen & Co. was concerned that questionable methods and practices had become justified under the imprimatur of GAAP, and the firm believed that the formal link between fair presentation and conformity with GAAP might preclude auditors from taking exception to the application of accounting principles (i.e., methods) of which they disapproved but which were nonetheless believed to be generally accepted. In an internal memorandum dated November 21, 1941, the firm indicated its uneasiness with the link between fairness and GAAP:

The reputation and standing of the firm have been built upon a foursquare policy of honesty and forthrightness. If, after the most thorough investigation and careful consideration, we are convinced that a certain accounting policy is fundamentally unsound and that its application will result in financial statements that are materially misleading, we must take exception to the policy in our certificate; we will not avail ourselves of the technicality that the principles to which we object may be quite generally accepted.

This policy reflected the view of Arthur Andersen himself that the partners in the firm, no less than other members of the profession, should use their independent judgment when assessing the propriety of accounting principles, and should not unquestioningly subordinate their professional opinions to the rules and procedures approved by a committee of the Institute.

In 1944, the Institute's Committee on Accounting Procedure approved *Accounting Research Bulletin No. 23*, "Accounting for Income Taxes." The committee accepted interperiod tax allocation except "in the case of differences between the tax return and the income statement where there is a presumption that they will recur regularly over a comparatively long period of time" (AIA, 1944, p. 190). Arthur Andersen & Co., however, favored interperiod tax allocation for oil and gas companies that capitalized the drilling costs of productive wells for financial accounting purposes while deducting them immediately for tax purposes—a difference that could well persist for a considerable number of periods.

Finally, in 1946, the firm concluded that the auditor's standard report, with a single opinion, placed it in an indefensible position. The decision was made to decouple the opinion on fair presentation from that on conformity with GAAP.

In an internal memorandum dated July 2, 1946, the firm "reemphasized the established policy of the firm to take exception in our certificate to accounting principles or procedures of which we cannot approve, regardless of the fact that there may be a substantial weight of accounting authority or usage in support thereof." The 1946 memorandum continued:

A corollary of this policy is the proposition that the certifying paragraph expresses three separate and distinct opinions: (1) that the financial statements present fairly the financial position and results of operations, (2) that the statements have been prepared in conformity with generally accepted accounting principles and (3) that these principles have been consistently applied.

The fact that the certifying paragraph in its standard form is an expression of more than a single opinion may not have been uniformly understood in the past. Some of the misunderstanding, if any, may have resulted from a lack of clarity in the wording of the paragraph, and it is the purpose of this release to revise this wording so that it will hereafter more clearly convey the appropriate meaning of the paragraph. Insertion of the words "and are" just preceding the present reference to conformity with generally accepted accounting principles will accomplish this purpose. Therefore, in the future the standard certifying paragraph in our certificate will read as follows:

"In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the XYZ Company at \_\_\_\_ and the results of its operations for the year ended that date and are in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

Somewhat more than a year later, the firm replaced "are" with "were prepared," as an investment banker had suggested that this revised wording would improve the clarity. One supposes that the phraseology in *Accounting Series Release No. 4*, the SEC's basic statement of its administrative policy on accounting principles, commended the word "prepared" in the firm's opinion paragraph. *ASR No. 4* (1938) begins as follows:

In cases where financial statements filed with this Commission . . . are *prepared* in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite dis-



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closures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material (emphasis supplied).

Another motivation behind the firm's decision was to differentiate its services from those of other firms: to create the image that principle, not expediency, governed its actions and that the firm had the courage to break with tradition. Leonard Spacek, who was the firm's partner in charge of the Chicago office when the decision was made, subsequently said, "Of course a lot of our attraction to clients was the fact that we would do things if we thought they were right" (Spacek, 1985, p. 238). Moreover, in a conformist profession the firm was willing, even eager, to break ikons. Spacek recalls that Arthur Andersen himself "liked the idea of bucking a trend" (p. 231). In 1970, *Fortune* magazine wrote that "Arthur Andersen [& Co.] . . . has long been regarded as the maverick of the profession, a role the firm obviously relishes" (Louis, 1970, p. 96). The decision to opt for a two-part opinion in the auditor's report was tailor-made to demonstrate these virtues.

In the mid-1940s, Arthur Andersen & Co. was known as "a small [public] utility firm" (Spacek, 1985, p. 8) and was based in the Middle West, when all of the country's major accounting firms had their headquarters in New York City. Shortly after Spacek became the firm's managing partner in 1947, following Andersen's death, he gave several speeches that ruffled the feathers of the profession's elders. Spacek was asked to meet with the heads of other firms at a prominent New York City club. All of the large firms were represented, as were a number of middle-sized firms. The session was chaired by George O. May, the retired senior partner of Price Waterhouse & Co. and the *éminence grise* of the profession. Spacek (1985, p. 55) recalls the encounter as follows:

I remember George O. May telling us, but looking me straight in the eye, and said that the leadership of the accounting profession must rest in the hands of the larger, successful firms and that the smaller firms can enjoy the success but must acknowledge that the leadership of the profession is in the hands of the larger firms. It had a terrific impression on me because I was just trying to work out our own leadership in the profession. But I said to myself, at that time, if it is bigness that it takes to have any say in the accounting profession, why then we will concentrate on first things first. We'll get big. That's when I really went out for promotion. I really—everything I did in one way or the other was to see that it eventually resulted in promotion.

One could easily imagine that this encounter with the Eastern establishment served only to redouble Spacek's determination to differentiate his firm from the others.<sup>3</sup>

3 Spacek's fiery personality and the dominant role that he played as unquestioned leader of Arthur Andersen & Co. from 1947 to 1963 combine to make this as much a study of Leonard Spacek as of his firm. Indeed, in his oral history, he takes credit for having made the decision in 1946 to shift to the two-part opinion (Spacek, 1985, p. 238). For a further discussion of Spacek and his role in the firm, see *A Vision of Grandeur* (1988, esp. pp. 107–112 and 118–122).

**Amplification of the firm's rationale**

On May 7, 1957, almost ten years after Arthur Andersen & Co. abandoned the single-opinion format of the auditor's report, Carman G. Blough, the Institute's full-time Director of Research and former SEC chief accountant, questioned the firm's practice in a letter to Richard S. Claire, an Andersen home-office partner. Blough, as it happened, had become a manager in the firm in 1938, following his departure from the SEC; he was admitted to the partnership in 1940 and left to join a federal government agency in 1942. (He had represented Arthur Andersen & Co. on the Institute's Committee on Accounting Procedure between 1938 and 1942.) Blough and Claire had discussed the firm's preferred format of the auditor's report during the April 1957 meeting of the Institute's Council. Claire replied to Blough in a lengthy letter dated May 15, 1957. In his letter, Claire (1957, p. 2) said that

we view the distribution of significance to each of the three parts of the opinion paragraph in the standard certificate to be roughly 85% to the fair presentation of financial position and results of operations, 10% to generally accepted accounting principles, and 5% to consistency. Any exaggeration that there may be in the foregoing distribution of values is done just to make clearer what we consider to be a most important point. The reference to generally accepted accounting principles we regard as a statement of the objective standards by which the fairness of presentation is judged. We recognize also that the term "generally accepted accounting principles" as used in certificates today is applied both to principles and to practices. Improvements in accounting practices are continually in process. A practice generally accepted today may a few years from now not be generally accepted. During the interim period there may be two practices covering the same accounting matter, both of which may be said to be generally accepted. One, however, may clearly result in a better statement of net income.

Claire illustrated his argument with two cases. In the first, he compared the income statements of a small oil company on two different bases: successful-efforts costing and full costing. The latter practice, he said, was in accordance with GAAP, while the former had the support of "substantial precedent and authority." By adhering to the Institute's standard form of auditor's report, an accounting firm could, Claire argued, give an unqualified opinion for either practice. With respect to the financial statements prepared in accordance with the successful-efforts practice (of which the firm disapproved), Arthur Andersen & Co. would insert a middle paragraph in its auditor's report that would include the following sentence:

While the practice of expensing such costs for financial reporting purposes was generally followed in the petroleum industry some years ago, the practice of capitalizing such costs and amortizing them over the productive lives of the properties is now more generally followed and, in our opinion, is preferable ... (Claire, 1957, p. 3).

Since, in Claire's factual case, the full-costing net income for the year was 10

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times the successful-efforts costing net income, he said (1957, p. 3) that his firm would conclude with the following opinion paragraph:

Because of the significance of the matter referred to in the preceding paragraph, we are of the opinion that the accompanying balance sheet and statements of income and earned surplus do not fairly present the financial position of X Company as of \_\_\_\_, 195\_\_, nor the results of its operations for the \_\_ months then ended.

In his second illustrative case, Claire referred to the prevailing practice of auditors with respect to railroad clients. Since interperiod tax allocation was not required for railroads by the Interstate Commerce Commission, most auditors followed a practice of giving an opinion on railroads' financial statements "in accordance with accounting principles and practices prescribed or authorized by the Interstate Commerce Commission," rather than in accordance with GAAP. Arthur Andersen & Co.'s practice, wrote Claire, was to draw attention to, and quantify the effect of, the railroad's departure from GAAP, and to state the firm's opinion on what was the *proper* practice (which, in this instance, conformed to GAAP). The firm's opinion on fair presentation would be qualified in the light of the railroad's departure from proper practice (or, one assumes, an adverse opinion would be given if the effect of the departure were very significant).

In closing his letter, Claire contended that his firm believed that its form of the auditor's report "conforms more closely to Rule 202 [of SEC's Regulation S-X] that the accountant's certificate shall state clearly 'the opinion of the accountant in respect of the financial statements covered by the certificate and the accounting principles and practices reflected therein'" (Claire, 1957, pp. 4-5). Claire reported to Blough that "we have never discussed [our form of the auditor's report] with the Securities and Exchange Commission . . ." (Claire, 1957, p. 4). One therefore infers that the SEC's accounting staff had never registered a formal objection to the use of Arthur Andersen & Co.'s dual-opinion format in the filings by its clients.

On May 8, 1958, two senior partners of Arthur Andersen & Co. met in Washington with Andrew Barr, the SEC's chief accountant, and three of his aides. The meeting had been requested the previous fall by the firm, owing apparently to Claire's letter to Blough. The firm sought to ascertain the accounting staff's reaction to the form of its audit opinion. According to the firm's report of the meeting, Barr said it was "unfortunate that [the firm] adopted this wording because it created dissension in the profession" (Arthur Andersen & Co., 1958, p. 1). Asked whether, in his view, the firm should not have adopted the two-part opinion, Barr avoided a direct reply and repeated his expression of disquiet about dissension in the profession (p. 1). Barr allowed the inference that the two-part opinion, while unfortunate and perhaps ill-advised, was not objectionable. This seems to have been the only recorded reaction of the SEC to the firm's practice of using a two-part opinion. There is no indication that the SEC ever declined to accept financial statements with the firm's two-part opinion attached.

**Partners vote on returning to single opinion**

By 1957, leading partners in the firm were troubled by the apparent conflict between the firm's espousal of price-level-adjusted depreciation and its practice of not expressing an exception in its auditor's report when clients did not follow this practice.

In 1954, Arthur Andersen & Co. had petitioned the SEC "to formally require disclosure of the effect on income of depreciation adjustments related to price level changes in financial statements filed for purposes of public record" (Spacek, 1956, p. 5), but the petition was denied. Also in 1954, Garrett T. Burns, an Arthur Andersen & Co. partner, made a determined effort to persuade the Institute's Committee on Accounting Procedure, of which he was a member, to reverse its long-standing opposition to the recognition of price-level-adjusted depreciation in companies' financial statements. In Chapter 9A of *Accounting Research Bulletin No. 43*, issued in 1953, the Committee had once again reaffirmed its earlier position, but only by the narrowest majority. Burns' effort within the Committee failed, if only because of the SEC's known antipathy to departures from traditional historical cost.

Since 1954, Leonard Spacek, the firm's managing partner and an uncompromising advocate of the principles and standards in which he believed, had been promoting the cause of price-level depreciation in speeches before academics and professionals. Spacek's campaign for price-level depreciation further served to differentiate Arthur Andersen & Co. from other firms. Not only did price-level depreciation raise a central question about the meaningfulness of corporate financial statements, it would also have struck a responsive chord among companies who believed that the federal income tax was a levy upon capital, and among public utilities who questioned the fairness of a rate-base determination without considering the effect of changing prices (see, e.g., Chandler, 1953).

There was, some noticed, a discordance between Spacek's aggressive espousal of price-level depreciation and his firm's failure to take exception in the "present fairly" portion of its two-part opinion when clients did not accept the practice. In a widely reported speech in February 1957, Spacek gave his own answer to this apparent conflict (p. 21):

Our clients have the right to prepare their financial statements on the same basis as the financial statements of the corporations with which they are competing. We cannot interfere with this right. We, as auditors, cannot impose upon our clients new principles of financial accountability when those principles are not accepted by the accounting profession and business generally, even though we are strongly convinced of their merit . . . . We will give each of our clients and their shareholders all the benefits accruing to them under "generally accepted accounting principles," except in those cases where we believe that such "principles" are at variance with the concepts for which there is, or has been, substantial acceptance.

In an internal memorandum dated February 19, 1957, the firm's partners were

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asked whether the policy of giving a two-part opinion should be continued. The alternatives were laid before the partners. The firm could

1. Revert to the single-opinion format, continue to take exception to practices that do not "fairly present," but omit any exception in cases, like price-level depreciation, where the practice had not secured substantial acceptance.
2. Revert to a single-opinion format but omit an exception "in all cases in which the practice of a client, with which we disagree, has the support of the American Institute of Accountants or is supported by substantial precedent in actual practice."
3. "Retain our present form of certificate and continue to explain frankly (outside the certificate) why we do not believe we have a right to take exception to a failure to recognize price level depreciation or other practice [which we believe is sound and] for which there is no authoritative support or precedent in practice" (Arthur Andersen & Co., 1957, p. 5).

In the six-page memorandum, arguments were presented on both sides of the question of whether to retain the two-part opinion, but by far the longest and more impassioned argument was given in defense of continuing to give the two-part opinion. Spacek's views in his February 1957 speech (quoted above) were reflected in the latter argument. Among the points made in favor of retaining the two-part opinion were the following:

To revert back to the other form at this time would mean an abandonment of a long-established policy which is just as sound today as it was twenty years ago. It would represent a departure from a policy based upon principles and the adoption of one justified only by considerations of expediency . . .

Rule 202 of the Securities and Exchange Commission states: "The accountants' certificate shall state clearly (i) the opinion of the accountant in respect of the financial statements covered by the certificate and the accounting principles and practices reflected therein." We *should* be advocating the universal adoption of a certificate that does that, but the adoption of the proposed revision would forever bar us from recommending such a change (pp. 3, 4).

Also in support of the argument for retaining the two-part opinion, it was stated that legal counsel had given the firm an opinion that a change to the single-opinion format would not lessen any liability of the firm, "but on the contrary might *jeopardize* our position because the change might be construed as a course of action designed to conceal rather than to disclose." (Arthur Andersen & Co., 1957, p. 4).

The principal argument in favor of making the change was given in the 1957 Arthur Andersen memo as follows:

Admittedly this is a compromise, but since there is no satisfactory way out of our present dilemma, it represents a better policy than the one we now follow. Anyone who reads our present certificate could assume that we judge independently of generally accepted accounting principles as well as in conformity with them. This is not true at the present time in those cases involving price level depreciation (p. 2).

As these excerpts suggest, one side could claim principle, while the other was supported only by expediency.

At the partners' meeting in May 1957, the matter was discussed at length, and their decision was to retain the two-part opinion. No transcript was preserved, and the reasons that were considered the most persuasive were not recorded.

### Public criticism by Carman G. Blough

Following the exchange of correspondence between Carman G. Blough and Richard S. Claire in May 1957, there was no indication that Blough intended to carry the matter further. It came as a surprise, therefore, when Blough devoted a portion of his "Accounting and Auditing Problems" department in the March 1958 issue of *The Journal of Accountancy* to a criticism of the dual-opinion format of the auditor's report. Without naming Arthur Andersen & Co., Blough wrote that "At least one accounting firm has, for some time, been using a variation of the standard form of auditor's report which apparently uses some other basis, which is not disclosed, for the judgment as to 'fairness'" (Blough, 1958a, p. 76). After stating "we feel that this is a most unfortunate practice," he added:

If every accountant were to decide for himself what a "fair presentation" is, there would be no standards to go by. One person might consider that a certain presentation was fair while someone else might feel that it was unfair and that something very different was fair. Both might be very honest in their convictions yet be miles apart in their presentations. It is only if their judgments are reached within the framework of generally accepted principles of accounting, i.e., the recognized and widely accepted conventions and procedures, that there can be any test of the reasonableness, or even the honesty, of a particular representation.

... it seems to us the accountant puts himself in a dangerous position when he departs from established ground rules in determining the fairness of a financial presentation (Blough, 1958a, p. 76).

A reply to Blough's position appeared in the May 1958 issue of the *Journal*. It was written not by a partner of Arthur Andersen & Co. but by Maurice E. Peloubet, to whom Blough referred as "a well-known and highly regarded member of our profession, for whose views we have the highest respect" (Blough, 1958b, p. 73). Peloubet, in fact, had been one of the original members (1939-1941) of the Institute's Committee on Auditing Procedure and had been a long-time member (1941-1953) of the Committee of Accounting Procedure. He was a partner in a small firm, Pogson, Peloubet & Co., which merged into Price Waterhouse & Co. in 1963. In his reply, Peloubet criticized Blough for suggesting that "present fairly" means no more than "in conformity with GAAP." He argued (1958, p. 73) that

Wherever choices are presented or where the exercise of judgment is required, either on the part of the management or the accountant, I do not think the full responsibility has been discharged by merely stating that the accounts have been prepared on the basis of generally accepted accounting principles.

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If this is sufficient, why bother about “present fairly”? It seems to me that the phrase “present fairly in conformity with generally accepted accounting principles” means that the accounts are prepared in accordance with appropriate and applicable generally accepted accounting principles, and that where there are choices, and where alternative methods are permitted, the methods under which the accounts have been prepared are either the most appropriate under the circumstances, or are one of possibly several alternative methods, any of which, in the judgment of the accountant, are applicable.

Although Peloubet seems to dilute his argument by suggesting, at the close of the foregoing quotation, that applicability can be substituted for appropriateness, he added (1958, p. 74) that “in the vast majority of cases some one of the accepted principles or methods will be applicable, but the accountant will still be forced to decide on the propriety of the method used.” Blough did not agree. He wrote (1958b, p. 75):

If there are two or more such alternatives, we agree that the auditor may use his influence to have management adopt his choice, but if the management chooses an accepted alternative that he agrees is appropriate, though not what he considers the best, we question whether he can properly deny its fairness in accordance with generally accepted accounting principles.

Blough contended that, until the accounting profession could get together and agree upon criteria for assessing appropriateness, the determination of “fairness” should be guided by generally accepted accounting principles that are applicable in the circumstances.

Yet the premise underlying Arthur Andersen & Co.’s decision in 1946 to adopt the two-part opinion was that the auditor has a professional responsibility to determine appropriateness when deciding whether the financial statements “present fairly.” The issue of appropriateness was, in one sense, more serious in the 1940s and even in the 1950s than it is today. In the years prior to the establishment in 1959 of the Accounting Principles Board, the number of pronouncements was relatively few and there was resistance within the profession to narrowing the range of acceptable methods (see Zeff, 1984, pp. 458–459). In such controversial areas as inventory valuation, depreciation, tax allocation, goodwill amortization, pensions, leases, business combinations, and the treatment of unamortized discount, issue cost, and redemption premium on refunded bonds, the Institute’s pronouncements either were silent or admitted of alternatives, usually with scant regard for differing circumstances.<sup>4</sup>

4 A profound difference in accounting ideology existed between Arthur Andersen & Co., a firm whose early development had been primarily in the regulated public utility field, and Price Waterhouse & Co. and Haskins & Sells, which had developed client bases composed heavily of major industrial corporations whose presidents were among the early captains of American industry. Companies in regulated industries were accustomed to uniform accounting systems imposed by governmental fiat, while unregulated businesses were disposed toward freedom of enterprise. Not surprisingly, Arthur Andersen & Co. urged a greater degree of company-to-company uniformity in financial reckonings (see, e.g., Spacek, 1961), while PW and H&S were defenders of flexibility (see, e.g., Grady, 1965, pp. 32–35; and Powell, 1965). Prior to

Leonard Spacek believed that, in such a permissive climate, it was incumbent on the auditor to make a judgment on the appropriateness of alternative methods. In an August 1957, speech, he reiterated that view and said that the profession would “at least put the teeth of responsibility into the present form of audit certificate” if it were to modify the opinion paragraph as follows:

In our opinion (the statements) present fairly the financial position and results of operation in conformity with *those* generally accepted accounting principles *considered appropriate in the circumstances* and applied on a basis consistent with that of the preceding year (Spacek, 1958, p. 374, italics added).

In the same speech, Spacek proposed that the Institute establish “a court or professional tribunal of accounting principles” and charged the Institute with responsibility for “defining the criteria of accounting principles” (1958, p. 377).

According to Blough, the auditor’s determination of appropriateness had to await the day when the profession could agree upon suitable criteria, and until then the auditor should not be basing judgments on his own personal opinion (1958b, p. 74). Spacek, ever the activist, was pressing the profession to develop criteria for evaluating appropriateness and, in the end, to eliminate alternative accounting principles.

The controversy over appropriateness flared anew in the 1970s, when the SEC proposed to charge auditors with the responsibility for determining whether a client company’s switch from one accounting principle to another “is preferable under the circumstances.” The SEC eventually lightened the burden by permitting the auditor to rely on the client’s business judgment. Nonetheless, issues were raised about how an auditor might determine preferability in the absence of agreed-upon objectives and established criteria (see Revsine, 1977, and footnote 8, *infra*). It will be recalled that an appropriateness test currently exists as a formal recommendation in Canada, yet criteria for making such judgments seem to be lacking there as in the United States (see Gibbins and Mason, 1988, chap. 6).

### **Two-part opinions on price-level depreciation**

As demonstrated by the firm’s internal debate during 1957, its advocacy of price-level depreciation was testing the partners’ depth of support for the two-part opinion. Evidently, it was not contemplated by the firm in the 1940s that it might one day espouse an accounting principle, such as price-level depreciation, for which there was no general acceptance, thus placing the firm in the unacceptable position of imposing on its clients “new principles of financial accountability,” as Spacek termed it in his February 1957 speech.

In audit reports given to three of its clients who adopted price-level depre-

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the showdown in AICPA Council in 1964 (Zeff, 1972, pp. 180–183), the flexibility school was the dominant force in the AICPA committees that pronounced upon accounting principles. In this arena as well, Arthur Andersen & Co. was “bucking the trend.”



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ciation during the 1950s, Arthur Andersen & Co. used its two-part opinion to lend support to this departure from GAAP.<sup>5</sup>

Ayrshire Collieries Corporation, an Indianapolis client, reflected price-level depreciation in the Comparative Statement of Earnings included in its 1958 annual report as follows:

|  | Year Ended<br><u>June 30, 1958</u> | Year Ended<br><u>June 30, 1957</u> |
|--|------------------------------------|------------------------------------|
| Net income for the year                              | \$2, 884, 256                      | \$2, 904, 730                      |
| Provision for price-level<br>depreciation (See note) | <u>195, 429</u>                    | <u>143, 587</u>                    |
| Balance of Net Income                                | \$2, 688, 827                      | \$2, 761, 143                      |

After giving its usual two-part opinion on the company's financial statements, Arthur Andersen & Co. added the following paragraph as part of its auditor's report:

In our opinion, however, the net income for the year is more fairly presented after deducting the provision for price-level depreciation, since current price levels have been recognized in determining the current cost of property consumed in operations. Generally accepted principles of accounting for cost of property consumed in operations are based on historical costs and do not reflect the effect of price-level changes since dates of acquisition or construction of the companies' depreciable property.

In the 1957 annual report of Sacramento Municipal Utility District (SMUD), the Operating Expenses section of the Income Statement included the following breakdown:

|  |             |
|--|-------------|
| Provision for depreciation—Computed on historical cost           | \$1,506,624 |
| Additional provision to reflect increase in price level (Note 1) | 665,000     |

In the auditor's report, the following two paragraphs were given after the scope paragraph:

As set forth in Note 1 to the accompanying financial statements, the statement of net revenue reflects an additional charge for depreciation of \$665,000; this charge is equivalent to the amount by which depreciation computed on the cost of depreciable property adjusted to reflect current price levels exceeds depreciation computed on cost. Although this practice is not yet recognized as a generally accepted principle of accounting, it is our opinion that, for the District, it results in a fair statement of net revenue for the year, and we have approved its adoption. In other respects, the financial statements, in our opinion, were prepared in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

5 Expanded treatment of these company disclosures and the resulting auditors' reports may be found in a news feature in *The Journal of Accountancy* ("Price-level Depreciation . . .," 1959) and in Appendix D in *Accounting Research Study No. 6* (Staff of the Accounting Research Division, 1963, pp. 211-217).

In our opinion, the accompanying balance sheet and statement of net revenue present fairly the financial position of Sacramento Municipal Utility District as of December 31, 1957, and the results of its operations for the year then ended.

Iowa-Illinois Gas and Electric Company, which had been authorized by the Iowa Supreme Court to recover, through rates charged to customers, the fair value of the property used to provide customer service, also recognized fair value depreciation in its financial statements. In its 1958 annual report, the company included fair value depreciation in the operating expenses in its Statement of Income. Included in the middle paragraph of the auditor's report were the following two sentences:

We approve the practice adopted by the Company, since it results, in our opinion, in a fairer statement of income for the year than that resulting from the application of generally accepted accounting principles. In all other respects, the financial statements were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Andersen & Co. concluded its auditor's report with an opinion on fair presentation similar to the final paragraph in its auditor's report given to SMUD.

Both Ayrshire and Iowa-Illinois were subject to SEC jurisdiction, and the Commission's accounting staff took exception to the treatment of price-level depreciation as an expense. As a result of the SEC's objection, the companies amended their presentation to show price-level depreciation as an appropriation of earned surplus (i.e., retained earnings).

The auditors' report in these three instances illustrate Arthur Andersen & Co.'s use of its two-part opinion to express approval of companies' use of price-level depreciation. The dilemma that faced the firm, however, was the inconsistency between these opinions and those given to companies whose financial statements reflected traditional historical cost depreciation.

### **The firm reverts to the single-opinion format**

Spacek's despair in 1957 was that the Institute's Committee on Accounting Procedure was making no progress toward reducing the number of alternative accounting principles, and that no one in the Institute's hierarchy seemed interested in actively developing criteria for judging appropriateness when alternatives were available. In that climate, his firm had decided to continue its policy of giving two-part opinions.

During 1957, the stridency of Spacek's public criticisms of the accounting profession's record in improving financial reporting accelerated, and the Institute appointed a special committee to investigate Spacek's charge that an Institute committee had yielded to industry pressure. The committee, composed of Institute leaders, found his claims to be unsupported by the facts (see Zeff, 1984, p. 461). The firm's strong view that it should base its auditor's opinion on only

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those accounting principles that it believed were proper led to the loss of some of its railroad clients (Spacek, 1985, pp. 248–249).

In October 1957, changes began to occur that, for the first time, gave Spacek and his firm some basis for believing that progress might soon be made on both fronts. Institute President Alvin R. Jennings, a senior partner in Lybrand, Ross Bros. & Montgomery (as the U.S. firm of Coopers & Lybrand was then known), delivered a major address in which he responded to criticisms (including Spacek's) of the performance of the Committee on Accounting Procedure. Jennings (1958) proposed the creation of an independent research organization that would be more attuned to the changing economic and financial times.

In December 1957, Jennings appointed a blue-ribbon Special Committee on Research Program "to consider a new approach to the means whereby accounting research should be undertaken, accounting principles should be promulgated, and adherence to them should be secured" (Report to Council of the Special Committee on Research Program, 1958, p. 62). The committee's charge was broad and dealt with fundamental issues. Spacek was among those invited to serve, and he accepted. Other members of the special committee included Carman Blough, Paul Grady, William W. Wertz, Andrew Barr, and Weldon Powell—all leaders of the profession. Wertz was chairman of the Institute's Committee on Accounting Procedure, and Barr was the SEC's chief accountant. Blough and Wertz were former chief accountants.

In its historic report issued in September 1958, the special committee unanimously recommended a major reform in the Institute's accounting principles program, which included the following points:

- the Committee on Accounting Procedure be replaced by an Accounting Principles Board (APB),
- an accounting research division be created within the Institute to serve the Board,
- two initial research projects be directed at identifying the basic accounting postulates and broad accounting principles, and
- the Board use these and subsequent research studies as a basis for its accounting pronouncements.

As Spacek saw it, the high priority given to the two research projects on postulates and broad principles inspired hope that the Institute would finally develop criteria for assessing appropriateness and that, as a consequence, the Board's pronouncements would lead to a reduction in the number of alternative accounting principles. This was Spacek's first service on an Institute committee, and one may infer from his unqualified assent to the special committee's report that he believed that the profession's leaders were of a mind to make real progress toward solving the problems of which he had been complaining. The Institute swiftly approved the special committee's recommendations and established the

APB and its accounting research division in 1959. One year later, after resolving some initial concerns, Spacek accepted an appointment to the Board.<sup>6</sup>

In his address to the Institute's 1960 Annual Meeting, Spacek voiced support for the goals implicit in the special committee's report. He referred to two publications recently issued by his firm that supplied agenda material for the newly formed Accounting Principles Board. One, a 127-page booklet, *Accounting and Reporting Problems of the Accounting Profession* (Arthur Andersen & Co., 1960a), was a critical analysis of alternative accounting principles in 20 major problem areas. The second of the two publications, a 43-page booklet on "the basic postulate of accounting," discussed his firm's views on the Board's research project on basic accounting postulates (Arthur Andersen & Co., 1960b).

Spacek's avowed endorsement of the aims of the APB, coupled with his firm's emerging policy of publishing technical booklets dealing with matters coming before the Board, created a climate in which the firm could consider abandoning its departure from the Institute's standard form of the auditor's report and instead channel its efforts at achieving accounting reform through the Institute's new accounting principles program.

In an internal memorandum dated October 2, 1962, a proposed revision of the firm's dual-opinion auditor's report was again placed before the partners for a vote. Only the argument in favor of reverting to the single-opinion format was presented, and it was stated that Spacek, the firm's managing partner, concurred with that argument. The memorandum drew attention to the booklets in which the firm took issue with settled practice in a number of problem areas. The memorandum (Arthur Andersen & Co., 1962, p. 2) added:

In some of these areas where the effect is very substantial, we have qualified and would currently qualify our opinions on financial statements, and in some of the other areas we have not qualified and ordinarily would not qualify our opinions.

In articles, speeches and other communications, as well as in our booklets, we have emphasized to businessmen and accountants that "fairness" in financial reporting is not being achieved through some of the present accounting practices. The continued use of our present form of opinion, in the light of the position we have taken publicly on many of these practices and the general recognition by the profession that these problems do exist, could easily create the impression that we are being hypocritical or intellectually dishonest.

6 The Institute's executive committee had insisted that, apart from Weldon Powell (who was to be the chairman), all representatives on the APB from the Big Eight firms must be their firm-wide managing partners. Spacek balked at this requirement, believing that his firm's senior technical partner should represent the firm. William M. Black, the managing partner of Peat, Marwick, Mitchell & Co., held the same view. Consequently, only six of the Big Eight firms were represented on the APB during 1959-1960, its inaugural year. J.S. Seidman, the Institute's 1959-1960 President, believed it was essential to the success of the APB for all of the Big Eight firms to be represented. A close professional acquaintance of Spacek's, Seidman succeeded in persuading Spacek and Black to join the APB in 1960, when its size was increased from 18 to 21 to accommodate the new members. Seidman was also instrumental in arranging for Spacek, whose aggressive manner and outspoken criticism had irritated many members of the profession's establishment, to deliver a major address at the Institute's 1960 Annual Meeting.

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By the early 1960s, price-level depreciation was not the only subject on which the firm was recommending a practice that was not generally accepted. In October 1962, when the memorandum was issued, the Accounting Principles Board was embroiled in a controversy over accounting for the investment credit, and Arthur Andersen & Co. had announced its position in favor of deferral.<sup>7</sup> Since the investment credit was without precedent, neither the flow-through nor the deferral approach to accounting for the credit could be said to enjoy general acceptance. Perhaps the firm sensed that, in the event that the Board were to support only the flow-through approach, it would find itself (as with price-level depreciation) in opposition to the only practice that was generally accepted. It may not have been entirely an accident in timing that the memorandum was issued in the thick of the controversy over accounting for the investment credit. Furthermore, if the firm's managing partner was serving on a board that would have a large hand in determining GAAP, it might have seemed incongruous if the firm were to continue giving opinions on fairness of presentation not predicated on GAAP.

The vote of the partners was not recorded, but on October 25, 1962, the firm issued an internal accounting release in which the single-opinion auditor's report was presented as firm policy.

#### **The reversion decision: Some major influences**

What had happened since 1957? For one thing, the firm had adopted a strategy of publicly venting its views on a wide range of financial reporting issues. The number of problem areas in which the firm took issue with generally accepted accounting principles was considerable. Prior to 1957, by contrast, the firm had focused its public criticism on the unwillingness of the profession and the SEC to approve price-level depreciation as an accepted principle. The inconsistency between the firm's public advocacy of price-level depreciation and its policy of giving clean "fairness" opinions to companies not adopting price-level depreciation had troubled many of the partners at the time of the reconsideration of the two-part opinion in 1957. Owing to the firm's outspokenness on the entire agenda of issues coming before the APB, the number and variety of potential inconsistencies between what it said and what it did multiplied between 1957 and 1962. The firm's internal memorandum of October 2, 1962, stated the dilemma as follows:

If we retain our present form of opinion, we would be continuing to state that, in our opinion, the financial statements "present fairly," while at the same time we are saying publicly in booklets, articles, addresses, etc. (in order to obtain corrective action by the accounting profession), that some of the practices on the basis of which we give unqualified opinions do not result in financial reporting that meets the test of "fairness."

7 For a discussion of the controversy over the investment credit in 1962, see Moonitz (1966).

It was awkward, to say the least, for the firm to be giving an unqualified opinion on the “fairness” of financial statements that reflected the use of accounting principles that the firm publicly criticized.

Second, the firm’s practice of championing price-level depreciation in some of its auditors’ reports, as illustrated in the previous section, had drawn even further attention to the inconsistency dilemma. In 1957, a problem that concerned the firm was the juxtaposition of Spacek’s public utterances on price-level depreciation as against the firm’s policy of giving clean “fairness” opinions to companies not adopting the practice. In 1958, as reported above, the firm began to carry its advocacy of price-level depreciation into its reports on the financial statements of companies that had adopted the practice. Yet the firm continued, as it knew it must, to give clean opinions to nonadopters.<sup>8</sup>

Third, the Institute in the 1960s seemed to be committed to abandoning its earlier tolerance of alternative accounting principles, and the firm, as suggested above, believed that its advocacy in the form of publications, speeches, and articles might gain support within the APB for a reduction in the number of alternatives. To Spacek’s disappointment (1962a), the Board’s research studies on postulates and principles did not become the building blocks for later pronouncements, and the Board itself disavowed the two studies in June 1962. By mid-1962, the APB still had not been tested on a major accounting pronouncement, yet Spacek continued to believe in the Board. In July 1962, he said, “I do believe that our Accounting Principles Board will eventually succeed in coming to the right answer” (1962b, p. 205).

Fourth, the firm’s policy of tackling controversies in its auditors’ report was not working. The policy was having no perceptible impact on practice or on the literature. No other firms had followed suit even though the SEC’s accounting staff did not object to the practice, and no evidence has come to light that it influenced companies in their choice of accounting principles. Apart from Blough’s 1958 column in *The Journal of Accountancy*, and some discussion in one of the firm’s publications (Arthur Andersen & Co., 1960a, pp. 4–5), nary a reference to Arthur Andersen & Co.’s two-part opinion can be found in the academic or professional accounting literature, or even in the minutes of the

<sup>8</sup> A somewhat similar problem involving the preferability dilemma (see discussion on p. 457, *supra*) arose in the mid-1970s, when Arthur Andersen & Co. challenged the SEC’s *Accounting Series Release No. 177* (1975). The SEC required that, when a registrant company seeks to change an accounting principle, “a letter from the registrant’s independent accountants shall be filed as an exhibit indicating whether or not the change is to an accounting principle which in his judgment is preferable under the circumstances . . .” In response, the firm wrote: “A letter from our firm stating that a particular principle is preferable for one client could adversely affect many other clients not participating in such a decision and could adversely affect the reputation and credibility not only of such clients but also of our firm in giving reports on the financial statements of those other clients, whether or not they ever make accounting changes, and thus open our clients and our firm to potential costly litigation” (Arthur Andersen & Co., 1976, p. 8). The threat of litigation, while considered in the firm’s 1957 internal debate and perhaps also in the decision to abandon the two-part opinion in 1962, had become a significantly more serious issue in the 1970s.

Institute's Committee on Auditing Procedure. The firm's practice had attracted virtually no notice.

Fifth—and perhaps the pivotal factor—was Spacek's interest in taking over a long-time client from Price Waterhouse & Co. Superior Oil Co. had been a Price Waterhouse client since 1933, and the company's management wished to change auditors. If only because of George O. May's condescending manner in the meeting with Spacek in the late 1940s, the prospect of acquiring a Price Waterhouse client must have been irresistible. Moreover, Superior Oil was thinking of moving its headquarters from Los Angeles to Houston, where Arthur Andersen & Co.'s major oil and gas audit work was based. But there was a problem. Superior Oil, with conservative management, followed the minority but accepted practice of expensing not only the cost of unsuccessful wells but also the cost of successful wells. Arthur Andersen & Co. had been very critical of this practice and did not have any clients following it. The firm was an avowed advocate of capitalizing the costs of both successful and unsuccessful wells. Before accepting the engagement, Spacek asked SEC Chief Accountant Andrew Barr, "If we took over an oil company who was charging all their drilling cost to expenses, including the good wells, I mean the successful wells as well as the dry holes, and we qualified it, would [you] stand behind us and require the capitalization of the successful wells?" (Spacek, 1985, p. 239). Barr responded that, in his view, the company's practice was "generally accepted." It therefore became necessary for the firm to endorse what was "generally accepted" in this regard if it wanted to obtain the new client. As Spacek later said, "That triggered [the firm's decision to revert to the one-part opinion] because the accounting profession always said 'You preach all these things but you don't follow them.' I just said okay, [from] now on we will follow generally accepted accounting principles [in our auditor's report] but nobody will stand in our way in our efforts to improve them" (Spacek, 1985, p. 239). Arthur Andersen & Co. acquired the audit of Superior Oil in 1962, and the firm's report issued in 1963 in the one-part format was not qualified.<sup>9</sup>

The Superior Oil incident was the last straw. In a permissive climate, when other major firms were willing to give unqualified opinions on a wide range of alternative accounting principles, Arthur Andersen & Co. ran the risk of offending newly acquired clients that were accustomed to the flexibility of their previous auditors. The advocacy of the firm's views through the medium of its auditor's report had become too costly. It was thought wiser to promote the firm's views on accounting principles through its publications and the speaking and writing activities of its partners.

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<sup>9</sup> The author is grateful to George R. Catlett for advice in characterizing this episode.

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# The Primacy of “Present Fairly” in the Auditor’s Report\*

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## ABSTRACT

In this paper, the author examines the historical evolution in the United States of the use of the term “present fairly” in the auditor’s report, as well as the experience and arguments in the United States and Canada regarding the use of a “two-part” opinion in the report. He then develops an argument for the adoption of a “two-part” opinion, decoupling “present fairly” from conformity with generally accepted accounting principles, which would place primary emphasis on “present fairly”.

**Keywords** Auditing standards; Auditor’s report; Present fairly

## LA PRÉSÉANCE DE LA FORMULE « DONNE UNE IMAGE FIDÈLE » DANS LE RAPPORT DU VÉRIFICATEUR

### RÉSUMÉ

L’auteur examine l’évolution, au fil du temps, de l’usage de la formule « donne une image fidèle » (« *present fairly* ») dans le rapport du vérificateur aux États-Unis, ainsi que l’expérience du Canada et des États-Unis et les arguments qui y sont invoqués pour justifier l’expression d’une « opinion en deux parties » dans le rapport. Il élabore ensuite une argumentation légitimant l’adoption d’une telle opinion distinguant l’« image fidèle » de la conformité aux PCGR, ce qui donnerait préséance à l’« image fidèle ».

One of the hottest issues in accounting today is “principles versus rules”, but it goes back a long way. I have in my files a letter in which the top partner in one of the major U.S. public accounting firms wrote me as follows:

I suspect that the greatest single difficulty at the present time is that we have forgotten what the word “principle” means. Many of the accounting controversies today and in the recent past actually deal with rather detailed accounting treatments and methods.

The author of these words was Herman W. Bevis, the senior partner of Price Waterhouse and a former member of the Accounting Principles Board (APB). He wrote them to me in a letter dated May 5, 1967. Leading figures in the accounting profession later complained about *APB Opinion No. 15*, issued in 1969, on earnings per share being a “cookbook” of rules (see Zeff, 2003: 197). “Principles versus rules” is hardly a new issue in this country.

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\* This paper was given as the Emanuel Saxe Lecture, Baruch College, City University of New York, on April 10, 2006. The author is grateful to the following commentators on earlier versions of the paper: Andy Bailey, Denny Beresford, Doug Carmichael, Bala Dharan, Michael Granof, Dan Guy, Jonathan Hayward, Bob Herz, Bill Kinney, Peter Knutson, Chris Nobes, Hugo Nurnberg, Larry Revsine, and Brian Rountree. The author is solely responsible for what remains.

What I wish to do in this paper is to draw on history to propose an important change in the opinion that the auditor gives on a company's financial statements. I wish to refocus the "principles versus rules" controversy from the role and performance of the standard-setter to the role and performance of the external auditor. My proposal is to decouple the two elements in the phrase "present fairly in conformity with generally accepted accounting principles", to "present fairly and were prepared in conformity with generally accepted accounting principles", thus obliging the external auditor to give two opinions, not just one. The first opinion, on a matter of principle, is whether the financial statements "present fairly". The second opinion, on a matter of conformity with the practices specified in accounting standards and other authoritative pronouncements, is conformity with generally accepted accounting principles (GAAP).

The focus of my paper is primarily the audit environment in North America.

I will first delve into some history and then indicate how the issue of giving a separate opinion on "present fairly" is a live one today. I will conclude with my argument.

## A BIT OF HISTORY

### Origin of "Present Fairly"

The origin in the United States of the term "present fairly" in the standard form of the auditor's report may be traced to the report of a special committee set up in 1932 by the American Institute of Accountants (AIA). After engaging in correspondence with the New York Stock Exchange (NYSE), the special committee recommended the "modern" form of the auditor's report, whose opinion paragraph included the wording "fairly present, in accordance with accepted principles of accounting" (AIA, 1934: 31). Walter A. Staub, the senior partner of Lybrand, Ross Bros. & Montgomery and one of the six signatories of the special committee's letter to the NYSE of December 21, 1933, in which it recommended the format of the auditor's report, wrote in 1942 that the committee meant that the auditor should give separate opinions on "fairly present" and "in accordance with accepted principles of accounting" (Staub, 1942: 75). Perhaps the comma between "fairly present" and "in accordance with accepted principles of accounting" was intended to signify a disengagement of the two elements into two separate opinions.

Note should be taken of the somewhat embarrassing origin of "fairly". The term "fairly ... present" was an innovation put forward in January 1933 by Richard Whitney, the president of the New York Stock Exchange (AIA, 1934: 16). Five years later, Whitney pleaded guilty to two counts of grand larceny, was expelled from the NYSE, and was sentenced to a term of 5 to 10 years in Sing Sing prison.<sup>1</sup>

George O. May, the chair of the Institute's special committee, made it clear that "principles of accounting" was intended to mean norms of accepted usage, and not the rules, conventions, or methods that are applications of the principles (May, 1937: 423–4).<sup>2</sup> The

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1. For Whitney's downfall, see "Richard Whitney," Wikipedia ([http://en.wikipedia.org/wiki/Richard\\_Whitney](http://en.wikipedia.org/wiki/Richard_Whitney)) and Seligman (2003: 169).

2. For further discussion, see Storey (1964: 11) and AIA (1934: 4–14).

special committee believed the principles were few in number. The term “generally accepted accounting principles” was used for the first time in an Institute publication in 1936 (AIA, 1936: 1). The idea was that accounting principles had to secure acceptance by more than just a few companies — thus the term “generally”. “Accepted” was preferred over “acceptable” as setting a more objective standard.<sup>3</sup> This was before the Institute authorized a committee to develop a body of accounting principles on a programmatic basis in order to guide judgements. Despite the intention to limit “accounting principles” to norms of accepted usage, in 1949 the authors of the leading auditing textbook said that “generally accepted accounting principles” had come to mean rules, conventions, and doctrines (Montgomery, Lenhart, and Jennings, 1949: 66).

By 1937, it was reported that the special committee’s recommended format was being used in substance by the auditors of more than 95 percent of the corporations, other than railroads, listed on the New York Stock Exchange (The auditor’s report, 1937: 246–7).

In 1939, the AIA’s Committee on Auditing Procedure altered the wording of the opinion paragraph to: “present fairly ... , in conformity with generally accepted accounting principles” (Committee on Auditing Procedure, 1939). Andrew Barr, who was on the accounting staff of the Securities and Exchange Commission (SEC) in 1939, subsequently said that he was “fairly certain that SEC staff urged including ‘generally’ to strengthen the [auditor’s] certificate”.<sup>4</sup> This wording has, but for a recent change to indicate the country of origin for GAAP (for example, U.S. GAAP or Canadian GAAP), remained essentially the same in all the years since then.<sup>5</sup> Again, the comma, mentioned above, appeared. The comma continued to appear in the same format recommended in *Statement on Auditing Standards (SAS) No. 2* (Auditing Standards Executive Committee [AudSEC], 1974: para. 7). The comma was removed in 1988, in *SAS No. 58* (Auditing Standards Board [ASB], 1988a: para. 8). After conferring with several of those who took part in the development of *SAS No. 58*, I have concluded, with some surprise, that there was no awareness that the deletion of the comma was a substantive issue.<sup>6</sup>

But this was not the end of the “comma affair”. Four years later, in *SAS No. 69* (ASB, 1992), which superseded and reaffirmed *SAS No. 5* (AudSEC, 1975) (see below), the comma suddenly reappeared in the rendering of the standard form of the auditor’s opinion

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3. Letter from Samuel J. Broad to the author, dated January 3, 1966. Broad was chair of the AIA committee that drafted the 1936 report, *Examination of Financial Statements by Independent Public Accountants* (AIA, 1936).
  4. Letter from Andrew Barr to the author, dated September 3, 1987. The term “generally accepted accounting principles” appeared for the first time in an SEC annual report in 1939 (SEC, 1940: 47–8, 118).
  5. The decision to specify the country of origin was made in *SAS No. 93* (Auditing Standards Board [ASB], 2000: para. 3).
  6. Carelessness about the comma was evident before then. In *The Independent Auditor’s Reporting Standards in Three Nations* (Accountants International Study Group [AISG], 1969), a cooperative venture among the professional accounting bodies in the United States, the United Kingdom, and Canada, the comma was omitted from the standard form of the U.S. auditor’s report given in paragraph 26. This AISG booklet was prepared by staff of the American Institute of Certified Public Accountants (AICPA).

(ASB, 1992: para. 1). Evidently, punctuation was not a strong suit at the Auditing Standards Board.

The comma finally disappeared from auditing statements in 2000, when *SAS No. 93* was issued (ASB, 2000: para. 3).

What practice do the Big 4 audit firms follow? In a casual sample of 75 annual reports for 2004 issued by U.S. companies, I found that Deloitte, Ernst & Young, and KPMG, with a few exceptions, insert the comma, while PricewaterhouseCoopers, also with a few exceptions, omits the comma. Evidently, there is a “comma crisis” in the profession!

### “Present Fairly”: The Upside

In 1952, Eric L. Kohler wrote in *A Dictionary for Accountants* that “present fairly” meant that the presentation of the financial statements “conforms to overall tests of truth, justice, equity, and candor” (1952: 177).

In 1961, R. K. Mautz and Hussein A. Sharaf, in their classic work *The Philosophy of Auditing* (1961: 169), wrote:

[T]he determination of accounting propriety is ultimately a matter of audit judgment. Although the auditor borrows generally accepted accounting principles from the field of accounting, he does so with full recognition that he may have to reject their application in some cases. To the extent that they are satisfactory in bringing about a realistic portrayal of the facts of business activity and conditions he is grateful to them; to the extent that they fail, he must draw upon his knowledge of their goals and develop solutions which his experience and judgment tell him are constructively useful.

In 1969, Judge Henry J. Friendly of the U.S. Court of Appeals for the Second Circuit ruled in the *Continental Vending* case (*United States v. Simon*, 1969) that the auditor’s judgment about what is called for by GAAP does not necessarily mean that the financial statements “present fairly”. In effect, he regarded “present fairly” and “in conformity with GAAP” as separate opinions. His ruling is still valid law today (Mano, Mouritsen, and Pace, 2006: 60).<sup>7</sup>

In February 1975, John C. (Sandy) Burton, the SEC chief accountant, sided with those who believe that “‘fairly’ adds something significant to the auditor’s representation beyond attesting to conformity with generally accepted accounting principles” (1975: 28). He said that the SEC “for many years has taken the position that fairness connotes something beyond conformity with generally accepted accounting principles” (32).

In 1975, SEC commissioner Al Sommer made the point even more emphatically: “The increased concern with the fairness of financial statements poses an opportunity to move away from the rigidities of generally accepted accounting principles and other deterrents to meaningful financial disclosure” (1976: 23).

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7. For a recent application of *United States v. Simon*, see the decision reported in the case of *United States of America v. Bernard J. Ebbers* in the Court of Appeals for the Second Circuit, dated July 28, 2006.

### **“Present Fairly”: The Downside**

“Present fairly” has had an uncertain career. In 1972, probably influenced by the *Continental Vending* decision, the Institute’s Committee on Auditing Procedure recommended deletion of “fairly” from the auditor’s report, but in the end it withdrew the recommendation.<sup>8</sup>

In 1974, Douglas Carmichael, the Institute’s director of auditing standards, contended that a two-part opinion “might be as chaotic as using fairness alone. The state of confusion would be blatantly apparent in auditor’s reports” (1974: 85). He concluded that “the essential meaning of the auditor’s opinion that financial statements are fairly presented in conformity with GAAP is that the accounting principles a company uses are appropriate for the circumstances to which they are applied” (86).

In July 1975, the Auditing Standards Executive Committee issued *SAS No. 5*, also a reaction to *Continental Vending*, which said that the auditor should apply “fairness” within the framework of GAAP. “Without that framework”, *SAS No. 5* went on, “the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and changes in financial position in financial statements” (AudSEC, 1975: para. 3). To the untutored reader, this advice seems to suggest that “present fairly” adds little, if anything, beyond conformity with GAAP. In February 1975, Sandy Burton pointed out that he was instructed by the SEC Commissioners to advise AudSEC, “We believe that it is apparent from court cases and other sources that ‘present fairly’ cannot be defined by simple references to generally accepted accounting principles” (Burton, 1975: 34). Hence, AudSEC instead referred to “the framework” of GAAP, which was not much different.

In 1978, the American Institute of Certified Public Accountants (AICPA) Commission on Auditors’ Responsibilities recommended, with the full support of its founding chair, former SEC chair Manuel F. Cohen, that “present fairly” be deleted from the auditor’s report because fairness “is not a property that can be objectively measured by the auditor” (Commission on Auditors’ Responsibilities, 1978: 13, 14). Two years later, the Auditing Standards Board proposed the deletion of “fairly” from the auditor’s report because “the word is subjective and is interpreted differently by different users of the auditor’s report” (ASB, 1980: 6). Finally, after reading the letters of comment and reconsidering, the board decided not to delete “fairly” (Carmichael and Winters, 1982: 18). Carmichael was the research director of the Commission and was the AICPA’s Vice-President, Auditing at the time of these deliberations on “fairly”.

### **“Present Fairly” Versus “Not Misleading”**

Since at least 1938, the SEC has held financial statements to the standard of being not “misleading”, a term that would appeal more to lawyers than would “fair presentation”. The term “misleading” is cited in the SEC’s *Accounting Series Release No. 4* (SEC, 1938), in rule 4-01(a) of the SEC’s *Regulation S-X*, and in rule 203 under the AICPA’s *Code of Professional Ethics*, now known as the *Code of Professional Conduct*, which took effect

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8. See Carmichael and Winters (1982: 14–5). For the Committee on Auditing Procedure’s proposed format of the auditor’s report, see Aranoff (1975: 31–2).



on March 1, 1973 (AICPA, 1972: 22). The latter obliges the auditor, in “unusual circumstances”, to countenance a departure in the financial statements “from an accounting principle promulgated by bodies designated by Council to establish such principles” (such as the Financial Accounting Standards Board [FASB]) where the use of the principle would have caused the financial statements to be “misleading”. Interestingly, the first draft of rule 203 referred to “fair presentation” instead of to “misleading” (Revised text, 1972: 9, 11). Sandy Burton said that rule 203 “seems to indicate that a fairness test should be applied, at least on a negative basis” (Burton, 1975: 34). And Judge Friendly, in the *Continental Vending* decision, seemed to use “fair presentation” and “not materially false and misleading” as rough equivalents.

It strikes me that “fair presentation” means that the financial statements meet a positive standard of informativeness. By contrast, “not misleading” connotes that readers have not been led astray. The object of financial reporting is to convey useful financial information, not merely to avoid a deception. R. J. Chambers once wrote that “if accounting is to be related to choices, it requires ‘leading information,’ not ‘not misleading information.’” (1982: 53). I agree with Chambers that “not misleading” is not a phrase equivalent in substance and connotation to “fair presentation”.

Mautz and Sharaf (1961: 169, footnote omitted) have written:

An approach sometimes followed is one that finds acceptable any [accounting] method that is “not misleading”. Such a negative attitude should not be condoned and certainly does not satisfy the concept of accounting propriety. Surely the auditor should insist upon something more constructive than the mere absence of injury; unless a practice actually aids and furthers understanding, it should be held deficient.

### **SHOULD THE AUDITOR GIVE ONE OR TWO OPINIONS? THE RECORD SO FAR**

As mentioned above, Walter Staub believed in 1942 that his special committee’s recommended form of the auditor’s report implied the giving of separate opinions on “fairly present” and “in accordance with accepted principles of accounting”. Whether auditors in the 1930s believed that they were to give separate opinions is not known.

#### **Arthur Andersen & Co. Adopts the Two-Part Opinion**

In 1946, the upstart Chicago-based accounting firm of Arthur Andersen & Co., whose lead partners — Arthur Andersen himself and Leonard Spacek — believed that the firm should stand up for what it believed, decided that the firm could no longer countenance giving an opinion that clients’ financial statements “present fairly” when they used accounting principles or applications thereof that were, in its judgement, not appropriate, even if they were “generally accepted”.<sup>9</sup> The firm therefore decoupled its single opinion into two, on “present fairly” and on “in conformity with generally accepted accounting principles”. To

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9. This section on Arthur Andersen & Co.’s two-part opinion is based on Zeff (1992).

do so, it added three words (shown here in italics) in the opinion paragraph of its auditor's report: "present fairly *and were prepared* in conformity with generally accepted accounting principles". The firm continued to use the two-part opinion in its auditor's report until 1962.

The firm had two levels of concern about GAAP. First, some generally accepted practices were not appropriate in the circumstances or were not believed to be proper accounting. Examples at that time were full costing versus successful-efforts costing in oil and gas exploration and the propriety of deferred tax accounting when companies adopted full costing in their financial statements but successful-efforts costing for tax purposes. Today, one could cite last-in, first-out (LIFO) versus first-in, first-out (FIFO), the use of accelerated versus straight-line depreciation methods, whether the capital lease or operating lease method should be adopted for long-term, noncancelable leases — if bright lines do not appear in the standard, as with *International Accounting Standard (IAS) No. 17 Revised* (International Accounting Standards Committee [IASC], 1997) — whether the conversion of bonds into stock should be accounted for at historical cost or at the market value of the issued shares, whether the proper treatment of marketable securities should be as "available for sale" or "trading", and by what method the cash received from installment sales should be recognized as revenue. Andersen believed that it was the professional responsibility of an audit firm to assess the propriety of the manner in which clients applied accounting principles, and not just to accept any application that was generally accepted. It believed that some applications of GAAP did not "present fairly" in all circumstances.

It is interesting to speculate whether such an interpretation of the audit firm's responsibility, by overriding the unquestioning adherence to GAAP rules, would have prevented any of the accounting and auditing scandals we have witnessed in the last number of years.

Second, Andersen believed that some non-GAAP did "present fairly". The best illustration of this was the firm's advocacy of depreciation based on general price-level restatements or current valuations of fixed assets, especially for its public utility clients, because of the importance of calculating a fair rate of return. In the 1950s and 1960s, the firm used its auditor's report to comment favorably on the "fair presentation" of these departures from GAAP (see below).

What did the SEC think of Andersen's two-part opinion? As far as is known, none of the three chief accountants between 1946 and 1962 — William W. Wertz, Earle C. King, and Andrew Barr — objected to it. They did insist that GAAP be followed, but the firm's opinion on "present fairly" was its own decision.

In 1958, Carman G. Blough, a former SEC chief accountant who was then the AICPA's director of research, criticized Andersen's two-part opinion, arguing that "present fairly" should be judged within the framework of GAAP and should not be decided by each auditor "for himself" (1958a: 76). In this respect, Blough anticipated *SAS No. 5*, issued 18 years later. Another prominent accountant, Maurice E. Peloubet, a former president of both the New York State Society of Certified Public Accountants and the New Jersey Society of Certified Public Accountants, as well as a former member of the AIA's Committees on Auditing Procedure and Accounting Procedure, disagreed with Blough. He argued that, where there are choices within GAAP, it is incumbent on the auditor to decide whether the methods chosen by the client are appropriate in the circumstances. If not, the auditor

should qualify his opinion on fairness. Otherwise, Peloubet said, “why bother about ‘present fairly’?” (1958: 73).

Arthur Andersen’s 16-year experiment with the two-part opinion represented a pioneering attempt to communicate the firm’s judgement on the propriety of the accounting norms used in its clients’ financial statements, and thus to infuse more meaning into the auditor’s report.

Why did Arthur Andersen revert to the single opinion in 1962? The reasons were several, but one was singled out by Leonard Spacek: “We could not get our clients to prepare statements according to our view and be out of step with other companies”.<sup>10</sup>

By the second half of the 1970s, Arthur Andersen’s position on “present fairly” had changed. It wrote, “‘Fairness’ in the presentation of financial data is a desirable objective, but the goal should be an *authoritative adoption* of ‘fair’ standards and principles on behalf of the profession [that is, by the standard-setter] and not the *personal definition* of ‘fairness’ by thousands of auditors” (Arthur Andersen & Co., 1977: 39).

### **Alexander Grant & Company Also Supports the Two-Part Opinion**

Alexander Grant & Company, another major accounting firm based in Chicago, signified its support of the two-part opinion in its submission to the Accounting Objectives Study Group, known as the Trueblood Committee, in 1972.<sup>11</sup> Charles Werner, who testified at the Study Group’s public hearing on behalf of the partners of the firm, said, “we believe that more is expected of us as professionals than simply compliance with a rulebook.” He asked, “isn’t the concept of fairness in presentation as clear to the professional accountant as honesty and decency are to the public?” (Werner, 1972: 1.59). There is no sign, however, that the firm actually used the two-part opinion in its audit engagements.

### **Canada Adopts the Two-Part Opinion**

It was not only Arthur Andersen that broke the mold. From 1967 (some would say even earlier) to 1976, the Canadian Institute of Chartered Accountants (CICA) required the auditor to give two opinions, on “present fairly” and on conformity with GAAP.<sup>12</sup> It seems that there was no clear rationale behind the adoption of the two-part opinion. The decision to move to a single opinion in 1976 was, in part, because one major audit firm allowed a client to use an accounting practice, the discounting of deferred tax, without noting that it was a departure from GAAP. The practice had little support in Canada and caused a furor within the profession. Another reason for the change was that the regulatory authorities declared the *CICA Handbook* to be the authoritative source of GAAP. It was therefore decided that the *CICA Handbook*, not each auditor, should be the arbiter of GAAP. But the CICA’s decision in 1976 to change to a single opinion said that “the auditor must exercise his professional judgment as to the appropriateness of the selection and application of

10. Letter from Leonard Spacek to the author, dated June 8, 1986.

11. The firm’s suggested auditor’s opinion was reproduced in Rosenfield and Lorenson (1974: 80).

12. See Zeff (1992: 444–7) and Eckel (1973).

[accounting] principles to the particular circumstances of an enterprise” (CICA, 1977: section 5400.13, “The Auditor’s Standard Report”), which led one commentator to exclaim, “In effect, we still have a two-part opinion!” (Johnston, 1979: 53). In effect, the CICA had seemed to exempt only non-GAAP from the opinion on “fairness”.

## **Contemporary Signs of Interest in the Primacy of “Present Fairly”**

### ***Sarbanes-Oxley Act (2002)***

In the Sarbanes-Oxley Act of 2002, the term “fairly present” in connection with corporate financial reporting entered federal legislation for the first time, in reference to the certification by the chief executive officer (CEO) and the chief financial officer (CFO) of their company’s annual and quarterly reports, including the financial statements. Section 302(a)(3) mandates that these corporate officers certify that “the financial statements, and other information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer”. “Fairly present” stands as the lone criterion of propriety, without any reference to conformity with GAAP. Lynn Turner, who helped draft that provision, has said that he and the Senate Banking Committee’s staff, who managed the drafting of the bill, wanted to preserve the spirit of the *Continental Vending* decision, which elevated “present fairly” to a position of primacy in the auditor’s report. Especially in the light of recent accounting scandals, they believed strongly that preparers should not be allowed to hide behind GAAP (Turner, 2005).

If preparers should not be allowed to hide behind GAAP in this certification, should they be allowed to take refuge in GAAP when their auditors opine on whether their financial statements “present fairly”?

### ***IAS No. 1 (2003)***

*IAS No. 1*, “Presentation of Financial Statements”, issued in 1997 by the International Accounting Standards Committee and revised in 2003 by the International Accounting Standards Board (IASB), expresses a preference to treat “fair presentation” as an overriding concept and not, as in the United States, as coextensive with GAAP. To be sure, the IASB counsels, “In virtually all circumstances, a fair presentation is achieved by compliance with applicable [IASB standards]” (IASB, 2003: paras. 13, 15, 17, 18). Above all, the purport of the revised standard is that “fair presentation” means adhering to the objective of financial statements and the definitions in its conceptual framework.

### ***U.S. Comptroller General’s Address (2004)***

On August 10, 2004, at the American Accounting Association’s annual meeting in Orlando, U.S. Comptroller General David M. Walker, a former partner in Arthur Andersen & Co., argued in a plenary address that auditors should give two opinions: one on “present fairly” and one on conformity with GAAP.<sup>13</sup>

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13. The Government Accountability Office (GAO) kindly supplied the slides for Walker’s address. The GAO, then the General Accounting Office, took a similar position for a short period in the early 1970s. See Rosenfield and Lorensen (1974: 80).

**Public Company Accounting Oversight Board Meeting (2005)**

The Public Company Accounting Oversight Board held a 25-minute discussion of the following question at the October 5, 2005 meeting of its Standing Advisory Group:

B4. Would a requirement for the auditor to express separate opinions on whether the financial statements (1) present fairly and (2) are in conformity with GAAP improve the quality of audits or audit reports? If so, how? (Office of the Chief Auditor, 2005: 10)

Views were expressed on both sides during the meeting.

These recent developments suggest that the subject of this paper continues to be a live one in accounting and regulatory circles. It is now my intention to develop the argument.

## **SHOULD THE AUDITOR GIVE ONE OR TWO OPINIONS? THE ARGUMENT**

**A Possible Framework**

Expectations rose for auditors in the 1960s and 1970s, and they have risen again since the beginning of the 1990s. Fair value accounting has become a riveting issue not only in standard-setting circles but also for SEC chair Richard C. Breeden, if only because of the failure of historical cost accounting to reveal massive unrealized losses in mortgage portfolios until after many savings and loans associations had entered bankruptcy. Breeden convened a conference entitled “Relevance in Financial Reporting: Moving Toward Market Value Accounting” on November 15, 1991, the first conference on accounting standards ever hosted by the SEC, a body that has, with few exceptions, always championed historical cost accounting.<sup>14</sup> During the 1990s, issues such as accounting for marketable securities and other financial instruments, employee stock options, and business combinations have sidelined historical cost accounting in favor of a wider use of fair values. Concerns have also been expressed at the SEC and elsewhere about the absence, in large measure, of intangibles from company balance sheets, which, for many companies, may be the bulk of their total asset values. On April 11–12, 1996, SEC commissioner Steven M. H. Wallman convened an SEC symposium on “Financial Accounting and Reporting of Intangible Assets”, which addressed the omission of many intangibles from company balance sheets. One sees good evidence, therefore, that the SEC has begun to question the propriety of long-standing GAAP.

There has been a growing belief that a company’s financial statements should reflect the economic substance of transactions, also characterized as economic reality. In a leading financial accounting textbook, Lawrence Revsine, Daniel Collins, and Bruce Johnson state that U.S. financial reports are “intended to reflect the underlying economic events and activities of the reporting entity” (2002: 943). Yet in the United States some believe that the “political” compromises made in the setting of accounting standards have led to a significant diminution of the meaningfulness of financial statements. In his last month as SEC chief accountant, in October 2005, Donald Nicolaisen, a former partner in Pricewater-

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14. For a report on the conference, see Atchley (1991).

houseCoopers, said in an open meeting, "If I were to opine on a set of financial statements with my own views, there are few that I would find to be other than misleading" (Nicolaisen, 2005). He blamed this circumstance on compromised accounting standards. Is this where GAAP has brought us?

The financial press often cites "present fairly" as a benchmark that it believes is implied by the wording of the standard form of the auditor's report.<sup>15</sup>

In 1950, a partner in a Big 8 firm who was president of the New York State Society of Certified Public Accountants wrote that "[a]ccounts are 'fair' if they are impartial, equitable" (Cochrane, 1950: 458), but that characterization is an anachronism in this day and age. In 1977, a leading Canadian author wrote, "To 'present fairly in accordance with GAAP' is to apply GAAP intelligently, judiciously and appropriately to the fact situation covered by the financial statements" (Anderson, 1977: 485). That is also a period piece. Today, there is an overriding concern that the financial statements reflect economic reality or, otherwise put, the economic substance of the transactions. GAAP, detailed and compromised as it is, will not necessarily reflect this reality. In some major areas, such as accounting for leases and pensions, it is far from economic reality. Paul Miller and Paul Bahnson recently wrote, "We feel so strongly about FASB's erroneous premise that compliance with GAAP automatically yields useful financial reports that we're producing three more columns that show how today's GAAP is too compromised, flexible and outdated to produce what the capital markets need" (2005: 14).

My premise is that principles should supplant, or at least supplement, rules in the conduct of the audit, just as they are being proposed to govern the setting of accounting standards. It should not be enough that the auditor's opinion reflects little more than a ticking off of the company's accounting methods against the rules of GAAP, even as challenging as that assignment is today. To serve the readers of financial statements and make the opinion paragraph of the auditor's report meaningful and not just a boilerplate, the auditor should be expected to treat "present fairly" as a substantive issue, and not as a "rubber stamp" of GAAP. Toward this end, I think that shareholders and the market would be served by decoupling the auditor's opinion into whether the financial statements "present fairly" and whether they are in conformity with GAAP. I realize that myriad legal questions could well be raised about such a change, but that must be the subject of another paper, written by a legal specialist. I will content myself here with recommending that serious consideration be given to decoupling the auditor's opinion into two.

The SEC's *Regulation S-X* should not be an obstacle to a two-part opinion, because the current version of its rule 2-02(c), on the opinion to be expressed in the auditor's report, says, in a rather open-ended manner, that the report is to state clearly "the opinion of the accountant in respect of the financial statements covered by the report and the accounting principles and practices reflected therein" (PricewaterhouseCoopers, 2005: vol. 1).<sup>16</sup> Nothing is said about "present fairly" or conformity with GAAP.

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15. For example, see "Why Everybody's Jumping on the Accountants These Days" (1977) and Worthy (1984).

16. In previous versions, *Regulation S-X* referred to the auditor's "certificate".



Now, how would it work? There are three variations:

- a “fairness” opinion on a company’s choice to depart from GAAP;
- a “fairness” opinion on a company’s choice of one method from among two or more alternatively accepted methods in the application of GAAP, where the auditor assesses whether the company’s choice is appropriate in the circumstances;
- a “fairness” opinion on the superiority of a non-GAAP accounting method over a GAAP method used by a company.

### **First Variation**

We have had considerable experience in the United States with the first of these variations. Between the 1950s and the 1990s, three public utilities, a colliery, and a property development company integrated either general price-level (GPL) restatements or current valuations into their basic financial statements, which the AIA’s Committee on Accounting Procedure had said should appear, if at all, in supplementary schedules (1953: ch. 9A, para. 17). Beginning in the middle 1950s and into the 1960s, the public utilities that so reported were Indiana Telephone Corporation, Iowa-Illinois Gas and Electric, and Sacramento Municipal Utility District (SMUD); the fourth company was Ayrshire Collieries. The motives of the public utilities were to raise their rate base and to reduce their reported net income (by means of the extra depreciation expense). For the three public utilities and the coal mining company, Arthur Andersen and a small audit firm (between 1954 and 1963 for Indiana Telephone, and Andersen afterward) managed to accommodate this adoption of non-GAAP measurement methods because they believed in their merit.

Iowa-Illinois, SMUD, and Ayrshire inserted into their traditional financial statements an additional depreciation charge based either on GPL restatements or on current valuations. The audit firms affirmed in their report that the financial statements “present fairly” in conformity with GAAP. They also said in their reports that income reflecting a depreciation charge based on GPL restatements or current valuations was “a fairer statement”, “a fair statement”, or “is more fairly presented”, respectively, than GAAP income, based on the methodology adopted and disclosed by the company.<sup>17</sup> Arthur Andersen audited all three companies.

Indiana Telephone divided its financial statements into columns A and B. Column A displayed traditional historical cost figures, while column B showed the corresponding GPL restated figures. The auditor said that the figures in column A “present fairly” in conformity with GAAP. Carman Blough, in one of his monthly columns in the *Journal of Accountancy*, regarded Indiana Telephone’s column B as being in line with what the Committee on Accounting Procedure had in mind as “supplementary”, but he took exception to the small audit firm’s opinion contained in the company’s 1956 report that the figures in

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17. For a discussion of Andersen’s opinion on Ayrshire, see “Price-Level Depreciation in Annual Statements” (1959: 18). Also see Zeff (1992: 457–9).

column B “more fairly reflect the economic truth of the operation of the corporation” (1958b: 49–50). In subsequent years, up to 1963, the small audit firm said that Indiana Telephone’s financial statement figures displayed in column B “were more fairly presented” or “more fairly present”. From 1964 to 1976, when Arthur Andersen was Indiana Telephone’s auditor, it continued to give the same opinion as the small audit firm on column B (“more fairly present”).

These unusual opinions given by the audit firms were reproduced in *Accounting Research Study No. 6* issued by the AICPA in 1963 (Staff of the Accounting Research Division, 1963: appendix D). Indiana Telephone, Iowa-Illinois, and Ayrshire were subject to the SEC and therefore had to display the extra depreciation charge below the derivation of income, as a surplus appropriation, in their filings with the SEC.<sup>18</sup>

The property development company was The Rouse Company, which, between 1976 and 1994, presented a current-value balance sheet based on valuations supplied by an appraisal firm. The SEC accepted the current-value balance sheet in lieu of the supplementary disclosures mandated in *Accounting Series Release No. 190* (Palmon and Seidler, 1978: 781). Rouse’s audit firm, Peat Marwick (succeeded by KPMG), said in its opinion in every year that the historical cost-based financial statements “present fairly” in conformity with GAAP, but that the current-value balance sheet was “presented fairly” in accordance with the methodology set forth in an explanatory note.

Not all auditors followed this path. In its 1979 annual report, Days Inns of America also presented a current-value balance sheet, based on an appraiser’s valuation, but its audit firm, Price Waterhouse, went no further than to say that it provided “relevant information about assets and liabilities of the Company which is not provided by the historical cost financial statements”. It declined to say that the current-value balance sheet “presents fairly”. In its 1977 annual report, Iowa Beef Processors presented a full set of current-value financial statements in addition to its traditional financial statements. After saying that the current-value statements differed significantly from GAAP, Touche Ross, its audit firm, opined only that the current-value statements “are a reasonable and appropriate presentation of the information set forth therein on the basis indicated in Note 1”.

Somehow, corporate financial reporting was not thrown into chaos because of these announced departures from GAAP measures, and three audit firms had the courage to give their opinion on the “fairness” of the information provided by the departures.

### **Second Variation**

As will be seen, the second variation is not as much of a challenge as the third. Let us say that a company selling products on the installment plan were to use the installment method, not the cost-recovery method, of recognizing revenues. Suppose, too, that the audit firm believes that the cost-recovery method is appropriate and that (as many believe) the installment method is not. If the company were adamant in its adoption of the installment

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18. For Indiana Telephone, see the letter from Pierre F. Goodrich (1959), the company’s president.



method, which is allowed under GAAP, the auditor could well opt to say, if the difference were material, that the financial statements do not “present fairly” even though they are in conformity with GAAP. That would be a useful bit of information for shareholders and the market.

If a company engaged in oil and gas exploration were to use full costing, while the auditor believed, in line with the FASB in *Statement of Financial Accounting Standards (SFAS) No. 19* (1977), that successful-efforts costing is the appropriate method, the auditor should be obliged to say that the financial statements do not “present fairly” even though a GAAP method was used.

If a construction company were to use the percentage-of-completion method for recognizing revenues in circumstances where the auditor believes that the estimates of total cash eventually to be received and the total construction cost eventually to be incurred were not sufficiently foreseeable to justify the use of this method, the auditor would be obliged to state that, although the financial statements were prepared in conformity with GAAP (though some might contest that assertion), they do not “present fairly”.

In other areas of GAAP where optional methods are admissible, the auditor should be expected to opine whether the company has made the appropriate selection so as to “present fairly”. If *SFAS No. 13* (FASB, 1976) on leases were modified to be similar to *IAS No. 17 Revised* (IASC, 1997b), which I think is likely, thus removing the bright lines, the auditor would be under an obligation to determine whether, as a lessee, the company should treat long-term, noncancelable leases as operating leases or as capital leases. If the company were to adopt the treatment with which the auditor disagrees, the auditor should qualify “present fairly”, even though the company’s method falls within the options allowed under GAAP.

Therefore, the second variation would oblige the audit firm to qualify “present fairly” if it were to disagree with the company *in principle* over a GAAP method used, or if it were to disagree with the company on the use of a GAAP method in the light of the particular circumstances in which it is being used. Examples of such circumstances would be a significant difference of view between the auditor and the company over the estimates of key variables (for example, the discount rate, estimated future cash flows, or fair values).

I believe that these qualifications of “present fairly” would be important information to shareholders and the market, and I agree with Arthur Andersen of the 1940s that one of the hallmarks of professionalism is for an auditor to give an opinion on whether a company’s financial statements “present fairly”, and not hide behind GAAP, or allow the company to hide behind GAAP.

The second variation is somewhat analogous to the attempt by SEC chief accountant Sandy Burton, in *Accounting Series Release No. 177* (SEC, 1975), supplemented by the SEC’s *Staff Accounting Bulletin No. 14* (SEC’s Office of the Chief Accountant and Division of Corporation Finance, 1977), to oblige the auditor to comment on whether a company’s change in accounting “principle”, other than a change mandated by a new standard, is “preferable in the circumstances”. Because the SEC release dealt with interim reports, it did not explicitly raise the issue of the auditor’s opinion on the “fairness” of the financial

statements.<sup>19</sup> Revsine has written, however, that “the method that is chosen should ‘present fairly’ the financial condition of the firm” (1980: 80). In the context of this paper, the issue facing the auditor should be the appropriateness of a GAAP method, and the question should not arise only when the company changes from one method to another. If the method is, in the auditor’s view, inappropriate and the difference is material, “fairness” is called into question.

The second variation also would reflect a strict application of *SAS No. 69* (ASB, 1992), which states that the auditor’s opinion on “present fairly” in conformity with GAAP should be based on a judgement concerning five attributes, one of which is that “the accounting principles are appropriate in the circumstances” (ASB, 1992: para. 4(b)). This variation also implements the advice of Maurice Peloubet (1958) and Douglas Carmichael (1974), cited above.

### **Third Variation**

The third variation presents the greatest challenge: whether the auditor believes that a non-GAAP method is superior to the GAAP method adopted by the company on a particular measurement or disclosure issue. This is somewhat the inverse of the first variation, where both the auditor and the company believe that the GAAP method is inferior to a non-GAAP method, and therefore unacceptable. Here, the auditor may believe that the use of historical cost accounting for certain assets or liabilities is inadequate to “present fairly” and that fair value accounting should be used instead, perhaps with the unrealized gains and losses to be taken directly into income. Or the auditor may believe that the omission of certain intangible assets from the balance sheet means that the financial statements do not “present fairly”.

Other examples could be cited. Does the auditor regard the recording of non-GAAP accretion or fair value for growing stands of timber as the proper accounting method for a forest products company? Does the auditor believe that non-GAAP proportional consolidation, not the equity method of accounting, should be used to reflect joint ventures? Should the implicit discount on an issuance of convertible securities be recorded instead of the GAAP method of crediting the entire proceeds to the bonds payable account? The options to U.S. GAAP in all three of these circumstances are prescribed as GAAP in Canada or under International Financial Reporting Standards, or both.

Such a difference of opinion will truly test the relationship between the auditor and the company, but professionalism — doing what society expects of a professional — must govern the engagement.

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19. “Preferability letters” are still required to be filed by the auditor with the SEC. Since 1971, under APB *Opinion No. 20* (1971: para. 17), the entity has been required to explain why a newly adopted accounting principle is preferable. The FASB’s *SFAS No. 154* (2005: para. 17(a)) reaffirmed this requirement.

## CONCLUSION

My argument is that the time has arrived, in the light of the heightened expectations for financial reporting, to give serious consideration to decoupling the auditor's opinion into two: whether the financial statements "present fairly", and whether they are in conformity with GAAP. I believe that this reform, which is hardly without precedent in North America, would provide shareholders and the market with useful information.

The question raised in the early 1970s, when *SAS No. 5* (AudSEC, 1975) was being drafted, was, what framework should the auditor use when making "fairness" judgements? The answer then was that the framework should be GAAP. Today, the framework that should be used is the FASB's conceptual framework for business entities, which was completed in 1984. The auditor should call on the conceptual framework to make such judgements.

A problem that I see as being an obstacle to acceptance of the argument in this paper is the absence of evidence that auditors, including the major audit firms, actually invest in *thinking in depth* about accounting principles and their applications and, indeed, about the conceptual framework. There was a time, before the 1980s, when partners in audit firms would give speeches in public forums, write articles, and even write books, in which they debated accounting principles and their applications. It was also a time when their firms issued booklets in which they took reasoned positions on accounting issues facing the Accounting Principles Board or the Financial Accounting Standards Board. They actively engaged in advocacy of their views. One does not see this behavior today and, with rare exceptions, it has not been in evidence for more than 20 years. I have written about the demise of this intellectual discourse and how its absence detracts from professionalism in our field (Zeff, 1986). Do partners and their firms even think about these issues any more? Do they have beliefs about what is "right" and "wrong" about accounting principles and their applications? There is little outward sign that they do. If accounting is to be regarded as a "profession", it would fall within a very shallow definition of the term. For this reason, putting questions of enhanced legal exposure aside, I am pessimistic that we will see a disposition on the part of audit firms to pronounce on "fairness" other than as being coextensive with rule-laden GAAP.

There is, however, a ray of hope. *SAS No. 90* (ASB, 1999), which amended paragraph 7 of *SAS No. 61* (ASB, 1988b), stated, "In each SEC engagement, the auditor should discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles applied in its financial reporting. ... The discussion should also include items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information included in the financial statements" (ASB, 1999: para. 11, footnote omitted). These three qualitative characteristics were drawn from the FASB's conceptual framework. This provision was reinforced by section 204 of the Sarbanes-Oxley Act (2002) and the SEC's rule adopted thereunder.<sup>20</sup> I am informed that these discussions between the auditor and the audit

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20. See section II(F)(6)(G) of the SEC's adopting release (SEC, 2003) and paragraph 210.2-07, which is the rule itself.

committee are in reality “fairness” discussions and, under section 204, the auditor is required to inform the audit committee of the treatment that he or she prefers. When there are material, unresolved disagreements with management over the accounting principles and their applications adopted by the entity, the next step should, in my view, be a qualification of “present fairly” in the auditor’s report.

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**General Responsibilities of the Auditor in  
Conducting an Audit  
and Amendments to PCAOB Standards**

PCAOB Release No. 2024-004  
May 13, 2024

PCAOB Rulemaking  
Docket Matter No. 049

**Summary:** The Public Company Accounting Oversight Board (“PCAOB” or the “Board”) is adopting a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, and amending other related PCAOB standards. The new auditing standard addresses the general responsibilities of the auditor, such as due professional care and professional skepticism, when conducting an audit in accordance with the standards of the PCAOB.

**Board**

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## Amendments:

The Board is adopting amendments to its standards that:

- (1) Adopt AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*;
- (2) Rescind:
  - AS 1001, *Responsibilities and Functions of the Independent Auditor*;
  - AS 1005, *Independence*;
  - AS 1010, *Training and Proficiency of the Independent Auditor*;
  - AS 1015, *Due Professional Care in the Performance of Work*; and
  - AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles"*;
- (3) Revise:
  - AS 1201, *Supervision of the Audit Engagement*;
  - AS 1215, *Audit Documentation*;
  - AS 2101, *Audit Planning*; and
  - AS 2810, *Evaluating Audit Results*; and
- (4) Make additional conforming amendments to PCAOB standards.

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## I. EXECUTIVE SUMMARY

We are adopting a new auditing standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (“new standard,” “final standard,” or “AS 1000”). The new standard replaces a group of standards originally developed by the American Institute of Certified Public Accountants (“AICPA”) and adopted on an interim basis by the PCAOB in 2003. That group of standards established the general principles and responsibilities of the auditor when conducting an audit (“foundational standards”). The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. These principles and related responsibilities provide a foundation for the proper performance of the audit.

Through this standard-setting project, we have reaffirmed the general principles and responsibilities of the auditor so that the foundation underlying our standards continues to be sound and appropriate for performing high-quality audits. These principles and responsibilities, enhanced and consolidated into a single auditing standard, together with related amendments, will modernize the auditing standards to better address fundamental aspects of the audit and provide auditors with better direction to protect investors and further the public interest in the preparation of informative, accurate, and independent auditor’s reports.

AS 1000 will replace four standards that set forth the general principles and responsibilities of the auditor: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*. AS 1000 combines and updates the general principles and responsibilities of these standards to reflect developments in the auditing environment.

We are also amending certain other PCAOB standards that address responsibilities fundamental to the conduct of an audit. These amendments clarify the engagement partner’s responsibility to exercise due professional care related to supervision and review of the audit, accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarify the auditor’s responsibility to evaluate whether the financial statements are “presented fairly.” Finally, we are adopting additional amendments to conform to these changes.

After carefully considering the comments we received, we are adopting the amendments substantially as proposed, with revisions that reflect the input of commenters.

### **Reasons for and Key Provisions of the New Standard and Amendments**

Since the PCAOB’s adoption of the foundational standards in 2003, the auditing environment has evolved, including:

- Changes to auditing requirements through Board-issued standards;
- New or revised independence requirements issued by the Board; and
- Advancements in technology that are increasing the availability of electronic audit tools and use of audit software.

The new standard and related amendments we are adopting will modernize PCAOB standards to:

- Reflect changes in the auditing environment;
- Eliminate outdated and inconsistent language; and
- Achieve consistency with Board-issued standards.

AS 1000 and the related amendments modernize, clarify, and streamline the general principles and responsibilities of the auditor and provide a more logical presentation, which should enhance the useability of the standards by making them easier to read, understand, and apply.

We are clarifying the auditor's responsibility to evaluate whether the financial statements are "presented fairly." We are also clarifying the engagement partner's due professional care responsibilities by adding specificity to certain audit performance principles set out in the standards. Finally, the accelerated documentation completion date reflects changes in the auditing environment, including advancements in technology that have enabled auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment. The new documentation completion date reduces the window of opportunity for improper alteration of audit documentation and also enables the Board to potentially begin the inspection process sooner after completion of an audit, which we believe can enhance the Board's efforts to improve audit quality and promote investor protection, ultimately enhancing investor confidence.

The new standard and related amendments will apply to all audits conducted under PCAOB standards. Subject to approval by the U.S. Securities and Exchange Commission ("SEC" or "Commission"), the new standard and related amendments will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2024, except that, for registered public accounting firms ("firms") that provide audit opinions for 100 or fewer issuers (i.e., smaller firms), the amendment relating to the documentation completion date will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025. More information on the effective dates is discussed in Section VI of this release.

This release provides background on the Board's standard-setting project, discusses the new standard and related amendments, and includes an economic analysis that further

explains the need for standard setting and the anticipated economic impacts of the changes. This release also includes three appendices. Appendix 1 sets forth the text of the new standard, Appendix 2 key amendments to related PCAOB auditing standards, and Appendix 3 conforming amendments to other PCAOB standards.

## II. BACKGROUND

In April 2003, the Board adopted, on an interim basis, the generally accepted auditing standards of the AICPA's Auditing Standards Board ("interim standards") and the related auditing interpretations as they existed then.<sup>1</sup> At that time, the Board stated that it would determine whether the interim standards "should become permanent standards of the Board, should be repealed, or should be modified."<sup>2</sup> Since then, the Board has adopted a number of new auditing standards that supersede or amend portions of the interim standards and related auditing interpretations.<sup>3</sup> However, certain remaining interim standards, including those that address the general principles and responsibilities of the auditor, have continued to be in effect substantially in the form adopted.

Since the adoption of the interim standards, the auditing environment has evolved in many ways, including (i) changes to auditing requirements through Board-issued standards; (ii) new or revised independence requirements issued by the Board;<sup>4</sup> and (iii) advancements in technology that are increasing the availability of electronic audit tools and the use of audit software. While these developments have generally been reflected through amendments to some interim standards and related interpretations in connection with the Board's standard-setting initiatives, the 2022-2026 Strategic Plan reinforced our intent "to modernize and streamline our existing standards and to issue new standards where necessary to meet today's needs" as part of the PCAOB's investor protection mission.<sup>5</sup>

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<sup>1</sup> See *Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). The auditing interpretations were the publications entitled "Auditing Interpretations" issued by the AICPA Auditing Standards Board, as they existed and were effective as of April 2003.

<sup>2</sup> See PCAOB Rel. No. 2003-006.

<sup>3</sup> See, e.g., AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 2101, *Audit Planning*; AS 2810, *Evaluating Audit Results*, and AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

<sup>4</sup> See generally Section 3 of PCAOB rules, *Auditing and Related Professional Practice Standards*, Part 5, *Ethics and Independence*.

<sup>5</sup> See PCAOB, Strategic Plan 2022-2026, at 10, available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a\\_4/](https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a_4/).

In connection with these initiatives,<sup>6</sup> we analyzed the interim foundational standards that address the general principles and responsibilities of the auditor in conducting an audit. These foundational standards are:

- AS 1001, *Responsibilities and Functions of the Independent Auditor*;
- AS 1005, *Independence*;
- AS 1010, *Training and Proficiency of the Independent Auditor*; and
- AS 1015, *Due Professional Care in the Performance of Work*.<sup>7</sup>

The general principles and responsibilities addressed by the foundational standards include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. Through this rulemaking, we are reaffirming and modernizing the general principles and responsibilities of the auditor to ensure that the foundation continues to be sound and appropriate for performing high-quality audits.

#### A. Rulemaking History

In March 2023, we proposed a new, single standard to replace the foundational standards that address the general principles and responsibilities of the auditor in conducting an audit (“proposed standard”).<sup>8</sup> The proposal also included key amendments to other PCAOB standards that address matters that are fundamental to the conduct of an audit. These proposed amendments clarified the engagement partner’s responsibility to exercise due professional care related to supervision and review of the audit, accelerated the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days, and clarified the auditor’s responsibility to evaluate whether the financial statements are “presented fairly.”

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<sup>6</sup> See PCAOB’s interim standards project, available at <https://pcaobus.org/oversight/standards/standard-setting-research-projects/interim-standards>.

<sup>7</sup> When adopted by the Board in 2003, this group of interim standards was designated as AU sec. 110, AU sec. 220, AU sec. 210, and AU sec. 230. In 2015, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, and these interim standards were designated as AS 1001, AS 1005, AS 1010, and AS 1015, respectively. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015). The reorganization did not impose additional requirements on auditors or change substantively the requirements of PCAOB standards.

<sup>8</sup> *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001 (Mar. 28, 2023) (“proposal” or “proposing release”).

We received 28 comment letters on the proposal.<sup>9</sup> Commenters included investor-related groups, firms, firm-related groups, academics, and others. We have considered all comments in developing the final standard and amendments, and specific comments are discussed in the analysis that follows.

## B. Overview of Existing Requirements

This section discusses key provisions of the existing standards.

Key provisions of AS 1001, *Responsibilities and Functions of the Independent Auditor*, include:

- The objective of an audit of financial statements is to express an opinion on the fairness of the financial statements in presenting, in all material respects, the financial position, results of operations, and cash flows in accordance with generally accepted accounting principles (“GAAP”). The auditor also disclaims an opinion if circumstances require. (AS 1001.01)
- The responsibilities of the auditor and management are that (i) the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud; and (ii) management is responsible for the financial statements, including adopting accounting policies and establishing and maintaining internal control to initiate, record, process, and report transactions (as well as events and conditions) consistent with management’s assertions in the financial statements. (AS 1001.02-.03)
- The auditor is to possess professional qualifications and exercise professional judgment in determining which auditing procedures are necessary in the circumstances to gain a reasonable basis for the opinion. (AS 1001.04-.05)
- The auditor should be aware of and consider auditing interpretations applicable to the audit and, if the guidance in the interpretations is not followed, be prepared to explain how the auditor complied with the provisions of the auditing standard addressed by the guidance. (AS 1001.11)

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<sup>9</sup> The comment letters received on the proposal are available in the docket for this rulemaking on the PCAOB’s website (<https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-049-responsibilities-auditor-conducting-audit/comment-letters>).

Key provisions of AS 1005, *Independence*, require that the auditor:

- Maintain independence in mental attitude and be intellectually honest, impartial, and without bias with respect to the client (i.e., be independent in fact). (AS 1005.01-.03)
- Be free from any obligation to or interest in the client, its management, or its owners, so that the general public maintains confidence in the independence of auditors. (AS 1005.03)
- Not only be independent in fact, but also avoid situations that may lead outsiders to doubt the auditor's independence. (AS 1005.03)

Key provisions of AS 1010, *Training and Proficiency of the Independent Auditor*, require that:

- The audit be performed by persons having adequate technical training, proficiency, and experience as an auditor. (AS 1010.01-.02)
- The training of the auditor be adequate to meet the requirements of the profession, be adequate in technical scope, and include general education. (AS 1010.01-.03)
- New audit professionals obtain professional experience through proper supervision and review of their work by those who are more experienced, with the nature and extent of supervision reflecting variances in practice. (AS 1010.03)
- The engagement partner exercise seasoned judgment in the varying degrees of supervision and review of work performed and judgments exercised by subordinates, and subordinates meet the responsibilities of their work. (AS 1010.03)
- The auditor continue professional training to become aware of developments in business and the profession, and study, understand, and apply new pronouncements on accounting and auditing. (AS 1010.04)

Key provisions of AS 1015, *Due Professional Care in the Performance of Work*, require that:

- The auditor exercise due professional care in the planning and performance of the audit and the preparation of the report, including observance of the auditing standards by professionals within the auditor's organization. (AS 1015.01-.02)
- The auditor possess "the degree of skill commonly possessed" by other auditors and exercise it with "reasonable care and diligence" (i.e., due professional care) in the



planning and performance of the audit and the preparation of the report.  
(AS 1015.01 and .05)

- The engagement team be assigned to tasks and be supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining. (AS 1015.06)
- The engagement partner know, at a minimum, the relevant professional accounting and auditing standards, be knowledgeable of the audit client, and be responsible for the assignment of tasks to, and supervision of, the members of the engagement team. (AS 1015.06)
- The auditor exercise professional skepticism throughout the audit, with a questioning mind and a critical assessment of audit evidence, to diligently gather and objectively evaluate audit evidence, and consider the competency and sufficiency of the evidence, and not be satisfied with less than persuasive evidence because of a belief that management is honest. (AS 1015.07-.09)
- The auditor obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Reasonable assurance is "a high level of assurance" but is not absolute assurance because of the nature of audit evidence and the characteristics of fraud. (AS 1015.10)

Key provisions of other standards relevant to this rulemaking include:

- AS 1201.04-.05 and AS 2101.03, which describe the engagement partner's responsibilities for supervision and review of audit documentation.
- AS 1215.06, which requires the auditor to document procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.
- AS 1215.15, which requires the auditor to complete the necessary auditing procedures and assemble for retention a complete and final set of audit documentation within 45 days after the report release date.
- AS 2810.30, which requires the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.
- AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles,"* which explains the meaning of "present fairly" as used in the phrase "present fairly ... in conformity with generally accepted accounting

principles,” and the basis for the auditor’s opinion on whether the financial statements present fairly an entity’s financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

## C. Reasons to Improve Auditing Standards

The new standard and related amendments are intended to modernize, clarify, and streamline the general principles and responsibilities of the auditor described in the foundational standards. We have identified several areas discussed below that we believe will enhance the useability of the requirements by making them easier to read, understand, and apply.

### 1. Alignment with Board-issued Standards and Rules

Since the adoption of the foundational standards, the Board has issued a number of new auditing standards and amendments. Certain of these standards address other principles and responsibilities that are fundamental to the conduct of an audit, including the engagement partner’s supervisory and review responsibilities and general requirements for audit documentation. Expressly incorporating these specific principles and responsibilities for conducting an audit in the new standard and related amendments should provide the auditor with more complete direction on matters that are central to the auditor’s work.

Certain descriptions of requirements in the foundational standards do not align with the language used in Board-issued standards. For example, some provisions in the foundational standards refer to GAAP;<sup>10</sup> however, in recognition of the SEC’s acceptance of filings that include financial statements prepared under accounting frameworks other than U.S. GAAP, such as International Financial Reporting Standards (“IFRS”), Board-issued standards are written as framework neutral and refer instead to the applicable financial reporting framework.<sup>11</sup> As another example, in describing professional skepticism, AS 1015 refers to the competency and sufficiency of the audit evidence rather than using terminology consistent with the Board-issued AS 1105, *Audit Evidence*, which refers to audit evidence as sufficient and appropriate. We believe that aligning the descriptions of the general principles and responsibilities in the new standard with language used in Board-issued standards will minimize potential confusion.

The foundational standards were originally written for audits of financial statements, but certain general principles and responsibilities described in the standards (e.g., reasonable

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<sup>10</sup> See, e.g., AS 1001.01 and .03.

<sup>11</sup> See paragraph .01, footnote 1 of AS 2410, *Related Parties* (“The auditor should look to the requirements of the U.S. Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company ...”); *Auditing Standard No. 18 – Related Parties Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Amendments to PCAOB Auditing Standards*, PCAOB Rel. No. 2014-002 (June 10, 2014), at A4-6 (describing the approach of AS 2410.01, footnote 1 as “framework neutral”).

assurance, due professional care, and professional skepticism) apply equally to audits of internal control over financial reporting (“ICFR”). None of the foundational standards mention audits of ICFR or refer to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. While AS 2201 refers to the foundational standards for the requirements related to technical training and proficiency as an auditor, independence, and the exercise of due professional care, including professional skepticism,<sup>12</sup> we believe it is important to clarify in the new standard that the general principles and responsibilities apply to an audit of ICFR as well as an audit of financial statements.

The application of the general principles and responsibilities should be improved by conforming the presentation of the related requirements to the structure used in Board-issued standards. This includes specifying an introduction and objectives to the new standard. In addition, the responsibilities from the foundational standards should be clarified by expressing the related requirements using terms described in PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* (e.g., using “must” and “should” to describe the degree of responsibility that the standards impose on auditors). Much of the explanatory material from the foundational standards that continues to be relevant has been relocated to the discussion in this release, which should facilitate the auditor’s navigation of the relevant requirements and align with the approach taken in Board-issued standards.

## **2. New or Revised Independence Requirements Issued by the PCAOB and the SEC**

Since the adoption of AS 1005 in 2003, the PCAOB has issued independence rules that have imposed certain incremental independence requirements on firms, relative to the SEC rules<sup>13</sup> (e.g., provisions related to tax services for persons in financial reporting oversight roles at issuer audit clients).<sup>14</sup> These incremental independence requirements are not expressly addressed in AS 1005, but nevertheless the auditor is required to comply with them. Further, while AS 1005 includes a general reference to the SEC’s requirements for auditor independence, there is no reference to the specific requirements. We believe it is helpful to refer explicitly in the new standard to the requirements that govern auditor independence, including independence requirements set out by the federal securities laws and related rules, which include an overarching provision for the auditor to maintain independence from its client in fact and in appearance.<sup>15</sup>

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<sup>12</sup> See AS 2201.04.

<sup>13</sup> See generally PCAOB rules under Section 3. Auditing and Related Professional Practice Standards, Part 5 – Ethics and Independence.

<sup>14</sup> See PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*.

<sup>15</sup> See Section 10A(g) of the Securities Exchange Act of 1934 (“the Exchange Act”), 15 U.S.C. § 78j-1(g); Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01.

### **3. Advancements in Technology Increasing the Availability of Electronic Audit Tools and Use of Audit Software**

Since the foundational standards were adopted by the PCAOB, advancements in technology have increased the availability of electronic audit tools and use of audit software. Auditors have largely moved away from a paper-based approach to audit documentation in favor of using software that houses electronic workpapers and audit programs. Use of electronic workpapers facilitates more efficient performance and review of audit procedures and enables auditors to assemble a complete and final set of audit documentation in less time than in a paper-based environment.

Auditors are also expanding their use of and reliance on electronic audit tools. For example, some firms have made significant investments in internally developed tools for use in the audit. In addition, some “off-the-shelf” applications such as data analysis software have become available to auditors. These advancements have changed the way that many auditors perform and document their audit procedures and retain related audit documentation. Accordingly, the new standard and amendments reflect an accelerated documentation completion date and related documentation requirements.

### **4. Outdated and Inconsistent Language**

The foundational standards include outdated and inconsistent language that is not relevant to audits conducted under the standards of the PCAOB. For example, paragraph .03 of AS 1001 provides that the auditor may draft the financial statements in whole or in part based on information from management during performance of the audit. This provision is outdated and should not be included in PCAOB auditing standards because an auditor drafting the financial statements would violate the applicable independence rules.<sup>16</sup> Eliminating outdated language used in the foundational standards should remove inconsistencies between PCAOB auditing standards and the relevant rules of the PCAOB and the SEC. Similarly, in describing the objective of the audit, paragraph .01 of AS 1001 refers to financial position, results of operations, and cash flows. This language could be unnecessarily limiting because the objective of the audit does not change based on the subject matter of the audit (e.g., whether it is an audit of ICFR or the financial statements). The new standard excludes references that are outdated or inconsistent, which we believe improves the application of the requirements and provides clearer direction to auditors in executing their responsibilities.

### **5. Activities of Other Standard Setters**

Since the Board’s adoption of the foundational standards, both the International Auditing and Assurance Standards Board (“IAASB”) and the Auditing Standards Board (“ASB”) of the AICPA have updated their analogous standards:

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<sup>16</sup> See Regulation S-X Rule 2-01(c)(4)(i), 17 C.F.R. § 210.2-01(c)(4)(i).

- IAASB Standard – International Standard on Auditing 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* (“ISA 200”) (effective 2009); and
- ASB Standard – AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (“AU-C 200”) (effective 2012).

These revisions were part of clarity projects that were designed to make the standards easier to read, understand, and apply.<sup>17</sup> These standards were updated to align the terminology used throughout the standards for consistency and to enhance and update explanatory materials.

## 6. Comments on Reasons for Standard Setting and Proposed Approach

The proposal sought comment on the appropriateness of the general principles and responsibilities of the auditor and the approach to reorganize and consolidate those responsibilities. Commenters who responded generally agreed that the general principles and responsibilities (i.e., reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment) described in the proposal are appropriate. One commenter suggested that we address the relevance and reliability of audit evidence and information in conjunction with the requirements in AS 1105, as part of the general principles and responsibilities. Some commenters addressed the reorganization and consolidation of the four existing foundational standards into one new standard and generally supported the proposed approach.

Commenters were generally supportive of the Board’s efforts to modernize and streamline the general principles and responsibilities of the auditor. Several commenters, for example, agreed that the proposed standard would provide a more logical presentation, which would enhance the useability of the standards by making them easier to read, understand, and apply. Some commenters, including investor-related groups, also expressed support for the proposal’s focus on investor protection.

Two commenters suggested consideration of analogous standards of the IAASB and the ASB. One commenter stated that PCAOB auditing standards should not diverge from AICPA auditing standards, to the extent appropriate. Another commenter recommended that we consider similar standards of the IAASB and the ASB and assess whether their approach could result in higher quality audits.

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<sup>17</sup> Descriptions of the clarity projects of the IAASB and ASB are available, respectively, at <https://www.iaasb.org/projects/clarity-iaasb-standards> and <https://us.aicpa.org/interestareas/frc/auditattest/improvingclarityasbstandards>.

The proposal also sought comment on the appropriateness of the general principles and responsibilities of the auditor in light of the availability of electronic audit tools and the use of audit software by both larger and smaller firms. Most commenters did not address this question. One commenter agreed that the proposed general principles and responsibilities of the auditor are appropriate and clear because they are necessary to the audit regardless of electronic tools and audit software. Another commenter recommended considering future possibilities and uses of machine learning and artificial intelligence (“AI”) technologies, which in the views of the commenter “are progressing rapidly.”

The final standard retains the general principles and responsibilities of the auditor described in the proposal, subject to revisions described below. The final standard also retains the overall approach of consolidating the foundational standards and the general principles and responsibilities of the auditor under one standard. We did not add specific requirements for evaluating the relevance and reliability of audit evidence, as suggested by one commenter, because AS 1105 provides the necessary framework for this evaluation. The final standard includes general requirements for conducting an audit, and obtaining sufficient appropriate audit evidence is part of those general requirements.

In addition, in the final standard we did not add provisions specific to the current and future use of emerging technologies. Due to the ever-evolving nature of technology, specifying requirements for certain types of technology based on how those tools are used today could quickly make the standard become outdated. Further, the general principles and responsibilities addressed in the standard apply to all audits, irrespective of the technology that may be used in performing audit procedures. We continue to address emerging technologies (e.g., machine learning and AI) as part of the staff’s ongoing Data and Technology research project.<sup>18</sup> Research from this project may give rise to individual standard-setting projects and may also inform the scope or nature of other projects that are included on our standard-setting agenda.

With respect to comments on analogous standards issued by other standard setters, we believe that AS 1000 is based on general principles and responsibilities of the auditor, similar to the bases of analogous IAASB and AICPA standards. We carefully considered the approaches of other standard setters when developing the proposal, and the new standard and amendments being adopted reflect the approach that we believe best protects investors and furthers the public interest. As a result, certain differences exist between our new standard and those of other standard setters, including a number of provisions that we believe are appropriate and consistent with our statutory mandate to protect the interests of investors and further the public interest.

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<sup>18</sup> See the PCAOB’s agenda related to standard setting, research, and rulemaking projects, available at <https://pcaobus.org/oversight/standards/standard-setting-research-projects>.

### III. DISCUSSION OF FINAL RULES

#### A. Overview of Final Rules

We are replacing AS 1001, AS 1005, AS 1010, and AS 1015 with one standard, AS 1000, that describes the general principles and responsibilities of an auditor<sup>19</sup> in conducting an audit in accordance with the standards of the PCAOB. Briefly, the new standard:

- Includes introductory language that reaffirms the auditor’s fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports;
- Includes objectives for the auditor to conduct and communicate the results of both an audit of a company’s financial statements and an audit of a company’s ICFR and satisfy and fulfill other general principles and responsibilities described in this standard;
- Retains and clarifies the general principles and responsibilities that are important for an audit, including reasonable assurance, due professional care, professional skepticism, and professional judgment;
- Aligns the engagement partner’s supervisory responsibilities under AS 1201 with due professional care;
- Retains the requirement for the auditor to be independent but expresses the obligation more directly by referring to the PCAOB’s independence criteria in its rules and standards, and the independence criteria set out in the rules and regulations of the SEC;
- Describes the auditor’s obligations to (i) comply with ethics requirements, (ii) obtain and maintain competence, and (iii) prepare audit documentation;
- Expresses the auditor’s responsibilities by using the terms set forth in PCAOB Rule 3101 (e.g., must and should) that describe the degree of responsibility that PCAOB standards impose on auditors; and
- Removes language that is outdated, inconsistent, and not relevant to audits conducted under the standards of the PCAOB.

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<sup>19</sup> The term “auditor” includes both a public accounting firm registered with the PCAOB and associated persons thereof, as defined in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*. For example, engagement quality reviewers (“EQRs”), by virtue of their status as associated persons, are within the term “auditor” in AS 1000. See also paragraph .03 of AS 1220, *Engagement Quality Review*.

As previously noted, we are amending other PCAOB auditing standards that address responsibilities fundamental to the conduct of an audit to:

- Clarify the engagement partner’s existing responsibilities for supervision and review in AS 1201, AS 1215, and AS 2101 to provide more specificity about the engagement partner’s responsibility to exercise due professional care related to supervisory and review activities required to be performed under existing auditor requirements;
- Clarify the requirements for audit documentation in AS 1215 to identify who performed the work, who reviewed the work, and the date of such review;
- Accelerate the period in AS 1215 to assemble a complete and final set of audit documentation for retention from 45 days to 14 days; and
- Update and incorporate the underlying requirements of AS 2815 into AS 2810, and rescind AS 2815, while preserving the meaning of “present fairly” and streamlining the requirements to provide a more logical presentation.

In a separate release, the Board is also adopting a new quality control standard, QC 1000, *A Firm’s System of Quality Control*, and a new ethics standard, EI 1000, *Integrity and Objectivity*, together with other amendments to PCAOB standards, rules, and forms.<sup>20</sup> This release includes references to QC 1000 and EI 1000, where appropriate.

## B. AS 1000

### 1. Introduction

*See paragraphs .01 through .02 of the new standard in Appendix 1.*

The first paragraph of the proposed standard, under the heading “Introduction,” described the fundamental obligation of auditors to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports. It noted that an audit primarily benefits investors who rely on the audit to provide objective and independent opinions on whether the company’s financial statements are presented fairly and, if applicable, on the effectiveness of the company’s ICFR. The proposed paragraph further provided that a properly conducted audit and related auditor’s report enhance the confidence of investors and other market participants in the company’s financial statements and, if applicable, ICFR. The existing foundational standards do not include an introduction and do not describe the auditor’s fundamental responsibility to protect investors.

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<sup>20</sup> See *A Firm’s System of Quality Control and Other Amendments to PCAOB Standard, Rules, and Forms*, PCAOB Rel. No. 2024-005 (May 13, 2024).



Investor-related groups strongly supported the proposed standard's emphasis on the auditor's obligation to protect investors. These commenters suggested some clarification in the language describing the auditor's obligation for, and role in, protecting investors, as described in the Supreme Court opinion in *United States v. Arthur Young & Co.*<sup>21</sup> Some pointed to, for example, language stating that the auditor "assumes a *public* responsibility transcending any employment relationship with the client" and that the auditor "owes ultimate allegiance to the corporation's creditors and stockholders, as well as the investing public."<sup>22</sup> One of these commenters stated that without additional clarification, the phrase "fundamental obligation" is a vague concept and open to interpretation. Two commenters recommended including in AS 1000 a footnote from the proposal that cites the *Arthur Young* opinion.

Two commenters, including an investor-related group, recommended that the standard's reference to investors be broadened to include shareholders, debtholders, and other financial statement users who rely on a company's financial statements, consistent with the usage by Financial Accounting Standards Board ("FASB") and the Supreme Court in the *Arthur Young* opinion. One of these commenters recommended including a definition of "financial statement users" in the final standard. Another recommended adding a footnote to the first sentence of paragraph .01 defining and describing the meaning of "investors."

A number of other commenters, primarily firms, expressed concerns that the introduction language describing the auditor's role was unclear and could be misleading. For example, several commenters noted that the description of the auditor's role in protecting investors could be viewed as creating a new legal obligation owed to investors. In the view of one commenter, the proposed language implied that investor protection is the sole responsibility of the auditor and could give investors false confidence that they can solely rely on an auditor's report as investment advice, when in fact there are many other factors investors should consider. Another commenter asserted that the proposed language could create a misimpression that auditors are permitted and expected to deviate from auditing standards when they believe such a departure would be warranted to further investors' interests. These commenters suggested that the Board clarify the introduction language in the final standard. Some commenters provided alternative language for the Board's consideration. For example, two commenters suggested replacing the phrase "properly conducted" in the last sentence of paragraph .01 with "conducted in accordance with the standards of the PCAOB" to align with language used in the auditor's report. One commenter suggested deleting paragraph .01 entirely.

After considering the comments received, we are retaining the proposed approach to the introduction section, while making certain revisions in light of the comments received.

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<sup>21</sup> *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984).

<sup>22</sup> *Id.* at 817 (emphasis in original).

We have revised the first sentence of the introduction to state that the auditor has a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports. We also removed a redundant statement from proposed paragraph .01 (“and that obligation governs the auditor’s work under the standards of the PCAOB”). This statement is unnecessary because paragraph .02 already clarifies that AS 1000 describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the PCAOB. This includes the fundamental obligation to protect investors as described in paragraph .01.

The fundamental obligation to protect investors is interwoven in the general principles and responsibilities that guide auditors throughout their work. Under current law, the auditor plays a critical role in the financial reporting process. By issuing opinions concerning whether financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, auditors serve a special “public watchdog” function under the existing federal securities laws, requiring “complete fidelity to the public trust.”<sup>23</sup> As “gatekeepers,” auditors have a public responsibility to serve the public interest.<sup>24</sup> Investors rely on auditors to promote companies’ adherence to federal securities law mandates and companies’ disclosure of accurate and reliable financial information.<sup>25</sup> “Investor confidence is bolstered by the knowledge that public financial statements have been subjected to the rigors of independent and objective investigation and analysis” by an auditor.<sup>26</sup> This enhanced confidence of investors and other financial statement users in the company’s financial statements and ICFR also plays an integral role in maintaining the public trust in the capital markets. The introduction in the final standard underscores the auditor’s obligation under our auditing standards and other applicable laws and regulations.

We emphasize – in response to commenters who expressed concern that the introductory language, and specifically its use of the term “obligation,” could be interpreted to establish a new legal duty – that the introductory language does not alter any existing regulatory or legal requirements or obligations between auditors and investors. It does not establish a novel duty or new form of legal obligation. Rather, it reaffirms the auditor’s

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<sup>23</sup> *Arthur Young*, 465 U.S. at 817-18.

<sup>24</sup> *In the Matter of KPMG Peat Marwick LLP*, SEC Rel. No. 34-43862, at 14 & n.54 (Jan. 19, 2001); see John C. Coffee Jr., *Gatekeepers: The Professions and Corporate Governance* 2-3 (2006) (describing “gatekeepers” as “repeat players who provide certification or verification services to investors, vouching for someone else who has a greater incentive than they to deceive”).

<sup>25</sup> *In the Matter of the Application of S.W. Hatfield, C.P.A.*, SEC Rel. No. 34-69930, at 33 (July 3, 2013) (reviewing PCAOB disciplinary action).

<sup>26</sup> *McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005); see *Arthur Young*, 465 U.S. at 819 n.15.

obligation under the existing legal framework and the important role of the auditing profession in our capital markets.<sup>27</sup>

Paragraph .01 of the final standard has also been revised, as suggested by some commenters, to state that the auditor's responsibility<sup>28</sup> transcends the auditor's relationship with management and the audit committee of the company under audit, providing the foundation for an objective and independent audit. This statement expresses a longstanding principle of public accounting.<sup>29</sup> Paragraph .01 also states that a properly conducted audit and the related auditor's report enhance the confidence of investors and other financial statement users in the company's financial statements and, if applicable, ICFR. We have retained the phrase "properly conducted audit" to align with the description in paragraph .02. We removed the sentence that states that "An audit primarily benefits investors, who rely on the audit to provide an objective and independent opinion on whether the company's financial statements are presented fairly and, if applicable, on the effectiveness of the company's internal control over financial reporting" because it is redundant and unnecessary in the context of the surrounding statements. We do not believe that the language in paragraph .01 suggests that auditors may deviate from PCAOB auditing standards to protect investors. In fact, the language clearly establishes the fundamental duty of auditors to prepare and issue their reports in accordance with PCAOB standards. Similarly, we do not interpret the language of paragraph .01 as suggesting that investors should view auditor's reports as the sole source of investment advice. Collectively, these provisions emphasize that auditors play a critical role in ensuring the accuracy and transparency of a company's financial information, and that this role helps investors make well-informed decisions and supports trust in a company's financial statements.

Finally, a new footnote to paragraph .01 clarifies that references to "investors and other financial statement users" in AS 1000 encompass a broad spectrum of stakeholders. This group

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<sup>27</sup> See Section 101(c)(6) of the Sarbanes-Oxley Act of 2002 (authorizing PCAOB to enforce compliance with the "Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the *obligations* and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof ....") (emphasis added).

<sup>28</sup> The terms "obligation" and "responsibility" are used synonymously in this standard.

<sup>29</sup> See *Arthur Young*, 465 U.S. at 817-818 ("By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public.") (emphasis in original); AICPA Professional Standards, Vol. 2, Code of Professional Conduct, ET Section 53, Article II – The Public Interest (2002) (".01 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce.").

includes not only a company's existing and potential shareholders, but also bondholders, lenders, other creditors, and others who use the company's financial statements.<sup>30</sup>

In addition to the revisions to paragraph .01, we relocated certain content, discussed in more detail below, from proposed paragraph .15 into a new note to paragraph .01. The note reminds auditors that their obligation to protect investors provides important context to the auditor's work when applying the requirements of AS 1000 and other PCAOB standards and rules (e.g., when conducting interim reviews in accordance with AS 4105, *Reviews of Interim Financial Information*, or when conducting audits of ICFR in accordance with AS 2201).

Paragraph .02 summarizes the scope and content of AS 1000. We did not receive comment on this paragraph and are adopting it as proposed.

## 2. Objectives of the Auditor

*See paragraph .03 of the new standard in Appendix 1.*

The proposed standard set forth three objectives of the auditor (a) in an audit of financial statements, to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and to issue an auditor's report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; (b) in an audit of internal control over financial reporting, to obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment, and to issue an auditor's report that expresses an opinion on the effectiveness of the company's internal control over financial reporting; and (c) to communicate externally, as required by applicable professional and legal requirements. Other than AS 1001,<sup>31</sup> the existing foundational standards do not include an objective.

The proposal defined the term "applicable professional and legal requirements" by referring to the term's definition in proposed QC 1000.<sup>32</sup> That proposed definition included (i) professional standards, as defined in PCAOB Rule 1001(p)(vi); (ii) rules of the PCAOB that are not professional standards; and (iii) to the extent related to the obligations and responsibilities of accountants or auditors or to the conduct of engagements, rules of the SEC, other provisions

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<sup>30</sup> See FASB, Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 1, *The Objective of General Purpose Financial Reporting* (Dec. 2021) ("The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity").

<sup>31</sup> See AS 1001.01.

<sup>32</sup> See *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

of U.S. federal securities law, and other applicable statutory, regulatory, and other legal requirements.

Several commenters expressly supported the proposed objectives of the auditor. Some commenters suggested ways to further clarify these objectives. For example, one commenter suggested that the objectives be reframed as objectives of the “audit” rather than of the “auditor.” Another commenter suggested moving the requirements on the determination of critical audit matters (“CAMs”) from AS 3101.11, to the objectives of the auditor in AS 1000 in order to highlight the importance of CAMs. One commenter recommended that the objective related to the audit of ICFR refer to the relevant criteria used (e.g., criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission) and clarify that it is integrated with the audit of financial statements.

With respect to the communication objective, one commenter stated that the proposed objective should also refer to communications with the company. Another commenter stated that the term “applicable legal and professional requirements” is overly broad and may inadvertently scope in legal requirements outside of public accountancy laws. An additional commenter suggested that AS 1000 refer instead to “PCAOB rules and standards.”

We are adopting the objectives in the final standard substantially as proposed, with the modifications discussed below.

The purpose of the objectives is to provide additional context for understanding the requirements in the standard. Therefore, we added the objective to “satisfy and fulfill the other general principles and responsibilities described in this standard.” This provides more explicit linkage to the general principles and responsibilities set forth in the final standard.

The objectives refer, as proposed, to the “objectives of the auditor.” Because the standard addresses the general principles and responsibilities of the auditor in conducting an audit, we believe that the objectives should be directed at the “auditor” rather than the audit as a whole.

The determination of CAMs is an important part of the auditor’s reporting responsibilities and is encompassed under the applicable professional and legal requirements. The auditor’s responsibilities for determining and communicating CAMs are described in AS 3101 and align with the stated objectives of that standard.<sup>33</sup> Rather than repeating these requirements, we have instead added a note to paragraph .17 of the final standard that refers to the potential inclusion of CAMs in the auditor’s report (see Section III.B.6).

The suggested references to the relevant criteria used in the audit of ICFR are not suitable for the objective section of AS 1000 and are already covered in other PCAOB standards. The specific requirements relevant to performing an audit of ICFR are addressed in AS 2201,

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<sup>33</sup> See AS 3101.04 and .11-.17.

which provides the appropriate context for the framework to be used by the auditor when conducting an ICFR audit and integrating the audit of ICFR with an audit of financial statements.

As was proposed, the final standard includes an objective to communicate externally in accordance with applicable legal and professional requirements. The auditor has a responsibility to make certain communications (e.g., communications about audit results to the audit committee under AS 1301, *Communications with Audit Committees*), in addition to reporting externally on the results of the audit. The reference to these requirements in the objective is not intended to limit or preclude appropriate communications with company personnel. For example, PCAOB auditing standards require the auditor to conduct various inquiries of management and other company personnel (e.g., AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2201), which is part of complying with applicable professional and legal requirements.

For ease of reference, the final standard includes the definition of the term “applicable professional and legal requirements,” in Appendix A as:

- Professional standards, as defined in PCAOB Rule 1001(p)(vi);
- Rules of the PCAOB that are not professional standards; and
- To the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system, rules of the SEC, other provisions of U.S. federal securities law, ethics laws and regulations, and other applicable statutory, regulatory, and other legal requirements.

This definition is intended to capture all professional and legal requirements specifically related to engagements under PCAOB standards of issuers and SEC-registered broker-dealers, including relevant accounting, auditing, and attestation standards, PCAOB rules, SEC rules and regulations, other provisions of federal securities law, other relevant laws and regulations (e.g., state law and rules governing accountants), applicable ethics law and rules, and other legal requirements related to the obligations and responsibilities of accountants or auditors in the conduct of the firm’s engagements or in relation to the quality control system.<sup>34</sup> It does not

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<sup>34</sup> The requirements related to compliance with applicable professional and legal requirements are meant to make clear that, in engagements subject to PCAOB auditing standards, all applicable professional and legal requirements must be followed. The requirement does not suggest that application of “other applicable statutory, regulatory, and other legal requirements” could supersede rules of the SEC, other provisions of U.S. federal securities law, rules of the PCAOB that are not professional standards, or PCAOB professional standards. On the contrary, requirements relating to “applicable professional and legal requirements” are meant to highlight the importance of adhering to other requirements when those requirements do not conflict with or abridge requirements of federal securities laws, PCAOB rules, or PCAOB standards.

encompass requirements that apply to businesses generally, such as tax laws, safety regulations, and employment law.

This definition reflects revisions made in response to comments received on proposed QC 1000.<sup>35</sup> The definition was expanded to explicitly mention ethics laws and regulations.<sup>36</sup> It was also refined to make clear that it encompasses statutory, regulatory, and other legal requirements beyond professional standards and other PCAOB rules “[t]o the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system.” This change is designed to limit the breadth of the definition to the relevant circumstances. The phrase “quality control policies and procedures,” used in PCAOB Rule 1001(p)(vi), is drawn from Section 110(5) of Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), and therefore no amendment to the PCAOB rule was necessary.

### 3. Professional Qualifications of the Auditor

#### i. Independence

*See paragraphs .04 through .05 of the new standard in Appendix 1.*

We proposed to carry forward the existing requirement in AS 1005 for the auditor to be independent, and to align the language that describes auditor independence obligations with language used in PCAOB Rule 3520, *Auditor Independence*, and SEC Rule 2-01.<sup>37</sup> Specifically, we proposed to require the auditor to be independent of its audit client both in fact and in appearance throughout the audit and professional engagement period.<sup>38</sup> The proposed standard also clarified that the auditor is not independent with respect to an audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed within the engagement. This clarification aligned the standard with

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<sup>35</sup> Two commenters supported the definition as proposed. One commenter recommended including the profession’s ethical standards explicitly. Two commenters stated the phrase “other applicable statutory, regulatory, and other legal requirements” could be read broadly and extend beyond regulations that directly bear on the conduct of audit engagements. Another commenter suggested amending the definition of “professional standards” in PCAOB Rule 1001(p)(vi) to refer to “quality control standards” rather than “quality control policy and procedures.”

<sup>36</sup> These include those arising under state law or the law of other jurisdictions (e.g., obligations regarding client confidentiality).

<sup>37</sup> Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01.

<sup>38</sup> See PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term “audit and professional engagement period.”

language used in SEC Rule 2-01(b)<sup>39</sup> to explain further the meaning of being independent both in fact and in appearance. In addition, we proposed to require the auditor to satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the SEC under the federal securities laws.

Several commenters expressed support for including in AS 1000 the existing requirements from AS 1005 and stating more directly the auditor's obligation to comply with the independence requirements of the PCAOB and SEC. Two commenters, including an investor-related group, suggested that we replace references to "audit client" with "company under audit." One commenter asserted that using "client" does not recognize that the auditor's public responsibility transcends the employment relationship with the client. Another commenter asserted that the use of "client" mischaracterizes the relationship between auditor and the company or its management, and places the auditor in a "subservient" position. In addition, one commenter suggested adding to the final standard additional language from SEC Rule 2-01(b) to indicate that the PCAOB and SEC will consider "all relevant facts and circumstances" in determining independence. That commenter also suggested limiting the use of the term "independent" in the title of the auditor's report to only those auditors that have complied with the SEC and PCAOB rules.

After considering the comments received, we are adopting the requirements related to independence substantially as proposed with some modifications. We agree with the commenters' observation that language used in our standards can help emphasize that audits are performed primarily for the benefit of investors, not management of the company. Accordingly, we have replaced references to "audit client" with "company under audit" and added a footnote to clarify that the phrase "company under audit" has the same meaning as "audit client" as defined by PCAOB Rule 3501(a)(iv).

We did not add to the final standard additional language from SEC Rule 2-01(b) stating that the PCAOB and SEC will consider "all relevant facts and circumstances" in determining independence. Our standards do not address the SEC's processes, and we need not repeat in this standard that relevant matters are considered in PCAOB independence determinations.<sup>40</sup>

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<sup>39</sup> Under the general standard in SEC Rule 2-01(b), the SEC "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."

<sup>40</sup> See Note to paragraph (b) of PCAOB Rule 3525, *Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting* ("Independence requirements provide that an auditor is not independent of his or her audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of



We also did not add limitations on the use of the term “independent” in the title of the auditor’s report. AS 3101 contains requirements regarding the content of the auditor’s report, including the title “Report of Independent Registered Public Accounting Firm.” AS 3101 also requires that the auditor’s report include a statement that the auditor is required to be independent with respect to the company in accordance with U.S. federal securities laws and the applicable rules and regulations of the SEC and PCAOB. Imposing any limitations on the use of the term “independent” in the title, as suggested by a commenter, is outside of the scope of this standard.

## ii. Ethics

*See paragraph .06 of the new standard in Appendix 1.*

We proposed to require the auditor to comply with applicable ethics requirements, including the rules and standards of the PCAOB. Under the proposed standard, ethics requirements included the rules in Section 3, Part 5 of PCAOB rules and proposed EI 1000, *Integrity and Objectivity*, of the QC proposal. The existing foundational standards do not reference the auditor’s responsibility to comply with ethics requirements.

A few commenters suggested revisions to the proposed requirement. Two commenters, including an investor-related group, stated that the proposed requirement is weak because it focused on merely complying with rules and standards of the Board. The investor-related group also suggested adding language that discusses subordination of judgment to others, specifically those outside the audit firm (e.g., external specialists). The other commenter recommended requiring that firms create and maintain codes of ethics embracing the principles of proposed EI 1000 and upholding the integrity of capital markets and auditors’ fundamental obligations to investors. An additional commenter suggested addressing in the standard broader ethical principles, such as integrity and objectivity, in addition to compliance with rules and standards.

After considering the comments received, we are retaining the requirement to comply with ethics requirements substantially as proposed, with the modifications discussed below. We have added the word “ethics” before “rules and standards of the PCAOB” to provide a clearer indication of the rules and standards we are referencing. Under the final standard, applicable ethics requirements are not limited to the ethics rules and standards of the PCAOB but also include state law and the laws of other jurisdictions that may establish additional ethics provisions with which the auditor is required to comply (e.g., obligations regarding conflicts of interest).

We agree with the underlying point of the comment that auditors should not subordinate their judgment to individuals outside the audit firm (e.g., external specialists) and believe that the new standard will achieve the desired objective of the comment. A

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exercising objective and impartial judgment on all issues encompassed within the accountant’s engagement.”) (emphasis added).

subordination or relinquishment of professional judgment would be inconsistent with the requirements of AS 1000.09-.10 related to due professional care, which are discussed in Section III.B.4 below. In addition, EI 1000 addresses the broader ethical principles of integrity and objectivity. Specifically, the overarching requirements in EI 1000 include (i) maintaining integrity, which includes being honest and candid, not knowingly or recklessly misrepresenting facts, and not subordinating judgment; and (ii) maintaining objectivity, which includes being impartial, intellectually honest, and free of conflicts of interest. The intent of the requirement to comply with ethics in AS 1000 is to remind auditors of their responsibilities described in EI 1000 and Section 3, Part 5 of PCAOB rules. Therefore, additional discussion of broader ethical principles and responsibilities is appropriately addressed in EI 1000 and need not be duplicated in AS 1000. We have expanded the reference to EI 1000 in footnote 6 of paragraph .06 of AS 1000 to clarify that EI 1000 specifically requires auditors to maintain integrity and objectivity. Further clarification on matters related to subordination of professional judgment is unnecessary in this release. Lastly, we considered comments related to firms' adoption of an ethics code as part of the adoption of EI 1000.

### iii. Competence

*See paragraphs .07 and .08 of the new standard in Appendix 1.*

#### a. Description of competence

We proposed to require that the audit be performed by an auditor who has competence to conduct an audit in accordance with applicable professional and legal requirements. Competence, as described in the proposed standard, consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. In the proposing release, we explained that the auditor's knowledge and skill relate to adequate technical training and proficiency as an auditor, and the auditor's ability relates to the capabilities to perform, and in the case of supervisory staff, to review assigned tasks. The proposed standard also provided that, in determining the appropriate level of competence, the measure is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time. A note to the proposed requirement stated that competence includes knowledge and expertise in accounting and auditing standards and in SEC rules and regulations relevant to the company being audited and to the related industry or industries in which it operates. The proposed requirement was consistent with the auditor's existing responsibilities under AS 1010 for maintaining "adequate technical training and proficiency" but used updated terminology.

Several commenters sought greater clarity in the proposed requirement, stating that it did not account for the collective competence of the engagement team or that it might imply that all individual members of an engagement team are expected to have the same level of competence. These commenters generally suggested (i) revising the requirement to apply to, for example, "the engagement team, including specialists" or "auditors, collectively" instead of

“an auditor” and (ii) clarifying that necessary competence is commensurate with the assigned tasks of the individual auditor. One commenter suggested (i) defining the individuals intended to be covered by the requirement, including subject matter experts and EQRs; (ii) explaining that the competence of individuals varies based on a variety of factors; and (iii) including quantitative factors in the measure of competence. Another commenter noted that the proposed requirement could be interpreted to limit the ability to assign challenging work to junior staff because they may lack significant experience.

Some commenters, mostly firms and professional organizations, also expressed concern with the description of competence in the note to the proposed requirement – which referred to having “expertise” in SEC rules and regulations and the relevant industry of the company being audited – and asked for additional clarification. These commenters asserted that the term “expertise” may impose a higher standard of competence than intended and could imply that the expected level of knowledge is that of a person qualified to engage in the practice of another profession or occupation (e.g., the legal profession). One of these commenters also expressed concern with the implication that a partner without relevant expertise in the industry in which the issuer operates may not be competent to perform an audit of the issuer, even with the assistance of other firm or engagement team members with relevant industry expertise. Several commenters recommended deleting the reference to “expertise” or using alternative language such as “proficiency” or “sufficient knowledge.”

After considering the comments received, we are adopting the requirement related to competence substantially as proposed, with the modifications discussed below.

First, consistent with our description in the proposal, we continue to believe the level of competence needed to conduct the audit is driven by the activities assigned to the individual auditors performing those activities. As the assigned activities in an audit vary from individual to individual, so does the required level of competence to complete those activities in accordance with applicable professional and legal requirements and the firm’s policies and procedures. For example, a first-year auditor is not expected to have the same level of competence as a more experienced auditor because the tasks assigned to the seasoned auditor generally require experience gained over time. Further, PCAOB standards and rules use the term “auditor” to mean both a firm registered with the PCAOB and its associated persons.<sup>41</sup> Therefore, we believe that defining the individuals covered by the requirement or revising terminology to “auditors” or “engagement team,” as suggested by some commenters, is not necessary. The requirements regarding the appropriate assignment of responsibilities to engagement team members and proper supervision are addressed in other PCAOB standards.<sup>42</sup>

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<sup>41</sup> See PCAOB Rule 1001(a)(xii).

<sup>42</sup> See, e.g., paragraph .05 of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*, and AS 1201.05.

Second, we agree that quantitative measures are not wholly irrelevant when measuring competence. Quantitative measures alone may not accurately reflect the nature of experience gained over time and therefore competence should not be measured exclusively on a quantitative basis.<sup>43</sup> In consideration of comments, the final requirement clarifies that competence is measured both qualitatively and quantitatively.

Third, the intent of the proposed requirement's note (providing that competence "includes knowledge and expertise" in certain areas) was to provide additional direction to auditors on the meaning of competence in the context of the company being audited. We did not intend to impose a higher standard of competence beyond having the knowledge, skill, and ability to enable the auditor to perform the assigned activities in accordance with applicable professional and legal requirements. We have therefore changed "expertise" to "proficiency" in the final requirement in response to comments. Nevertheless, we continue to believe that understanding the company's business and being proficient in the rules and regulations relevant to the company under audit and its related industry is an important part of competence. For example, an engagement partner with significant experience mostly in auditing manufacturing companies may not necessarily have the appropriate level of competence to oversee, and have primary responsibility for, an audit of a financial institution.

#### b. Developing and maintaining competence

We also proposed to require that the auditor develop and maintain competence through an appropriate combination of academic education; professional experience in accounting and auditing with proper supervision; and training, including accounting, auditing, independence, ethics, and other relevant continuing professional education. Existing AS 1010 includes a similar requirement.

Investor-related groups advocated for the inclusion of investor-related training that focuses on investors as the primary beneficiaries of the audit and being responsive to investors' needs. These commenters also emphasized the importance of including the auditor's understanding of the business and industry related to the company under audit as part of developing competence. One investor-related group suggested specific training on materiality.

We are retaining the requirement to develop and maintain competence as proposed. We agree with investor-related groups' views on the importance of protecting investors when conducting an audit. In that regard, paragraph .01 of the final standard and the related discussion in Section III.B.1 of this release provide the context of investor protection that is relevant to the auditor's compliance with the requirements for developing and maintaining competence. Further, in considering commenters' suggestion about investor-focused training, we believe that the implementation of the final standard will necessarily involve training

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The description of competence is consistent with the description in QC 1000.

auditors on the application of the relevant requirements, including conducting an audit with investor protection in mind.

The note to paragraph .07 of the final standard reinforces the need for auditors to have knowledge and proficiency in the requirements relevant to the company being audited and the related industry. Further, the auditor's responsibilities for understanding the company's business and consideration of materiality in planning and performing an audit are specifically addressed in other PCAOB auditing standards,<sup>44</sup> and we expect that these responsibilities would already be included in training on auditing standards.

#### **4. Due Professional Care, Including Professional Skepticism**

##### **i. Due professional care**

*See paragraphs .09 through .10 of the new standard in Appendix 1.*

We proposed to require the auditor to exercise due professional care in all matters related to the audit. The proposed standard stated that due professional care (i) concerns what the auditor does and how well the auditor does it, and (ii) means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements. The proposed requirement was based on the existing requirement in AS 1015 to exercise due professional care.

The proposing release explained that exercising due professional care "in all matters related to the audit" would encompass all aspects of planning and performing an audit, including client acceptance and continuance procedures, and would extend to periods after the issuance of the auditor's report, such as completion of audit documentation,<sup>45</sup> reporting on Form AP, *Auditor Reporting of Certain Audit Participants*,<sup>46</sup> and procedures performed in connection with filings under the federal securities statutes.<sup>47</sup> We also proposed to retain language from existing standards related to an auditor's use of the work of other auditors, which emphasized that other auditors are responsible for performing their work with due professional care.<sup>48</sup>

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<sup>44</sup> See AS 2110 and AS 2105, *Consideration of Materiality in Planning and Performing an Audit*.

<sup>45</sup> See AS 1215.15 (as proposed to be amended).

<sup>46</sup> See PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

<sup>47</sup> See AS 4101, *Responsibilities Regarding Filings Under Federal Securities Statutes*, which describes the auditor's responsibilities when the auditor's report is included in filings under federal securities statutes.

<sup>48</sup> See *Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm*, PCAOB Rel. No. 2022-002 (June 21, 2022) (amendments

Some commenters acknowledged that due professional care is an important principle that should be retained in the final standard. Several commenters expressed support for requiring auditors to exercise due professional care “in all matters related to the audit.”

Some commenters, primarily some firms, advocated for retaining certain contextual language from AS 1015.03-.04, including, for example, the description of due professional care in the 1932 legal treatise, *Cooley on Torts*.<sup>49</sup> These commenters expressed concern that without such language there may be a lack of transparency, or confusion among investors and other stakeholders, about the limitations of due professional care.

After considering comments, we are adopting the requirement to exercise due professional care as proposed. We continue to believe that the description of due professional care in the final standard is consistent with the description in AS 1015.03 (and the reference in the current standard to the legal treatise, *Cooley on Torts*), which uses the terms “reasonable care and diligence” and “good faith and integrity but not infallibility” to describe due care. As discussed in the proposal, we have retained explicit reference to “reasonable care and diligence,” which we believe is well understood. We also believe that “good faith and integrity” means acting with “integrity.” Our use of the term “integrity” aligns with its meaning established in EI 1000, which we are adopting in connection with the Quality Control rulemaking. EI 1000 codifies the concepts of integrity and objectivity, emphasizing that integrity includes being honest and candid, not knowingly or recklessly misrepresenting facts, and not subordinating judgment.<sup>50</sup> We believe that the terms used to describe due professional care are clear and should not cause confusion, as suggested by some commenters, because we have not changed the meaning of due professional care.

The proposed standard specified that, for engagement partners, due professional care also includes (i) appropriately assigning responsibilities to, and supervising, engagement team members; (ii) determining that the audit is properly planned and performed to obtain reasonable assurance; (iii) evaluating that significant findings or issues are appropriately addressed; (iv) determining that significant judgments and conclusions on which the auditor’s report is based are appropriate and supported by sufficient appropriate audit evidence; and (v) determining that required communications under applicable professional and legal requirements have been made.

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approved by the SEC in Rel. No. 34-95488 (Aug. 12, 2022)), which amended AS 1015 to add this provision.

<sup>49</sup> The treatise states, among other things, that “no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment.”

<sup>50</sup> See also PCAOB Rel. No. 2024-005.

The proposed clarifications of the engagement partner's responsibilities leveraged existing requirements for planning and performing an audit and for completing the corresponding audit documentation. For example, AS 1215 describes matters that are considered to be significant findings or issues in an audit and requires the auditor to document the significant findings or issues, including the actions taken to address them.<sup>51</sup> As part of the engagement partner's supervisory responsibilities under AS 1201, the proposal stated that the engagement partner would need to evaluate (in a timely manner) the significant findings and issues identified by the engagement team to ensure appropriate action was taken.<sup>52</sup>

Similarly, the proposal stated that significant judgments made by the engagement team, which AS 1220 specifically requires the EQR to review, also warrant the engagement partner's review. Because the engagement partner has primary responsibility for the engagement, they have primary responsibility for the significant judgments made during the engagement, notwithstanding any involvement in or responsibility for those judgments by firm personnel outside of the engagement team, such as members of the firm's national office. Accordingly, the "significant judgments made by the engagement team" include all of the significant judgments made during the engagement.<sup>53</sup> The proposed standard aligned the engagement partner's supervisory and review activities with existing auditor responsibilities.

A few commenters addressed the proposed requirement regarding the engagement partner's responsibilities for exercising due professional care. One commenter recommended separating the partner's responsibilities from the broader requirement to exercise due professional care. Another commenter expressed concern that, as presented, the responsibilities of the engagement partner could be viewed as a substitute for the broader responsibilities applicable to all auditors. This commenter suggested emphasizing in the final standard that for engagement partners, the responsibilities are in addition to those required for all auditors.

Several commenters also suggested clarifications to the proposed requirements. For example, one commenter suggested that the requirements be extended to team members performing supervisory activities. Another commenter pointed to potential inconsistencies with requirements of AS 1201 and AS 2101, noting that AS 1201 does not explicitly require the partner to assign activities to team members that adequately match their levels of competence and allows the partner to seek assistance from appropriate engagement team members in fulfilling responsibilities. One commenter recommended adding a footnote to AS 1220 to the discussion of significant judgments and conclusions.

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<sup>51</sup> See AS 1215.12.

<sup>52</sup> See AS 1201.05.

<sup>53</sup> See *Auditing Standard No. 7 – Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Controls Standards*, PCAOB Rel. No. 2009-004 (July 28, 2009), at 4 n.7.

In response to commenters, we have relocated the proposed engagement partner's responsibility for due professional care into a separate paragraph in the final standard, with certain clarifications. Specifically, we agree with commenters' views that the engagement partner is not required to directly assign responsibilities to all engagement team members (e.g., audit staff at other accounting firms involved in the audit). Nevertheless, consistent with AS 1015.06, the engagement partner is responsible for the appropriate assignment of tasks to, and supervision of, engagement team members. As such, the final standard states that the engagement partner's responsibility for due professional care includes "being responsible for the appropriate assignment of responsibilities to, and supervision of, engagement team members." This formulation acknowledges that in certain audit engagements, such as large, multi-tiered audits, the engagement partner may not be directly assigning work to engagement team members. Instead, other engagement team members performing supervisory activities may assist the engagement partner and inform engagement team members of their responsibilities.<sup>54</sup>

We believe that relocating the engagement partner's responsibility for due professional care into a separate paragraph helps draw a distinction between the responsibilities applicable to all auditors and those that are incremental for engagement partners. To clarify this further, we added "also" to the requirement in paragraph .10 to indicate that the engagement partner responsibilities for due professional care are in addition to those applicable to all auditors. We did not expand the applicability of the engagement partner responsibilities described in AS 1000 to other members of the engagement team performing supervisory activities because, as discussed above, the intent of this requirement is to focus the engagement partner on exercising due professional care as the person with the primary responsibility for the engagement and its performance. As suggested by one commenter, we added a footnote to the final standard referencing AS 1220 for the discussion of significant judgments and conclusions. We are adopting the remaining provisions of the requirement as proposed.

## **ii. Description of professional skepticism**

*See paragraph .11 of the new standard in Appendix 1.*

The proposed standard stated that exercising due professional care includes exercising professional skepticism in conducting an audit, and described professional skepticism as an attitude that includes a questioning mind and a critical assessment of information related to the audit. This requirement is based on the existing auditor responsibility to exercise professional skepticism in AS 1015. We emphasized in the proposal that application of professional skepticism extends beyond the information used as audit evidence, which is described in AS 1105.02 as the information "that is used by the auditor in arriving at conclusions on which the auditor's opinion is based." For example, by exercising professional skepticism in the preparation of Form AP, the auditor may become aware of inconsistencies in total audit hours

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*See AS 1201.05.*



reported by another accounting firm participating in the audit based on the level of work assigned to that accounting firm and take corrective action.

An investor-related group supported the proposed description of professional skepticism to include a critical assessment of information related to the audit. In contrast, a number of other commenters, mostly firms, expressed concern about the proposed change in the description of professional skepticism from a critical assessment of “audit evidence” to “information related to the audit,” stating that this language is overly broad and its meaning unclear. Some of these commenters noted that, unlike with audit evidence, there is no established framework for auditors to assess information related to the audit and it is unclear what such an assessment would entail. Many of these commenters advocated for retaining the extant description of professional skepticism in AS 1015.07, which includes “a critical assessment of audit evidence.”

Some commenters offered additional explanation or suggestions, for example:

- One commenter indicated they were unable to identify information, other than Form AP data, that would be considered “information related to the audit” that is not already part of “audit evidence.” This commenter and another recommended specifically incorporating Form AP data into the requirement.
- One commenter indicated the proposed language could risk including information related to the audit that was never presented to the auditor. This commenter suggested retaining reference to “audit evidence” and including a reference to information obtained to comply with rules of the Board.
- Another commenter recommended retaining the reference to “audit evidence” because this concept is supplemented by the requirements in proposed paragraph .11 and by the overarching responsibility to exercise due professional care in relation to all matters related to the audit (including the preparation of Form AP).

Several commenters offered other views related to the description of professional skepticism. For example, one commenter stated that the difference between “critical assessment of information related to the audit” and “objective evaluation of evidence obtained in an audit” in proposed paragraph .11 is unclear. This commenter suggested combining proposed paragraphs .10 and .11 or providing further guidance, including guidance that is aligned with other standard setters. Another commenter questioned the assumption in the proposed standard that all auditors can exercise professional skepticism consistently for the duration of the audit, pointing to a lack of research.

After consideration of comments, we have revised the description of professional skepticism. The final standard describes professional skepticism as “an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules.” While we agree with commenters that

information related to the audit that is obtained by the auditor is generally audit evidence, we continue to believe that the exercise of professional skepticism in an audit extends beyond the evaluation of the sufficiency and appropriateness of audit evidence. Professional skepticism is an attitude held by the auditor throughout the audit process. For example, AS 2401, *Consideration of Fraud in a Financial Statement Audit*, provides that professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred.<sup>55</sup> The revised description in AS 1000 retains the extant reference to “critical assessment of audit evidence” but also, as suggested by one commenter, refers to information obtained by the auditor to comply with PCAOB standards and rules, such as information to complete Form AP. We believe that the revised description will provide auditors with a clear framework for exercising professional skepticism and aligns with the auditor’s obligation to exercise due professional care, which applies to all matters related to the audit.

As suggested by one commenter, the final standard also combines in paragraph .11 the description of professional skepticism (proposed paragraph .10) with the description of what exercising professional skepticism entails (proposed paragraph .11) discussed below. We believe this unified paragraph will provide better context for the application of professional skepticism.

### iii. Exercise of professional skepticism

*See paragraph .11 of the new standard in Appendix 1.*

The proposed standard described several factors involved in the exercise of professional skepticism, which were largely consistent with extant requirements. Under the proposed standard, the auditor’s exercise of professional skepticism included:

- Objective evaluation of evidence obtained in an audit (including information that supports and corroborates management’s assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions), and consideration of the sufficiency and appropriateness (i.e., relevance and reliability) of that evidence;
- Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- Not relying on evidence that is less than persuasive;
- Not assuming that management is honest or dishonest; and

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*See AS 2401.13.*

- Consideration of potential bias on the part of management and the auditor.

Some commenters provided views on specific aspects of the factors involved in the auditor's exercise of professional skepticism. The comments and related responses are discussed in more detail below.

*Objectively evaluating evidence.* One commenter suggested requiring the auditor to search for contradictory evidence. Another commenter stated that the proposed description did not sufficiently address professional skepticism in obtaining audit evidence and instead focused only on evaluating the evidence. One commenter stated that the proposed description was unclear and suggested using more direct language, including requiring the auditor to be more neutral in the assessment (e.g., evaluating evidence that both supports assertions and evidence that does not).

The intent of paragraph .11a of AS 1000 is not to alter the responsibilities for obtaining and evaluating evidence addressed in AS 1105, but to remind auditors of their responsibility to exercise professional skepticism in connection with both obtaining and evaluating audit evidence. As discussed in the proposal, sufficient appropriate audit evidence is necessary to support the auditor's opinion. While primarily obtained from audit procedures performed during the audit, audit evidence may also include information obtained from other sources such as previous audits, and client acceptance or continuance procedures. The exercise of professional skepticism is particularly important in obtaining and evaluating audit evidence when responding to assessed risks of material misstatement, including fraud risks.

Audit evidence consists of both information that supports and corroborates management's assertions and information that contradicts such assertions.<sup>56</sup> The auditor's appropriate application of professional skepticism includes critically assessing this information and should result in procedures that are focused on obtaining evidence that is more relevant and reliable,<sup>57</sup> such as evidence obtained directly by the auditor and evidence obtained from independent, knowledgeable sources. Further, if audit evidence obtained from one source is inconsistent with audit evidence obtained from another, the auditor is required to perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.<sup>58</sup>

Professional skepticism is important in all aspects of the audit, particularly in those areas of the audit that involve significant management judgments or transactions outside the

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<sup>56</sup> See AS 1105.02. A new footnote has been added to AS 1000.11a, referring to AS 1105 for the discussion of management's assertions regarding the financial statements and internal control over financial reporting, and the proposed phrase "regarding the financial statements or internal control over financial reporting" has been deleted from paragraph .11a.

<sup>57</sup> See AS 1105.07-.08.

<sup>58</sup> See AS 1105.29.

normal course of business. It is ultimately the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including when (i) identifying and assessing risks of material misstatement, (ii) performing tests of controls and substantive procedures, and (iii) evaluating audit results. For example, a lack of professional skepticism in the risk assessment process could result in an auditor not identifying or assessing risks appropriately, which could impact the effectiveness of the audit.

*Remaining alert to conditions that may indicate possible misstatement due to fraud.* We did not receive significant comments in this area. As part of exercising professional skepticism, the auditor remains alert to conditions that may indicate possible misstatement due to error or fraud. This includes, for example, being alert to information that calls into question the reliability of documents and responses to inquiries the auditor plans to use as audit evidence. Such information could identify conditions that may indicate possible fraud or error in the financial statements. As discussed above, AS 2401 provides further requirements regarding potential fraud risk factors.

*Not relying on evidence that is less than persuasive.* One commenter stated that the proposed phrase “not rely” appears to be more restrictive than the existing phrase “not be satisfied with” in AS 1015.09 because the proposed phrase would preclude the auditor from placing any reliance on anything less than completely persuasive evidence, even in combination with other persuasive evidence.

The proposed phrase “not rely” was intended to convey that, consistent with AS 1015.09, exercising professional skepticism involves seeking evidence that is more persuasive rather than settling on evidence that may be less so. AS 1000 is not intended to address the sufficiency and appropriateness of evidence. To avoid confusion, the final standard retains the existing terminology from AS 1015 as “not being satisfied with evidence that is less than persuasive.” The requirements for obtaining audit evidence, including evaluating its relevance and reliability, are discussed in AS 1105, which provides that the quantity of audit evidence needed is affected by both the risk of material misstatement and the quality of the evidence obtained (i.e., its relevance and reliability). To supplement evidence that is less relevant or obtained from a less reliable source, an auditor would need to gather additional evidence. The appropriate application of professional skepticism focuses the auditor on seeking the best evidence reasonably obtainable.

*Not assuming that management is honest or dishonest.* An investor-related group referenced certain views expressed in the 2000 report by the Public Oversight Board’s Panel on Audit Effectiveness.<sup>59</sup> That report recommended that auditing standards require forensic-type fieldwork in which auditors would “modify the otherwise neutral concept of professional skepticism and presume the possibility of dishonesty at various levels of management, including

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<sup>59</sup> See Public Oversight Board, *The Panel on Audit Effectiveness Report and Recommendations* (Aug. 31, 2000).

collusion, override of internal control and falsification of documents.”<sup>60</sup> We believe that establishing a presumption of management’s dishonesty would have broader implications beyond the exercise of professional skepticism under this standard.

*Consideration of potential bias on the part of management and the auditor.* Several commenters expressed concern that the obligations related to consideration of the auditor’s own bias were unclear or could be viewed as a requirement to seek contradictory evidence. Some of these commenters noted that consideration of auditor bias is inherent in the requirements for evaluating audit evidence under AS 1105 and suggested deleting the reference to “and the auditor” from proposed paragraph .11e. One commenter suggested aligning this concept with the approach used by the AICPA in their revised audit evidence standard. Two commenters also questioned the nature and extent of documentation necessary to demonstrate consideration of auditor bias. One investor-related group advocated for requiring the auditor to affirmatively consider the risk of bias, particularly confirmation bias, arising out of the financial relationship between management and the auditor.

We continue to believe that it is important to include reference to auditor bias in connection with exercising professional skepticism because certain conditions inherent in the audit environment create incentives and pressures that could impede the appropriate application of professional skepticism and allow unconscious bias to influence decisions. Examples of these incentives and pressures include avoiding significant conflicts with management, providing an unqualified audit opinion prior to the company’s filing deadline, achieving high client satisfaction ratings, keeping audit costs low, or cross-selling other services.

As discussed in the proposal, it is important for the auditor, as part of exercising professional skepticism, to consider the impact of management bias and the auditor’s own bias that could affect the auditor’s judgments. For example, the tendency to seek confirming information can lead the auditor to seek audit evidence that is only consistent with management’s explanations, or to favor conclusions that are consistent with the auditor’s initial beliefs or conclusions reached in prior year audits. In exercising professional skepticism, the auditor could mitigate such potential bias by being aware of “confirmation bias,” considering alternatives provided by others, and being aware of contradictory information.<sup>61</sup> Auditors and management may also have biases related to electronic information (e.g., a belief that electronic information is either always reliable or inherently prone to error). For example, a tendency to favor output generated from automated systems, even when contradictory information raises questions as to whether such output is reliable, illustrates a form of bias. Exercising professional skepticism, including critically assessing information related to the audit, helps the auditor address the effects of potential bias on professional judgment and decision-making. It is important to clarify, however, that the consideration of potential bias discussed

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<sup>60</sup> *Id.* at 88-89.

<sup>61</sup> For a discussion of confirmation bias, see, e.g., Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology* 175 (1998).

above does not change the auditor's responsibilities for evaluating contradictory evidence, as suggested by some commenters.

Finally, we are not adding new documentation requirements for demonstrating the auditor's exercise of professional skepticism beyond those addressed in AS 1215. Auditors can demonstrate that their work encompassed the exercise of professional skepticism by documenting the procedures performed and conclusions reached in accordance with AS 1215.

After consideration of the comments, we are adopting the provisions for exercising professional skepticism substantially as proposed, with the modifications discussed above.

## 5. Professional Judgment

*See paragraph .12 of the new standard in Appendix 1.*

Auditors exercise professional judgment throughout the audit, and existing standards refer to the use of professional judgment, but do not describe in detail what professional judgment means. The proposed standard provided that the auditor must exercise professional judgment and included a description of professional judgment. As discussed in the proposing release, auditors exercise professional judgment throughout the audit. For example, the auditor exercises professional judgment in:

- Determining the areas to be tested and the nature, timing, and extent of the tests to be performed;
- Interpreting the results of audit testing and evaluating audit evidence;
- Evaluating the reasonableness of accounting estimates in significant accounts and disclosures, based on information that could reasonably be expected to be available through the date of the auditor's report;<sup>62</sup>
- Determining if there are any CAMs in the audit of the financial statements;<sup>63</sup> and
- Determining the nature and extent of documentation to comply with documentation requirements.<sup>64</sup>

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<sup>62</sup> See AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, which discusses the auditor's responsibility to obtain sufficient appropriate evidence to determine whether accounting estimates in significant accounts and disclosures are properly accounted for and disclosed in the financial statements.

<sup>63</sup> See AS 3101 for requirements regarding CAMs.

<sup>64</sup> See AS 1215 for documentation requirements.

As proposed, professional judgment involved applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements.

Several commenters, primarily firms, expressed concern that the proposed description of professional judgment could be interpreted as imposing a new strict liability requirement. These commenters suggested removing the phrase “such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements” in the description, noting that a deficiency in an auditor’s compliance with applicable professional and legal requirements should not, by default, indicate a failure to exercise appropriate professional judgment. In the view of these commenters, this implication would be contrary to the established interpretation of an auditor’s responsibilities, which recognizes that reasonable observers may disagree regarding whether applicable standards were complied with while agreeing that the matter in question was within the purview of the auditors’ professional judgment and could result in hindsight challenges of auditors’ judgments.

One commenter recommended that the description of professional judgment refer to “sound” judgment, consistent with the description used by the International Ethics Standards Board for Accountants (“IESBA”).<sup>65</sup> Another commenter asked for clarification of the concept of “well-reasoned conclusions,” noting potential differences with the definition of professional judgment established by other standard setters. Two commenters advocated for the establishment of a judgment framework by the Board. One commenter stated that they heard auditors express the need for more clarity about the degree of documentation necessary to demonstrate their reasoned judgment. Another commenter suggested adding the concept of materiality to the description of an auditor’s exercise of judgment, based on the description of judgment in AS 2815.04 with regard to the auditor’s opinion on financial statements.

The proposed phrase “such that the audit is planned and performed, and the report or reports are issued, in accordance with applicable professional and legal requirements” was meant to provide context to the application of professional judgment and was not intended to introduce a strict liability requirement. After considering the comments received, we removed this phrase in the final description of professional judgment. We continue to believe that it is important to clarify that the use of professional judgment does not allow for an arbitrary exercise of discretion. While conclusions could vary, auditors are required to apply relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances. Therefore,

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<sup>65</sup> See IESBA, *Handbook of the International Code of Ethics for Professional Accountants* (2023), Subsection 113 – Professional Competence and Due Care, at 113.1 A1 (“Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.”).

we added a note to paragraph .12 to clarify that professional judgment is applied in the context of conducting an audit with due professional care in accordance with applicable professional and legal requirements. We believe that this note properly frames the exercise of professional judgment without implying that a deficiency in an auditor's compliance with applicable professional and legal requirements would by default also indicate a failure to exercise appropriate professional judgment.

We did not change the description of professional judgment to include "sound judgment" as we believe that term is redundant with the phrase "well-reasoned." The phrase "well-reasoned," used in the context of an auditor exercising professional judgment and reaching conclusions, is clear because it refers to judgment made and conclusions reached that are based on logical thinking and an analysis of relevant information.

As discussed earlier, the auditor is required to exercise due professional care in all matters related to the audit. The concept of the auditor's exercise of professional judgment is rooted in conducting the audit with due professional care. Therefore, we are retaining the phrase "well-reasoned" as proposed. Regarding the degree of documentation related to professional judgment, the auditor is expected to comply with documentation requirements of AS 1215, which includes requirements for considering the nature and extent of documentation needed.

We believe that creating a "framework" for how auditors should exercise their professional judgment, as suggested by some commenters, would be beyond the scope of this project. We further believe it is better for auditors to adhere to overarching principles and standards that mandate the exercise of professional judgment in connection with conducting an audit with due professional care. This approach acknowledges the multifaceted nature of audits and allows auditors to exercise their professional judgment in the unique circumstances of each audit engagement.

## **6. Conducting an Audit**

### **i. Auditor and management responsibilities**

*See paragraph .13 of the new standard in Appendix 1.*

We proposed to require the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence to (a) obtain reasonable assurance about whether: (1) in an audit of financial statements, the financial statements are free of material misstatement, whether due to error or fraud, or (2) in an audit of ICFR, material weaknesses exist as of the date specified in management's assessment; and (b) provide the auditor with a reasonable basis for forming an opinion. This requirement was retained from AS 1001 and AS 1015 but expanded to cover an audit of ICFR. We also proposed to include a note to the requirement that clarified the distinction between the responsibilities of the auditor and those of management, and to expand those responsibilities to include an audit of ICFR. Specifically, the note stated that in an



audit of financial statements, the financial statements are management's responsibility and the auditor's responsibility is to express an opinion on the financial statements. In an audit of ICFR, management is responsible for maintaining effective ICFR and for assessing the effectiveness of ICFR, and the auditor's responsibility is to express an opinion on the effectiveness of the company's ICFR.

Several commenters discussed the importance of clearly distinguishing the responsibilities of the auditor from those of management and suggested retaining the corresponding language from AS 1001.02-.03. For example, one commenter observed that some investors may mistakenly believe that the auditor drafts the financial statements. In the view of this commenter, stating that management is "responsible" for the financial statements may be interpreted as a legal responsibility and does not explicitly convey that management prepares the financial statements.

We are retaining the requirement substantially as proposed. In response to commenters, we updated the language in the note to clarify that the financial statements, "including their preparation," are the responsibility of management and that management is responsible for "establishing and maintaining" effective ICFR.

## **ii. Reasonable assurance**

*See paragraph.14 of the new standard in Appendix 1.*

We proposed to retain the concept of reasonable assurance from AS 1015. Specifically, the proposed standard stated that reasonable assurance is a high level of assurance and is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including in obtaining sufficient appropriate audit evidence.<sup>66</sup> The auditor is able to obtain reasonable, but not absolute, assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of ICFR, material weaknesses are detected.

Commenters generally supported retaining the concept of reasonable assurance but provided views on its proposed description. A number of commenters, primarily firms, recommended that we retain certain statements from AS 1015.10-.13 (or similar language) that describe the limitations of an audit. These statements include:

- Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with the

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<sup>66</sup> See paragraph .03 of AS 1101, *Audit Risk*.

standards of the PCAOB may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements.<sup>67</sup>

- Even with good faith and integrity, mistakes and errors in judgment can be made. .... [I]n the great majority of cases, the auditor has to rely on evidence that is persuasive rather than convincing.<sup>68</sup>
- Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement.<sup>69</sup>
- [T]he auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the PCAOB.<sup>70</sup>

A few of these commenters also pointed to the characterization of reasonable assurance in the standards of other standard setters (e.g., ISA 200).<sup>71</sup> These commenters generally expressed concern that without such language, the proposal would reduce transparency and contribute to the expectation gap among investors and other stakeholders regarding the nature of reasonable assurance (as compared to absolute assurance). For example, one commenter stated that the elimination of the existing clarifying language could also result in ambiguity as to whether a new level of assurance would be expected, beyond reasonable assurance but less than absolute assurance.

Some commenters offered other clarifications. For example, two commenters suggested retaining certain language from AS 1001.02, which states that the auditor has no responsibility

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<sup>67</sup> See AS 1015.10.

<sup>68</sup> See AS 1015.11.

<sup>69</sup> See AS 1015.12.

<sup>70</sup> See AS 1015.13.

<sup>71</sup> Paragraph 13(m) of ISA 200 defines reasonable assurance as “in the context of an audit of financial statements, a high, but not absolute, level of assurance.” Paragraph 5 of ISA 200 further describes that reasonable assurance “is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.”

to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected. One of these commenters also acknowledged that identifying limitations on the auditor's responsibilities should not be the main focus of the standard. One commenter recommended that the final standard include guidance on determining whether audit risk is reduced to an appropriately low level, including a requirement to consider changes in technology, the nature and quality of an issuer's financial reporting system, relevant academic and other research, and any other factor that can reduce the risk of material misstatements or fraud.

As discussed further below, we are retaining the description of reasonable assurance as proposed with some modifications. The concept of "reasonable assurance" is not new. Reasonable assurance refers to the auditor's degree of satisfaction that the evidence obtained during the audit supports the assertions of the financial statements. It is a high level of assurance and is obtained by reducing audit risk to an appropriately low level (i.e., the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated or in an audit of ICFR, when a material weakness exists) through applying due professional care, including obtaining sufficient appropriate audit evidence.<sup>72</sup> AS 1101 discusses audit risk and the relationships among the various components of audit risk in an audit of financial statements. We retained a reference to AS 1101 in the final standard and added the description of the term "audit risk." We believe that additional guidance on consideration of audit risk, as suggested by one commenter, is outside the scope of this standard. If additional guidance is necessary regarding the auditor's assessment of and response to the risks of material misstatement in an audit, it would be provided in connection with the Board's risk assessment standards.<sup>73</sup>

We did not change the meaning of reasonable assurance or the requirement to obtain reasonable assurance. In consideration of comments received, we emphasized in the final requirement that reasonable assurance is not absolute assurance. As observed by some commenters, absolute assurance is not attainable because of the nature of audit evidence (e.g., selective testing involving professional judgments<sup>74</sup> regarding the nature, timing, and extent of procedures to be performed; and inherent uncertainty of accounting estimates), and the characteristics of fraud (e.g., falsified company documentation). In many cases, the auditor has to rely on evidence that is persuasive rather than convincing. Because we did not change the meaning of reasonable assurance, we believe that further explanation of the difference between reasonable assurance and absolute assurance is not needed in the final standard.

We did not retain additional descriptions of the inherent limitations of an audit from AS 1015.10-.13. We believe that these matters are part of the differences between reasonable

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<sup>72</sup> See AS 1101.03-.04.

<sup>73</sup> See, e.g., AS 1101, AS 2101, AS 2105, AS 2110, and AS 2301.

<sup>74</sup> Section III.B.5 discusses requirements for exercising professional judgment.

and absolute assurance discussed above or addressed elsewhere in PCAOB standards. Although a properly planned and performed audit may not detect a material misstatement because of the characteristics of fraud, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.

### iii. Compliance with applicable professional and legal requirements

*See paragraph.15 of the new standard in Appendix 1.*

We proposed to require that the auditor comply with applicable professional and legal requirements in conducting the audit. As discussed above in Section III.B.2, the term "applicable professional and legal requirements" was proposed to have the same meaning as defined in proposed QC 1000. Under existing provisions, auditors are required to comply with PCAOB standards and rules. The proposed requirement emphasized that the overall objective of the auditor is achieved by complying with more than just the standards of the PCAOB. This includes compliance with requirements of Section 10A of the Exchange Act related to illegal acts, related party transactions, and an evaluation of whether there is substantial doubt about the ability of the company to continue as a going concern.<sup>75</sup> The proposed requirement also stated that, in fulfilling these requirements, the auditor should keep in mind its role in protecting investors.

One commenter on this proposed paragraph stated that the term "applicable professional and legal requirements" appears to exceed the Board's authority, citing Sections 104 and 105 of Sarbanes-Oxley and urged that the Board replace it with "PCAOB rules and standards." Two other commenters noted that applicable professional and legal requirements could be read broadly as a wide range of laws and regulations that do not directly bear on the conduct of audit engagements. Another commenter recommended adding clarifying language in the release to state that although the auditor is expected to comply with applicable legal requirements, the auditor is not expected to have the expertise of a lawyer or to express opinions on matters of law.

We disagree with the commenter's assertions regarding the Board's authority, which extends beyond PCAOB rules and standards. For example, Section 105(c)(4) of Sarbanes-Oxley empowers the Board to sanction a registered firm and its associated persons for violations not only of PCAOB rules and standards but also violations of "the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under [the] Act[.]"

As discussed above, the final standard includes a definition of the term "applicable professional and legal requirements" rather than a reference to the definition in QC 1000. The

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15 U.S.C. § 78j-1.

definition that was proposed in the QC 1000 project has been modified in response to comments received in that rulemaking, to explicitly mention ethics laws and regulations. The definition was also refined to limit the breadth of the term, by clarifying that it encompasses statutory, regulatory, and other legal requirements beyond professional standards and other PCAOB rules “[t]o the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system.” We believe that further changes to this term in the final standard are not necessary.

As discussed above in Section III.B.3, we changed “expertise” to “proficiency” in the final description of competence in response to comments. While we do not expect auditors to have the expertise of a lawyer, we believe that understanding the company’s business and being proficient in the rules and regulations relevant to the company under audit and the related industry is important.

Some commenters also stated that the requirement for auditors to “keep in mind their role in protecting investors” when fulfilling the requirement to comply with applicable professional and legal requirements was unclear, including how to apply such a requirement. As discussed in Section III.B.1 above, investor-related groups suggested including the language from the *Arthur Young opinion* to describe the auditor’s responsibility. Other commenters suggested that the proposed reference to the auditor’s role in protecting investors be deleted from the final requirement or reframed. One commenter pointed to research noting that encouraging auditors to adopt an investor perspective when making judgments may be detrimental to audit quality.<sup>76</sup>

After considering comments and for the reasons discussed above, we retained the requirement to comply with applicable professional and legal requirements. We removed the reference to “keep in mind their role in protecting investors” from the final standard based on changes made to paragraph .01 of the final standard. As discussed earlier, in connection with certain revisions made to the introductory paragraph of the final standard, we added a note to paragraph .01 to remind auditors that their obligation to protect investors is important when complying with all requirements of this and other PCAOB standards and rules.

#### **iv. Relevant guidance**

*See paragraph.15 of the new standard in Appendix 1.*

We also proposed a note to paragraph .15 stating that, as part of complying with all applicable professional and legal requirements in conducting the audit, the auditor is required to take into account relevant guidance applicable to the audit. The proposed requirement was

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<sup>76</sup> This commenter cited two research papers: (i) Altiero, Kang, and Peecher (2022) “show that auditors prompted to take an investor perspective are less likely to assess a misstatement as material” and (ii) Dong, Wang, and Chien (2022) “highlight that taking an investor perspective can decrease assessed risk of material misstatement.” See additional discussion below in Section IV.C.3.i.

an extension of the existing requirement in AS 1001.11 that the auditor be aware of and consider auditing interpretations issued by the AICPA as of 2003, and adopted by the PCAOB and in effect. Under the proposal, relevant guidance included PCAOB auditing interpretations, Board-issued guidance, and releases that accompany the rules and standards of the Board.

Many commenters, mostly firms and firm-related groups, expressed concern that the proposed note is overly broad and unclear. For example, some commenters cited a lack of clarity as to (i) the scope of the Board-issued guidance including whether documents such as concept releases would be covered; (ii) the timeline in which the requirement would apply; (iii) the hierarchy of guidance and what types of guidance would be considered authoritative; and (iv) how to reconcile potentially conflicting information between proposing and final releases. These commenters generally suggested either deleting the note, codifying the relevant guidance to ensure consistent application, or specifying that relevant guidance includes releases accompanying “final” standards. Another commenter also suggested clarifying the meaning of “take into account,” including defining the phrase in PCAOB Rule 3101.

A few commenters, including an investor-related group, recommended including relevant guidance within the standard rather than the accompanying release. Two commenters suggested that the Board consider restructuring guidance in a manner similar to the application and other explanatory material, as presented in the AICPA and IAASB standards. An investor-related group recommended a “codification” approach that would include placing all guidance, interpretations, releases, amendments, and rules in the same location.

After considering comments received, we have revised the note as follows:

- Replaced the reference to “relevant guidance” with “PCAOB auditing interpretations;” and
- Replaced a footnote describing the scope of the relevant guidance with a footnote describing the scope of PCAOB auditing interpretations.

The note in the final standard provides that, when complying with PCAOB standards, the auditor is required to also take into account PCAOB auditing interpretations applicable to the audit. As mentioned previously, this is an existing requirement that is being carried forward with modifications. In the final standard, PCAOB auditing interpretations refer to the PCAOB publications entitled “Auditing Interpretations” as currently in effect.<sup>77</sup> These interpretations were originally adopted by the Board in 2003 along with the interim standards. Since that time, certain of these auditing interpretations have been and continue to be revised or rescinded in connection with the other amendments to PCAOB standards. The requirement in the final standard, as it did previously, relates to the interpretations currently in effect.

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<sup>77</sup> PCAOB auditing interpretations do not include independence interpretations. The requirements to comply with independence interpretations are covered by PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.

Apart from the PCAOB auditing interpretations referenced in paragraph .15, the PCAOB also supports the implementation of and compliance with its standards in many other ways, including providing guidance in rulemaking releases that accompany standards, amendments, or rules, or issuing staff guidance.<sup>78</sup> Although there is no requirement to follow these guidance documents, we continue to believe that it is important for auditors to pay attention to such guidance, if relevant, when conducting an audit in accordance with PCAOB standards because it may help the auditor understand and comply with complex provisions of those standards or rules. For example, staff guidance can help auditors better understand how the PCAOB intends to implement, inspect against, or enforce existing rules and standards.

The phrase “take into account” in the rule text is not new. It has been used previously in PCAOB standards in reference to information or matters that the auditor should think about or give attention to in performing an audit procedure or reaching a conclusion.<sup>79</sup> Accordingly, the results of the auditor's thinking on the relevant matters should be reflected in the performance and documentation of the respective audit procedure performed or conclusion reached.

Lastly, we did not consider the “codification” approach because it is out of scope for this project.

**v. Audit documentation**

*See paragraph.16 of the new standard in Appendix 1.*

We proposed to require the auditor to prepare audit documentation in accordance with AS 1215. This requirement was intended to emphasize the importance of adequate audit documentation to planning and performing the audit and to the supervision and review of work performed during the audit. Commenters did not express concerns with the documentation requirement, and we are adopting it as proposed.

**vi. Auditor communications**

*See paragraphs .17 through .20 of the new standard in Appendix 1.*

We proposed an explicit requirement for the auditor's report to contain (i) an expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed; and (ii) in an audit of internal control over financial reporting, an

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<sup>78</sup> PCAOB staff prepares guidance to assist in the implementation of PCAOB standards and rules. The typical legend on such guidance states that the document represents the views of PCAOB staff and not necessarily those of the Board, and that the document is not a rule, policy, or statement of the Board. PCAOB staff audit practice alerts are examples of staff guidance that highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits under existing PCAOB standards.

<sup>79</sup> *See, e.g., AS 3101.12 and AS 2501.*

expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed. Under the proposed standard, the auditor would be in a position to express an unqualified opinion only when the auditor has performed the audit in accordance with standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that: (i) in an audit of financial statements, the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; and (ii) in an audit of internal control over financial reporting, the company maintained, in all material respects, effective internal control over financial reporting. The proposal also briefly addressed when circumstances require an auditor to express a qualified opinion, adverse opinion, or disclaimer of opinion and referred to AS 3105 and AS 2201 for a description of those circumstances. The proposed requirements were retained from AS 1001 with modifications to be consistent with provisions of AS 3101 and AS 2201.

One investor-related group requested that the required communications include CAMs, and that paragraph .17a of the proposed standard be revised to refer to CAMs "as a 'must contain' item in the auditor's report." The commenter was concerned with the low numbers of CAMs in auditor's reports and that auditors treat the determination of CAMs as "nearly a 'check the box' exercise." Another commenter suggested edits to proposed paragraphs .17 and .19 to align with existing requirements (e.g., adding the phrase "In an audit of financial statements" to paragraph .17a and moving the phrase "the company's" within paragraph .19).

We are adopting paragraphs .17-.19 substantially as proposed with some modifications. After considering the comments received, the reference to CAMs in a footnote has been moved to a note to paragraph .17 to emphasize the importance of CAMs. We did not make any additional changes to address concerns regarding CAMs. The proposal was not designed to address concerns about the frequency or informative quality of CAMs. Although we understand the importance of the concern raised by commenters, this is outside the scope of this project. We also revised paragraph .17a and paragraph .19 to incorporate commenters' suggestions described above. Additionally, we changed the phrase "modify the report" to "depart from an unqualified opinion" in paragraph .19 to align with other Board-issued standards that describe reports that include opinions other than an unqualified opinion.<sup>80</sup>

We proposed in paragraph .20 to require that the auditor communicate externally in accordance with applicable professional and legal requirements. This is an overarching requirement to communicate externally that is based on existing auditor communication requirements (e.g., AS 1301). We did not receive any comments on this requirement and are adopting it with slight modification. We changed "as required by" to "in accordance with" applicable professional and legal requirements to align with similar phrases used in other Board-issued standards.

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<sup>80</sup> See, e.g., AS 3105.



## C. Amendments Related to AS 1000

Appendices 2 and 3 of this release present amendments to PCAOB standards related to AS 1000. The amendments we are adopting are described below.

### 1. Amendments to AS 2810 and Rescission of AS 2815 (Appendix 2)

We proposed to incorporate into AS 2810 the requirements of AS 2815 regarding the determination of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework for a more logical presentation, and to rescind AS 2815. Currently, AS 2810 requires the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, and AS 2815 describes the meaning of this evaluation. The proposed approach was intended to streamline these requirements into one standard and eliminate redundant or unnecessary language. A number of commenters commented on the proposed amendments to AS 2810. After considering the comments received, we are adopting amendments to AS 2810 with certain modifications discussed below.

#### i. Clarifying the meaning of “present fairly”

The discussion in the proposing release was designed to clarify the auditor’s existing obligation to evaluate the fairness of the financial statements in conformity with the applicable financial reporting framework by stating that “present fairly,” under extant PCAOB standards, is a concept that goes beyond mere technical compliance with the requirements of the applicable financial reporting framework.

Some commenters, primarily investor-related groups, supported clarifying the meaning of “present fairly” and provided additional suggestions on amendments to AS 2810. Two investor-related groups suggested that the Board consider going further and require auditors to focus on whether the financial statements are a fair presentation of the company’s position rather than narrowly focusing on whether the company is following U.S. GAAP. One investor-related group suggested adding the word “and” immediately before the phrase “in conformity” to make it clear that there is an expectation that the financials are presented fairly, in all material respects *in addition to* conforming with the applicable financial reporting framework. Another group said that auditors should aid in disclosing and providing transparency around the sensitivity and accuracy of climate-related estimates and assumptions.

Other commenters, primarily firms and firm-related groups, viewed the proposed amendments as an expansion of auditors’ existing responsibilities. Some commenters asserted that the statement in the proposal that the auditor’s judgments concerning the fair presentation of the financial statements go beyond compliance with the applicable financial reporting framework may create a conflict between the auditor’s judgment and management’s judgment and introduce potential inconsistency in accounting treatment. Others expressed concern that under the proposal, auditors would expect the company to override the

requirements of an applicable financial reporting framework if the financial statements prepared in accordance with the framework did not fairly present the substance of the company's financial results.

Some commenters suggested retaining language from AS 2815.03 which states, "The independent auditor's judgment concerning the 'fairness' of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. 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." Other commenters suggested explicitly retaining the concept of professional judgment for evaluation of fair presentation.

Our proposed clarification of "present fairly" was not intended to change the auditor's existing responsibilities for the evaluation of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework.

First, the amendments to AS 2810 clarify that "presents fairly" involves evaluating whether information in the financial statements is presented and classified appropriately and in a manner that is not misleading, and that this evaluation is made within the applicable financial reporting framework. Contrary to the views of some commenters, the amendments do not require auditors to expect that the company override or deviate from the requirements of the applicable financial reporting framework. Any override or deviation from the requirements of the applicable financial reporting framework would normally result in a departure from an unqualified opinion under PCAOB standards.<sup>81</sup> Further, the auditor is required to evaluate the risk of omitted, incomplete, or inaccurate disclosures as part of the auditor's risk assessment procedures.<sup>82</sup>

Second, the amendments acknowledge that applicable financial reporting frameworks recognize that additional disclosures may be needed to ensure fair presentation. For example, as noted above, the SEC requires by rule that a company provide further material information as necessary to make any required statements, in the light of the circumstances under which

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<sup>81</sup> See AS 3105. In addition, under SEC rules, a company's "[f]inancial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided." Regulation S-X Rule 4-01(a)(1), 17 C.F.R. § 210.4-01(a)(1). Paragraph (a) of that rule also provides that "the information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

<sup>82</sup> See, e.g., AS 2110.67, which requires the auditor, as part of the auditor's evaluation of fraud risk factors, to include evaluation of how fraud could be perpetrated or concealed by presenting incomplete or inaccurate disclosures or omitting disclosures that are necessary for the financial statements to be presented fairly in conformity with the applicable financial reporting framework.

they are made, not misleading.<sup>83</sup> This obligation is also consistent with the accounting standards issued by the FASB<sup>84</sup> and International Accounting Standards Board (“IASB”).<sup>85</sup> Thus, when the auditor evaluates whether company transactions have been recorded and presented in conformity with the applicable financial reporting framework, the auditor may determine that additional company disclosures are needed to better reflect the substance of the transactions. Such evaluation is currently required under both AS 2810.31 and AS 2815.06, and the requirement is retained in the amendments to AS 2810.30A and .31.

In response to commenters, we are retaining, in the first note to AS 2810.30, the language of AS 2815.03, with some modifications. Specifically, we revised the reference to “generally accepted accounting principles” to “applicable financial reporting framework.” We rephrased the sentence to emphasize that the “applicable financial reporting framework

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<sup>83</sup> See Regulation S-X Rule 4-01(a), 17 C.F.R. § 210.4-01(a).

<sup>84</sup> See, e.g., FASB Accounting Standards Codification (“FASB ASC”) paragraph 105-10-05-1, Generally Accepted Accounting Principles – Overall – Overview and Background (“Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants.”); FASB ASC paragraph 235-10-05-3, Presentation – Notes to Financial Statements – Overall - Overview and Background – Importance of Accounting Policies Disclosure (“The accounting policies of an entity are the specific accounting principles and the methods of applying those principles that are judged by the management of the entity to be the most appropriate in the circumstances to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles (GAAP) and that, accordingly, have been adopted for preparing the financial statements.”).

<sup>85</sup> See, e.g., IASB International Accounting Standards (“IAS”) 1, paragraph 15, Presentation of Financial Statements – Financial Statements – General features – Fair presentation and compliance with IFRSs (“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.”); IAS 1, paragraphs 19-24, Presentation of Financial Statements – Financial Statements – General features – Fair presentation and compliance with IFRSs (describing financial reporting responsibilities in the “extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Conceptual Framework*”); IAS 8, paragraph 10, Accounting Policies, Changes in Accounting Estimates and Errors (“In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is: (a) relevant to the economic decision-making needs of users; and (b) reliable, in that the financial statements: (i) represent faithfully the financial position, financial performance and cash flows of the entity; (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form; (iii) are neutral, ie free from bias; (iv) are prudent; and (v) are complete in all material respects.”).

provides the basis for the auditor’s judgment regarding the presentation of financial position, results of operations, cash flows, and disclosures in financial statements.” We also agree with commenters that the auditor’s evaluation of fairness of presentation of the financial statements is an exercise of professional judgment in the context of an applicable financial reporting framework. The first note to AS 2810.30 refers to the auditor’s judgment when evaluating the fairness of the overall presentation of financial statements.

We have also added a new footnote to paragraph .30A, as discussed below, referencing SEC Rule 4-01(a) that describes the company’s obligation regarding additional information that may need to be disclosed in the financial statements so that the financial statements are not misleading.

## ii. References to SEC Rule 12b-20

The proposed amendment to AS 2810.30 included a new footnote 17A that referred to a company’s responsibility pursuant to SEC Rule 12b-20 under the Exchange Act, 17 C.F.R. § 240.12b-20 (“SEC Rule 12b-20”). That rule requires the company to disclose “such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.”

Most commenters who addressed the proposed citation to SEC Rule 12b-20 expressed concern with it. While one investor-related group recommended relocating the proposed footnote to the body of the amendments due to its significance, other commenters suggested removing the reference to SEC Rule 12b-20, with some commenters objecting primarily because the rule pertains to companies’ disclosures within or beyond the financial statements. Some commenters emphasized that disclosures beyond the financial statements are the responsibility of companies rather than of auditors. Many expressed concerns that referring to the rule might be viewed as expanding the auditor’s responsibilities, or would conflict with the auditor’s responsibilities described in AS 3101.08e.<sup>86</sup> One of these commenters suggested citing SEC Rule 4-01(a)(1) instead, because that rule relates specifically to financial statements, upon which the auditor expresses an opinion.

After considering the comments received, we are deleting proposed footnote 17A with the reference to SEC Rule 12b-20 from the final amendment to AS 2810.30 because that rule reflects a company’s responsibilities for information beyond as well as within the financial statements.<sup>87</sup> Instead, we are retaining the existing note to that paragraph requiring that the

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<sup>86</sup> AS 3101.08e requires that the auditor’s report include an opinion that the financial statements present fairly, in all material respects, the financial position of the company, results of operations, and cash flows in conformity with the applicable financial reporting framework, and that the opinion identify the applicable financial reporting framework.

<sup>87</sup> The auditor’s responsibility for other information outside of the financial statements is specified in AS 2710, *Other Information in Documents Containing Audited Financial Statements*.

auditor look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company. The requirements of the SEC for the company under audit are included in SEC Rule 4-01(a), which we reference in a new footnote to paragraph .30A, to remind auditors of the company's obligation regarding additional information that may need to be disclosed in the financial statements so that the financial statements are not misleading.

### iii. Other clarifications to proposed AS 2810.30A

We proposed a new paragraph AS 2810.30A based on the extant requirement from AS 2815.04, using language consistent with other PCAOB standards. Specifically, we:

- Combined the concepts in AS 2815.04a – b regarding acceptability and appropriateness of accounting principles and presented them in AS 2810.30Ab;
- Retained the concepts from AS 2815.04c – d regarding informativeness of information presented in the financial statements and presented them as a new AS 2810.30Aa; and
- Retained the concepts from AS 2815.04e regarding transactions presented in the financial statements within a range of acceptable limits as a new AS 2810.30Ac and an amendment to AS 2810.31.

Several commenters expressed concern about not retaining the reference to the “within a range of acceptable limits” from AS 2815 and suggested (i) retaining this phrase in AS 2810.30A or (ii) revising proposed 2810.30A to include a footnote referencing AS 2110 or a note describing the relationship between AS 2810.30A and AS 2110 and adding “in all material respects” to AS 2810.30Ac. Another commenter suggested defining “a reasonable investor” used in AS 2810.30Aa. One commenter encouraged the Board to provide guidance on the use of the term “informative” in AS 2810.30A because it could be widely interpreted and applied in practice.

In addition, several commenters suggested including or clarifying certain terminology or concepts used in the proposed new paragraph, AS 2810.30A. Suggestions included:

- Referencing the importance of exercising professional judgment when evaluating the requirements specified in AS 2810.30A; and
- Clarifying that (i) “financial statements” include all notes to the statements and all related schedules;<sup>88</sup> and (ii) “disclosures” used in AS 2810.30A means

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<sup>88</sup> See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b).

“accompanying notes,” not other information included in management discussion and analysis (“MD&A”) and other disclosures included in the annual report.

After considering the comments received, we are retaining proposed paragraph .30A with modifications discussed below.

The final AS 2810.30A requires an auditor, when evaluating whether the financial statements (including the accompanying notes) present fairly the financial position, results of operations, and cash flows, in all material respects, in conformity with the applicable financial reporting framework, to evaluate whether:

- a. The financial statements are informative of matters that may affect their use, understanding, and interpretation; and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading;
- b. The accounting principles selected and applied by the company’s management are appropriate in the circumstances; and
- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements.

We added “(including the accompanying notes)” in AS 2810.30A to clarify that financial statements include the accompanying notes, to match the description in AS 2810.31 of financial statements as “financial statements (including the accompanying notes).” Because we use “disclosures” as an interchangeable term with “notes” or “accompanying notes” throughout PCAOB standards, it is unnecessary to further clarify the terms in AS 2810.30A. We also did not add a reference to professional judgment in AS 2810.30A, but as discussed above we have revised the first note to AS 2810.30 to clarify that the auditor uses professional judgment when evaluating the fairness of financial statements.

The term “informative” is in AS 2815.04c, which refers to AS 2810.31, which in turn provides additional considerations for evaluation of information disclosed in the financial statements (e.g., consideration of the form, arrangement, and the amount of detail given). To clarify this further, we retained in the final standard language from AS 2815.04c stating that the information in the financial statements is presented appropriately, in a manner that is “informative of matters that may affect their use, understanding and interpretation” and not misleading. We removed the reference to “reasonable investor” from AS 2810.30A because it was limiting and did not consider a broader population of financial statement users (e.g., creditors). We also believe that introducing “reasonable investor” in AS 2810.30A may create confusion by implying that an analysis is needed that is distinct from determining if the financial statements are presented fairly in conformity with the applicable financial reporting framework.

Finally, we do not believe it is necessary to retain a reference to “within a range of acceptable limits” in AS 2810.30A. The standard is clear that evaluation of fairness is based on auditor judgment and that the concept of materiality is inherent in that judgment, which involves the consideration of qualitative as well as quantitative factors. The combination of these considerations should be clear that not every transaction or account is evaluated to arrive at the conclusion that the company’s financial statements, taken as a whole, are presented fairly, in all material respects.

#### **iv. Other clarifications to proposed AS 2810.31**

We proposed to revise the note to AS 2810.31 by (i) removing the first sentence that describes the requirements from AS 3105 (i.e., inadequate disclosures) and instead adding a reference to AS 3105.24-.27 in paragraph .31, and (ii) adding an extant requirement from AS 2815.06 for the auditor to also evaluate whether the substance of transaction or events differs materially from their form, but changing it from “should consider” to “should evaluate.”

Several commenters suggested, in addition to retaining the requirement from AS 2815.06, to also retain a provision from AS 2815.06 that states “generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance.” Some commenters suggested not changing the “should consider” requirement from extant AS 2815.06 to “should evaluate” when evaluating a transaction in substance over form. Additionally, some commenters recommended removing or relocating the note in AS 2810.31 to proposed AS 2810.30A for better context.

Two investor-related groups suggested providing guidance on AS 2810.31 by adding the existing concept of what the auditors are required to do (per AS 2815.04c) when the applicable financial reporting framework does not provide guidance (e.g., financial statements and accompanying notes do not disclose the necessary information required), or what considerations should be given by auditors in evaluating fair presentation of financial statements in accordance with proposed AS 2810.30.

After considering the comments received, rather than amending the existing note to AS 2810.31, we have removed the note in its entirety. We believe that a separate requirement to evaluate whether the substance of transactions differs from their form is unnecessary in light of the requirement in new AS 2810.30Aa. As discussed above, AS 2810.30Aa requires auditors to evaluate “whether the financial statements are informative of matters that may affect their use, understanding, and interpretation;” and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading. This evaluation includes determining whether additional disclosures are necessary to reflect, for example, the substance of the company’s transactions. The auditor’s evaluation of whether company transactions have been recorded and presented in conformity with the applicable financial reporting framework includes the determination of whether additional disclosures are needed in the financial statements.

We also believe that AS 2810.31 and the amendments are comprehensive and clear, and thus no additional guidance is warranted. For example, under US GAAP and IFRS, management has a range of conforming choices in selecting classifications and measurements of revenue recognition, segment reporting, and fair value measurement. The auditor is responsible for evaluating whether the disclosures reflect the choices made by management and are not misleading to investors and other financial statement users.

## **2. Amendments Related to Engagement Partner Responsibilities for Supervision (Appendix 2)**

### **i. Seeking assistance from other engagement team members**

AS 1201 and AS 2101 establish the engagement partner's responsibility for the engagement and its performance, including planning, supervision, and review. We proposed to amend the existing requirements in AS 1201 and AS 2101 to clarify that even when the engagement partner seeks assistance from other engagement team members, the engagement partner retains the primary responsibility for the engagement and its performance. One commenter strongly supported these amendments, and we are adopting them as proposed.

The final notes added to AS 1201 and AS 2101 clarify that while an engagement partner may seek assistance on specific tasks from other engagement team members, they continue to retain the primary responsibility for supervising, reviewing, and ensuring the quality of the work performed in the audit. In other words, the work of other engagement team members does not replace or reduce the engagement partner's responsibility for the engagement and its performance.

### **ii. Timing of review**

We also proposed a requirement to clarify that the review and evaluation by the engagement partner (and as applicable by other engagement team members performing supervisory activities) of work performed by engagement team members, as described in AS 1201.05c, must be completed prior to the report release date. These amendments did not receive any comment and are being adopted as proposed.

### **iii. Workpaper review**

We proposed to amend AS 1201 to clarify the extent of the planning, supervisory, review, and documentation activities to be performed by the engagement partner by aligning those activities with existing auditor responsibilities under AS 1015 because we believe that the engagement partner's review of audit documentation is an important part of supervision. These amendments were intended to reaffirm the engagement partner's supervisory and review responsibilities in the context of exercising due professional care.<sup>89</sup> Specifically, we proposed to

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<sup>89</sup> See AS 1000.10 discussed above.



add a note stating that notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner is required to review sufficient documentation to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner's attention pursuant to AS 1201.05b, were appropriately addressed; (iii) the conclusions expressed in the auditor's report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. The proposed note also provided that the engagement partner's review includes review of documentation of significant findings or issues<sup>90</sup> and review of documentation that is also subject to review by the EQR, citing the provisions of AS 1220 that specifically require the EQR to review certain documentation.<sup>91</sup>

One commenter stated that the proposed amendments were overly prescriptive and should allow more flexibility regarding the engagement partner's review and sign-off. Another commenter recommended clarifying how due professional care in AS 1201 relates to the engagement partner's responsibilities in AS 1000. This commenter further recommended better aligning AS 1201 with proposed AS 1000.09, including the interplay between Note 2 of AS 1201.05, which has specific workpaper review requirements by the engagement partner, while AS 1201.04 also allows the engagement partner to seek assistance from other engagement team members.

After considering the comments received, we are adopting amendments to AS 1201 substantially as proposed. We believe that the amendments clarify the engagement partner's existing obligations for supervision and review. As the engagement team member with primary responsibility for the engagement, the engagement partner must review, at minimum, sufficient documentation of specific audit areas that are deemed important to support the auditor's opinion. Without reviewing sufficient documentation in these areas, the engagement partner would not be able to demonstrate that the engagement partner has the primary responsibility for the audit.

One commenter asserted that the proposed requirement that the "engagement partner's review should include review of documentation ... subject to review by the engagement quality reviewer" could be interpreted to require the engagement partner to review all documentation reviewed by the EQR, beyond what is required in AS 1220.10 or .15. Another commenter expressed concern about the proposed note stating that in multi-tiered audits, other audit partners, not only the engagement partner, should retain the ability to review all documentation subject to EQR review. This commenter suggested not linking engagement partner review requirements to documentation subject to review by EQR.

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<sup>90</sup> See AS 1215.12.

<sup>91</sup> See AS 1220.09-.10 and .14-.15.

In response to the commenters, we have clarified the final requirement by changing the phrase “review of documentation subject to review by the engagement quality reviewer” to “review of documentation required to be reviewed by the engagement quality reviewer pursuant to the requirements of paragraphs .09-.10 and .14-.15 of AS 1220 ...” This revision further clarifies that we expect the engagement partner to review the documentation that the engagement quality reviewer is required to review in order to comply with those provisions of AS 1220, rather than all of the documentation that the engagement quality reviewer may have actually reviewed. We believe that the documentation of significant judgments made and conclusions reached by the engagement team that is required to be reviewed by the EQR provides important information to the engagement partner. This is true for all engagements, including multi-location and multi-tiered engagements. The extent of documentation reviewed by the EQR and, under the final amendment, by the engagement partner, will depend on the facts and circumstances of the particular engagement. Further, the requirement for the engagement partner to review documentation required to be reviewed by the EQR does not preclude other engagement team members performing supervisory activities to also review this documentation.

Several commenters further expressed concerns that the proposed amendments create an incorrect perception that the responsibility for all phases of the audit resides with the engagement partner only without any consideration given to the responsibility of the firm or other engagement team members. One of these commenters further suggested including a statement that the engagement partner should tailor the extent of their supervision based on a variety of factors as described in AS 1201.06. AS 1201.05 specifically addresses the responsibilities of the engagement partner relating to supervision of engagement team members, and we do not think it is necessary to change these requirements to address the responsibilities of others.

One commenter stated that the engagement partner’s review of documentation to determine that the engagement was performed as planned may be construed as expanding the partner review requirements beyond AS 1215.12c because the review of documentation only relates to “results of auditing procedures that indicate a need for significant modification of planned auditing procedures.” We do not believe that Note 2 of AS 1201.05 expands the engagement partner’s responsibilities. AS 1201.03 states that the engagement partner is responsible for planning the audit and that the engagement partner retains primary responsibility for the engagement and its performance. In addition, the documentation requirements under AS 1215 are not limited to the significant findings and issues described in AS 1215.12 and there are other documentation requirements outside of documenting specific matters.

Another commenter further suggested that we define “sufficient documentation” used in proposed Note 2 of AS 1201.05. We do not believe this is necessary. What is sufficient will depend on the facts and circumstances of the particular engagement under review. The amount of documentation that the engagement partner would review will vary depending on

the associated risk involved in the audit area and the nature of the work performed that the engagement partner reviews. We further clarified this point, by changing “sufficient documentation to determine” to “documentation sufficient to determine” in the final amendment. This change is designed to better connect the concept of sufficiency with the matters that the engagement partner will determine.

We also proposed other amendments to AS 1201 and AS 2101 to conform to the adoption of AS 1000. These technical and clarifying amendments included replacing references to titles of existing standards with the title of the new standard and updating cross-referenced terminology and paragraph citations. We are adopting these other amendments as proposed as no comments were received.

### **3. Amendments Related to Documentation (Appendix 2)**

We proposed several amendments to AS 1215 discussed in more detail below. Commenters generally supported the proposed amendments to AS 1215. Some commenters provided specific comments related to (i) documentation completion date and (ii) specific audit documentation and timing for documentation review. These are discussed in more detail below.

#### **i. Documentation completion date**

Audit documentation is the written record of the basis for the auditor’s conclusions that provides the support for the auditor’s representations, whether those representations are contained in the auditor’s report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor’s significant conclusions.<sup>92</sup> Under existing standards, a complete and final set of audit documentation is required to be assembled for retention as of a date not more than 45 days after the report release date, known as the documentation completion date.<sup>93</sup> We proposed to accelerate the documentation completion date by reducing the maximum period from 45 days to 14 days.

Many commenters who addressed the amendment generally supported it or agreed that the proposed acceleration of the documentation completion date would be appropriate or result in increased audit quality. Two commenters further stated that the shorter period of 14 days would not cause significant changes at most firms.

Several commenters raised concerns over the acceleration of the documentation completion date. One commenter stated that the acceleration would likely lead to more audit

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<sup>92</sup> See AS 1215.02.

<sup>93</sup> See AS 1215.15.

quality issues due to the increasingly more complex financial accounting, reporting, and auditing landscape requiring more time as well as the current talent crisis. Another commenter stated that 14 days is too short to handle any unforeseen consequences (e.g., technology interruptions). Another commenter questioned whether acceleration of documentation will (i) have any meaningful impact on PCAOB inspection timelines and operating efficiencies and (ii) be workable for smaller firms, who may not have the technology to implement this change.

Two commenters, both investor-related groups, recommended further shortening the documentation completion date to two days because an earlier PCAOB inspection would benefit investors. These two investor-related groups and another commenter questioned why 14 days is a more appropriate timeframe. Focusing on challenges that smaller firms may face in implementing the acceleration, and the diversity across global network firms in documentation archive systems, several commenters recommended a phased implementation approach or extending the implementation over a longer period (e.g., two-year period).

The proposal also sought comment, in light of the proposed 14-day documentation completion date, on whether firms would have difficulty, when filing Form AP within 35 days of the audit report being filed, complying with AS 1215.16. That paragraph of AS 1215 prohibits the deletion or discarding of audit documentation after the documentation completion date but permits the addition of documentation under certain conditions. Two firms stated that they did not foresee significant difficulties in complying with AS 1215.16 with additional costs, while another firm indicated some technological and process challenges. Two commenters recommended making both due dates (i.e., documentation completion date and Form AP due date) the same.

After considering the comments received, we are adopting the accelerated documentation completion date of 14 days as proposed with modification to the effective date for certain firms discussed below. The 14-day timeline strikes a good balance of meeting the objectives of this amendment (e.g., enhance investor protection by enabling the Board to begin the inspection process sooner after the completion of an audit) while still allowing a two-week period (14 calendar days) to assemble audit documentation for retention (i.e., archive audit documentation). As echoed by some commenters, we believe that the accelerated documentation period will not require a significant change for many firms. In our view, the changes to the archiving period (i.e., 14 days) are necessary to focus auditors on assembling a complete set of audit documentation that is high-quality and without documentation errors or omissions in a timely manner. We believe that a delay in assembling the audit documentation increases the potential for omissions to occur.

Further, shortening the archiving period also reduces the window of opportunity for improper alteration of audit documentation and increases the quality of documentation because recalling and describing audit procedures long after the work was actually performed can be difficult.

In accordance with AS 1215, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report before the report release date.<sup>94</sup> The presence of complex financial accounting, reporting, or auditing matters should not have a bearing on the archiving period as the effects of such matters on the audit should be addressed before the report release date (i.e., before the 14 days to assemble the audit documentation). Under existing AS 1215.16 auditors are allowed to add documentation after the documentation completion date, if needed.<sup>95</sup> While we understand that in practice some firms use a short archiving period, we believe that an archiving period of two days, as suggested by investor-related groups, may be too short to handle any unforeseen consequences (e.g., technology interruptions) and could result in inadvertent non-compliance.

We also continue to believe that the accelerated documentation completion date of 14 days is still appropriate even when considering the Form AP deadline of 35 days. We acknowledge that in most situations, firms currently have 35 days to file Form AP,<sup>96</sup> and a firm must document the computation of total audit hours and include that computation in the files.<sup>97</sup> If the actual hours become available after the documentation completion date but before the Form AP filing, the auditor is required under provisions of AS 1215 to add that information to the audit documentation after the documentation completion date.<sup>98</sup> The instructions to Form AP also provide that firms may use a reasonable method to estimate audit hours when actual hours have not been reported or are otherwise unavailable.<sup>99</sup>

We acknowledge that certain firms may have less technologically advanced systems in place and may need more time to implement new processes to comply with the accelerated documentation completion date requirement. Therefore, as discussed in more detail in Section VI, the effective dates for this requirement allow a phased-in approach for smaller firms to comply with the 14-day documentation completion date. This approach addresses implementation challenges that some commenters suggested smaller firms may face.

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<sup>94</sup> See AS 1215.15 (as amended).

<sup>95</sup> See AS 1215.16.

<sup>96</sup> Form AP has a filing deadline of 35 days after the date the auditor's report is first included in a document filed with the SEC, or 10 days after the auditor's report is first included in a document filed with the SEC for a registration statement under the Securities Act of 1933. PCAOB Rule 3211(b).

<sup>97</sup> See *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, PCAOB Rel. No. 2015-008 (Dec. 15, 2015).

<sup>98</sup> See AS 1215.16.

<sup>99</sup> See *Instructions to Form AP, Part IV – Responsibility for the Audit is Not Divided*.

## ii. Specific audit documentation and timing of review

We also proposed to emphasize that audit documentation must clearly demonstrate who performed the work, who reviewed the work, and the date of such review.<sup>100</sup> In order for an engagement partner to conclude that the audit evidence obtained is sufficient and appropriate to support the opinion expressed in the auditor's report,<sup>101</sup> the audit work is required to be reviewed prior to the report release date. Therefore, we also proposed to amend AS 1215.15 to clarify that, before the report release date, the engagement partner and other engagement team members performing supervisory activities have completed their reviews of audit documentation.

One commenter raised a concern that the amendments may result in lower quality documentation and an increase in late filings, providing an example of when a significant issue emerged closer to the issuer's filing deadline, because additional time to complete and review the relevant documentation would be needed. Another commenter suggested further clarifying whether the engagement partner and other supervisors must ensure that all review notes have been sufficiently addressed prior to the report release date.

We are adopting the amendments to AS 1215 as proposed. The requirement for the engagement partner and other supervisors to review relevant audit documentation prior to the report release date is a clarification of existing requirements in AS 1215 and AS 2101. As discussed earlier, since the auditor's report is dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion,<sup>102</sup> the auditor must have completed all necessary auditing procedures, including documentation to support the work performed that is reviewed by the engagement partner and other reviewers, on or before the auditor's report date, in all cases. The engagement partner and other supervisors should refer to existing requirements in AS 1215.07, in determining the sufficiency of audit documentation. Several factors to consider include nature of the audit procedure, risk of material misstatement associated with the assertion, and extent of judgment required in performing the work and evaluating the results (i.e., accounting estimates require greater judgment and commensurately more extensive documentation).<sup>103</sup>

Lastly, in relation to proposed amendments in AS 1215.06 and .06A, one commenter agreed with the addition of paragraph .06A but suggested removing the phrase of "who performed the work, the person or persons who reviewed the work, and the date of such review" in AS 1215.06 because the same phrase is already included in AS 1215.06Ab. We did not make changes to the final amendments to AS 1215.06 and .06A. The addition of the phrase

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<sup>100</sup> See AS 1215.06.

<sup>101</sup> See AS 2810.02.

<sup>102</sup> See paragraph .01 of AS 3110, *Dating of the Independent Auditor's Report*.

<sup>103</sup> See AS 1215.07.

in paragraph .06 is an intentional clarification, rather than duplication, of what the audit documentation is required to demonstrate. The requirement in paragraph .06, is different, and relates to the sufficiency of documentation needed to meet the experienced auditor threshold.

We also proposed other amendments to AS 1215 to conform to AS 1000. These technical and clarifying amendments included replacing references to titles of existing standards with the title of the new standard and updating cross-referenced terminology and paragraph citations. We did not receive any comments relating to other amendments to AS 1215 and are adopting those as proposed.

#### **4. Other Amendments (Appendix 3)**

In connection with the adoption of AS 1000, the Board is also adopting other amendments to several PCAOB standards to conform with AS 1000, amendments to AS 2810, and rescission of AS 2815. These amendments include superseding the foundational auditing standards.

The other changes being adopted include replacing references to titles of existing standards with the title of the final standard and updating cross-referenced terminology and paragraph citations. See Appendix 3 for these other amendments.

The proposed amendments that received comments are discussed in more detail below.

##### **i. Amendments to AS 2710, *Other Information in Documents Containing Audited Financial Statements***

AS 2710.05 refers to differences in the auditor's judgment or opinion. We proposed to amend that standard in two ways, by clarifying that the difference of judgment or opinion is "between the auditor and the client," and by adding a footnote clarifying the meaning of "judgment." One commenter suggested replacing "the client" with "management" to be consistent with other PCAOB standards. Although in this release we are adopting other amendments that refer to the management and audit committee of the company under audit rather than to the auditor's "client," we are not making this change throughout the auditing standards because such a sweeping change is outside the scope of this project and may not be warranted in each instance, and thus could create confusion. Because "client" is used in AS 2710 throughout the standard, we are retaining the use of that term in the existing standard and in the amendment, and thus are adopting the amendments to AS 2710.05 as proposed.

##### **ii. Amendments to AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion***

We proposed to move certain language in paragraph .01 of AS 3101 to AS 1000. We also proposed to move footnote 2 that describes the term "taken as a whole" to paragraph .02 of AS 3101. Two commenters on the proposed amendments to AS 3101 suggested amending

paragraph .11 and paragraph .14, primarily due to the declining number of CAMs disclosed by firms. Other commenters suggested adding language about the meaning of reasonable assurance means and the limitation of the audit in the auditor's report (paragraph .09 and Appendix B). We did not make these changes suggested by commenters because they are outside the scope of this project.

One commenter expressed concern that the meaning of "taken as a whole" was changed because a footnote was added to AS 3101.02. As discussed above, we did not change the meaning of "taken as a whole" by moving the existing footnote to another paragraph. We are therefore adopting the amendments as proposed.

### **iii. Amendments to AS 4105, *Reviews of Interim Financial Information***

We proposed to replace references to titles of existing standards with the title of the final standard and update cross-referenced terms and paragraph citations in paragraphs .01 and .07. Three commenters noted that the amendments are appropriate. One commenter suggested adding "to the extent those standards are relevant" in AS 4105.01 when referencing AS 1000 because interim reviews are not required to provide reasonable assurance. We believe this addition is not necessary because the amendment refers only to compliance with independence and ethics requirements, competence, and exercise of due professional care, which are fundamental to any audit, review, or attestation engagements under the PCAOB standards. All of these concepts are relevant to AS 4105 without exception. We are adopting the amendments as proposed.

### **iv. Amendments to Attestation Standards**

We proposed to replace references to titles of existing standards with the title of the final standard and update cross-referenced terms and paragraph citations. One commenter on these amendments stated that they are appropriate. Another commenter offered suggestions to (i) limit the references to AS 1000 in attestation standards because the general principles and responsibilities in AS 1000 should be specifically tailored to attestation engagements to be operable, (ii) retain paragraph .41 of AT Section 101, *Attest Engagements* a reference to *Cooley on Torts*, which was removed, and (iii) change the reference in footnote 9A of Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, as "review" engagement as opposed to "examination" engagement. We note that the references to AS 1000 have been tailored to the attestation standards. We are not retaining the reference to the 1932 treatise *Cooley on Torts* because, as we explained when we proposed AS 1000, that reference is unnecessary and AS 1000 explains the concept of due professional care in plain language without changing its meaning.<sup>104</sup> We are revising the footnote of AT No. 2 to refer to a "review" engagement. Otherwise, we are adopting the amendments as proposed.

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<sup>104</sup> See PCAOB Rel. No. 2023-001, at 22.



## IV. ECONOMIC ANALYSIS

We are mindful of the economic impacts of our standard setting. This section describes the economic baseline, need, and expected economic impacts of the final standard and related amendments, as well as alternative approaches considered by the Board. Due to data limitations, the economic analysis is generally qualitative in nature.

We sought and received comments on the economic analysis in the proposing release.<sup>105</sup> A majority of the commenters expressed views related to the economic analysis, and they generally agreed with the need for the standard. Some commenters suggested that the use of certain proposed language or certain proposed clarifications could result in potential confusion or expansion of auditors' responsibilities or that the proposed removal of certain extant explanatory language could reduce transparency regarding the meaning of the general principles and responsibilities and exacerbate an audit expectation gap. Some commenters suggested that the economic analysis should more carefully consider potential costs or unintended consequences associated with certain key provisions. These comments are addressed below. One commenter asserted that costs that have not been analyzed, quantitatively or qualitatively, include costs to firms from new legal duties and auditor responsibilities. The commenters did not provide data to support their concerns about potential costs and unintended consequences. Their views were based on interpretations that the Board's proposal would make broader changes. However, we believe the economic analysis is appropriate and consistent with the limited scope of changes the rulemaking requires. Commenters generally agreed that accelerating the documentation completion date is feasible for firms and beneficial to investors, although some commenters noted potential costs or questioned the expected benefits. One commenter suggested potential unintended consequences associated with clarifying engagement partner responsibilities. Three commenters referenced additional academic research for our consideration. These comments are addressed below.

We have considered all of the comments received and have developed an economic analysis below that includes these considerations and evaluates the expected benefits and costs of the final standard and related amendments, discusses potential unintended consequences, and facilitates comparison to alternative actions considered. Specific input is discussed where relevant in the analysis that follows.

### A. Baseline

Section II of this release describes important components of the baseline against which the economic impacts of the standard can be considered, including an overview of existing

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<sup>105</sup> See *id.* at 55-57.

requirements. In the following subsections, we discuss additional matters that inform our understanding of the baseline for each of the changes.

## **1. Modernization of the Foundational Standards**

Section II provides an overview of existing requirements of the auditing standards that describe the general principles and responsibilities of the auditor in conducting an audit in accordance with the standards of the PCAOB (i.e., foundational standards). The general principles and responsibilities addressed by the foundational standards are described in Section III.B and include reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment.

The foundational standards are required to be followed in every audit conducted in accordance with PCAOB standards. The general principles and responsibilities in the foundational standards are reflected in firm methodologies, commercially published guidance, and other technical tools. Although there may be circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by how the foundational standards are organized and written, we do not have evidence that auditors are systematically confused about the meaning of the general principles and responsibilities or that the foundational standards are insufficient to support high-quality audits, when applied appropriately.

One commenter suggested there is no evidence that audit personnel are unclear or uncertain about the meaning of the proposed requirements. An investor-related group noted that the proposed standard was consistent with the extant standards.

The views expressed by the commenters align with our belief that the core general principles and responsibilities encompassed by the foundational standards are well-established and sound. While the foundational standards are currently spread across four standards (i.e., AS 1001, AS 1005, AS 1010, AS 1015), contain some extraneous restrictive language, and do not emphasize the investor protection obligation as prominently as desired, applied appropriately, they are sufficient to support high-quality audits.

## **2. Clarification of Engagement Partner Responsibilities**

Under PCAOB standards, engagement partners are responsible for the engagement and its performance, including the proper planning and supervision of the engagement and its compliance with PCAOB standards. While engagement partners are permitted to seek assistance from other team members performing supervisory activities, engagement partners are responsible for proper supervision of the engagement and have primary responsibility for the engagement.

As discussed in the proposal, the staff reviewed firms' available methodology documentation to obtain an understanding of firms' policies and practices for engagement

partner review.<sup>106</sup> A number of larger firms have developed specific guidance, checklists, and other tools to facilitate the engagement partner's review. For example, some firms mandate the use of tools that specify workpapers or topics that engagement partners are required to review directly. These tools require the engagement partner to document their review. Conversely, similar policies of some smaller firms are designed to be applied at a higher level and are not as specific about the required review.<sup>107</sup> We did not receive comments that provided additional information addressing the baseline for engagement partner review.

### 3. Accelerating the Documentation Completion Date

The auditor is required to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. Auditors may need some time after the report release date to assemble the final audit file and complete the audit documentation. The PCAOB standard on audit documentation currently requires completion of documentation within 45 days after the report release date.

When PCAOB inspection staff select issuer audits for inspection, PCAOB notice of inspection and access to firm audit documentation generally do not occur until after the documentation completion date. After an inspection is complete, the Board issues a report on the inspection, and a portion of each report is made available to investors and the public on the PCAOB's website.

As discussed in the proposal, the staff reviewed firms' stated archiving policies and firms' archiving practices to obtain an understanding of firms' policies and practices for completing audit documentation.<sup>108</sup> We found a wide range of archiving periods among firms, from the full 45-day period to a much shorter period. In addition, PCAOB staff has observed that certain firms require audit documentation to be archive-ready upon completion of interim audit procedures. The PCAOB established the 45-day period in 2004<sup>109</sup> when firms relied more on paper documentation and needed time to copy, collate, finalize, and file workpapers. PCAOB staff has observed that most firms today have electronic audit tools and audit software that either make those tasks unnecessary or enable the tasks to be performed much faster.

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<sup>106</sup> See *id.* at 36.

<sup>107</sup> The observations in this paragraph are based on the staff's review of the policies of U.S. global network firms ("GNFs") and U.S. non-affiliate firms ("NAFs"). GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.). NAFs are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

<sup>108</sup> See PCAOB Rel. No. 2023-001, at 37.

<sup>109</sup> See *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Rel. No. 2004-006 (June 9, 2004), at 5.

Some U.S. GNFs require engagement teams to archive audit documentation within 10 days after the report release date. Other firms require engagement teams to archive audit documentation within longer periods (ranging from 30 to 45 days after the report release date). Of the firms with policies that allow longer periods, certain of them express expectations to complete documentation within a much shorter period.

All GNFs have established global policies for archiving to be used by their respective non-U.S. affiliate firms. The global policies generally allow for completion of documentation not more than 45 days after the report release date. The global policies of certain GNFs specify a documentation completion date within 14 days after the report release date, or sooner when required by local laws or regulations. In addition to the global policies, certain non-U.S. affiliates of GNFs have local policies requiring documentation completion dates earlier than their respective global policies. Examples observed through the PCAOB's 2022 inspections include non-U.S. affiliates that have local policies specifying completion of documentation by deadlines such as 2 days, 7 days, 10 days, 14 days, and 30 days after the report release date. Additionally, even among certain non-U.S. affiliates that have stated policies of 45 days after the report release date, their documentation systems require completion of documentation within 15 to 40 days (depending on the firm). Generally, non-U.S. affiliates of GNFs use electronic audit documentation systems for documentation and archiving.

The archiving policies of NAFs generally specify a documentation completion date of 45 days after the report release date. PCAOB staff has observed certain NAFs annually inspected by the PCAOB that, in practice, typically archive documentation within 40 days of the report release date. In addition, PCAOB staff has noted that certain other NAFs generally complete their documentation at the end of the full 45-day archiving period. While most NAFs use electronic audit documentation systems, PCAOB staff is aware that some smaller firms still use paper-based workpapers.

We did not receive comments specific to the baseline for the documentation completion date, including additional information on firms' current archiving policies and practices.

## B. Need

The changes introduced in the final standard are part of the Board's effort to continuously improve and update PCAOB standards. In practice, PCAOB standards are used by auditors, who are responsible for applying the general principles and responsibilities of the foundational standards. Investors and other stakeholders may also rely on the foundational standards (directly or indirectly) to establish expectations about auditor responsibilities.

## 1. Problem to be Addressed

### i. Modernization of the foundational standards

We identified three potential concerns about the foundational standards: (i) compliance with the standards; (ii) soundness of the general principles and responsibilities; and (iii) clarity of the standards. The next three subsections explain that we do not see a need to make changes to the standards based on compliance with the standards or soundness of the general principles and responsibilities, but we do see a need to make changes to modernize and enhance the clarity of the foundational standards.

#### a. Compliance with the foundational standards

In some instances, auditors have not performed audits in compliance with the foundational standards. For example, for the years 2018-2022, the PCAOB issued almost two dozen enforcement orders that described the violation of at least one of the foundational standards. One commenter, an academic, noted research that suggests that audit failures often relate to basic areas of auditor responsibility, such as failure to gather sufficient appropriate audit evidence, failure to exercise due professional care, or insufficient professional skepticism.<sup>110</sup> The commenter added that contributing factors to the noted failures appear to be auditor disincentives to be skeptical<sup>111</sup> or high auditor workloads.<sup>112</sup> For example, research indicates that professional skepticism could be affected by priorities such as engagement budgets rather than investor protection.<sup>113</sup> The commenter also suggested that persistent audit deficiencies, despite PCAOB inspection and enforcement efforts, highlight the importance of auditors' understanding of and compliance with foundational auditing principles.<sup>114</sup> The views expressed by the commenter seem to align with our understanding of auditors' adherence to

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<sup>110</sup> See, e.g., Mark S. Beasley, Joseph V. Carcello, Dana R. Hermanson, and Terry L. Neal, *An Analysis of Alleged Auditor Deficiencies in SEC Fraud Investigations: 1998-2010* (commissioned by Center for Audit Quality) (May 2013).

<sup>111</sup> See, e.g., Joseph F. Brazel, Scott B. Jackson, Tammie J. Schaefer, and Bryan W. Stewart, *The Outcome Effect and Professional Skepticism*, 91 *The Accounting Review* 1577 (2016) and Joseph F. Brazel, Christine Gimbar, Eldar M. Maksymov, and Tammie J. Shaefer, *The Outcome Effect and Professional Skepticism: A Replication and a Failed Attempt at Mitigation*, 31 *Behavioral Research in Accounting* 135 (2019).

<sup>112</sup> See, e.g., Julie S. Persellin, Jaime J. Schmidt, Scott D. Vandervelde, and Michael S. Wilkins, *Auditor Perceptions of Audit Workloads, Audit Quality, and Job Satisfaction*, 33 *Accounting Horizons* 95 (2019).

<sup>113</sup> See, e.g., Brazel et al., *The Outcome Effect and Professional Skepticism* and Brazel et al., *The Outcome Effect and Professional Skepticism: A Replication and a Failed Attempt at Mitigation*.

<sup>114</sup> See, e.g., Ashna L. Prasad and John C. Webster, *What Are the Trends in PCAOB Inspections and the Reported Audit Deficiencies?* 37 *Journal of Accounting, Auditing & Finance* 523 (2022).

the foundational standards and our assessment of the need to modernize and clarify those standards, including a reaffirmation of the auditor’s obligation to protect investors.

#### b. Soundness of the general principles and responsibilities

The foundational standards address the general principles and responsibilities of reasonable assurance, due professional care, professional skepticism, independence, competence, and professional judgment. These principles and responsibilities are interconnected. For example, due professional care requires the auditor to exercise professional skepticism, including a questioning mind and a critical assessment of audit evidence. Audit procedures performed with due professional care allow the auditor to obtain reasonable assurance about whether the financial statements are free of material misstatement. Reasonable assurance is achieved, in part, by the exercise of professional judgment, which involves the auditor making decisions based on applying relevant training, knowledge, and experience. There is ample published research that studies alternative versions of these general principles and responsibilities. We summarize here several papers that demonstrate an ongoing debate regarding alternatives.

As noted in the proposal,<sup>115</sup> academic research regarding professional skepticism provides a model that identifies two components – skeptical judgment and skeptical action – that are necessary for the effective exercise of professional skepticism.<sup>116</sup> In a synthesis of literature on professional skepticism, researchers conclude that professional skepticism is foundational to the performance of a high-quality audit, and they note that academic research tends to focus on skeptical judgment while PCAOB inspections tend to focus on skeptical action.<sup>117</sup> When accountability to regulators is an incentive based on principles, research suggests that auditors may exhibit more skeptical judgment.<sup>118</sup> When accountability is based on a checklist mentality of following a set of strictly specific requirements, research suggests that auditors may engage in cognitive processing that reduces skeptical judgment.<sup>119</sup> On the other

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<sup>115</sup> See PCAOB Rel. No. 2023-001, at 39.

<sup>116</sup> See Mark W. Nelson, *A Model and Literature Review of Professional Skepticism in Auditing*, 28 *Auditing: A Journal of Practice & Theory* 1, 5 (2009).

<sup>117</sup> See R. Kathy Hurtt, Helen Brown-Liburd, Christine E. Earley, and Ganesh Krishnamoorthy, *Research on Auditor Professional Skepticism: Literature Synthesis and Opportunities for Future Research*, 32 *Auditing: A Journal of Practice & Theory* 45, 47 (2013). According to the authors, “Skeptical judgment occurs when an auditor recognizes that a potential issue may exist and that more work or effort is necessary. Skeptical action occurs when an auditor changes his/her behavior based on the skeptical judgment. Both skeptical judgment and skeptical action are essential to the audit, with skeptical judgment being a necessary condition for skeptical action.”

<sup>118</sup> See Hurtt, et al., *Research on Auditor* 62.

<sup>119</sup> See M. David Piercey, *Documentation Requirements and Quantified versus Qualitative Audit Risk Assessments*, 30 *Auditing: A Journal of Practice & Theory* 223, 242-43 (2011).

hand, a principles-only approach to standards may provide insufficient guidance to support the exercise of judgment.<sup>120</sup> Overall, therefore, there is a spectrum of possible approaches to audit regulation that lies between excessively vague principles and excessively specific requirements. In practice, effective auditing standards may fit into the middle of that spectrum by emphasizing core principles while including some specific requirements to help support skeptical judgment and skeptical action.<sup>121</sup> One commenter, an academic, noted that research on rules- versus principles-based requirements for independence and ethics suggests that a combination of rules and principles is likely to be the most effective approach.<sup>122</sup>

One commenter referenced several academic papers and highlighted pragmatic challenges and costs auditors face when applying the concept of professional skepticism.<sup>123</sup> The commenter reported that past economic research finds violations of professional skepticism underlying audit deficiencies.<sup>124</sup> The commenter also reported that lack of professional skepticism by auditors regarding frauds of the early 2000s generated academic literature on models of professional skepticism,<sup>125</sup> a scale to measure professional skepticism traits,<sup>126</sup> and interventions designed to help increase professional skepticism.<sup>127</sup> Moreover, the commenter

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<sup>120</sup> See, e.g., SEC, *Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System* (July 25, 2003).

<sup>121</sup> See, e.g., AS 1210, *Using the Work of an Auditor-Engaged Specialist*.

<sup>122</sup> See, e.g., Terri L. Herron and David L. Gilbertson, *Ethical Principles vs. Ethical Rules: The Moderating Effect of Moral Development on Audit Independence Judgments*, 14 *Business Ethics Quarterly* 499 (2004) and Bryan K. Church, J. Gregory Jenkins, and Jonathan D. Stanley, *Auditor Independence in the United States: Cornerstone of the Profession or Thorn in Our Side?* 32 *Accounting Horizons* 145 (2018).

<sup>123</sup> See, e.g., Brazel et al., *The Outcome Effect*; Ashleigh L. Bakke, Elizabeth N. Cowle, Stephen P. Rowe, and Michael S. Wilkins, *How Do Audit Firms Treat Partners Who Issue Adverse Internal Control Opinions?* Available at SSRN: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4383557](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4383557) (2023); Richard C. Hatfield, Scott B. Jackson, and Scott D. Vandervelde, *The Effects of Prior Auditor Involvement and Client Pressure on Proposed Audit Adjustments*, 23 *Behavioral Research in Accounting* 117 (2011); and Sandra Waller Shelton, *The Effect of Experience on the Use of Irrelevant Evidence in Auditor Judgment*, 74 *The Accounting Review* 217 (1999).

<sup>124</sup> See, e.g., Mark S. Beasley, Joseph V. Carcello, and Dana R. Hermanson, *Top 10 Audit Deficiencies*, *Journal of Accountancy* 63 (2001).

<sup>125</sup> See, e.g., Mark W. Nelson, *A Model and Literature Review of Professional Skepticism in Auditing*, 28 *Auditing: A Journal of Practice & Theory* 1 (2009).

<sup>126</sup> See, e.g., R. Kathy Hurtt, *Development of a Scale to Measure Professional Skepticism*, 29 *Auditing: A Journal of Practice & Theory* 149 (2010).

<sup>127</sup> See, e.g., Jessica Maree Cross, Robyn Moroney, and Soon-Yeow Phang, *Is it All in the Mind(Fulness)? An Exploratory Study Assessing the Impact of Mindfulness on Professional Skepticism*, 37 *Accounting Horizons* 25 (2023).



reported that an area of academic psychology research asserts that skeptical behavior is a personality trait that may require a counter-dispositional change in mindset.<sup>128</sup> (We note that this research does not specifically study professional skepticism as a general principle or responsibility in auditing.) In contrast, another commenter reported that academic research highlights the merits of focusing on both obtaining and evaluating information as a pragmatic approach in the exercise of professional skepticism.<sup>129</sup>

These comments suggest that efforts by firms, such as training and on-the-job-coaching, may be needed regarding professional skepticism, but do not suggest that professional skepticism as a general principle and responsibility of auditors is flawed. In addition, the views shared by these commenters underscore the need for a well-defined standard that sets forth the requirements of due professional care and professional skepticism, which is discussed further in Section IV.B.1.i.c below.

As noted in the proposal, research also offers insights on the appropriate and expected levels of assurance for investors and other users of financial statements.<sup>130</sup> One accounting firm referenced a literature review that notes the audit expectation gap has existed for many years and describes it as a phenomenon in which the expectations of beneficiaries of audited financial statements exceed what auditors can reasonably be expected to accomplish.<sup>131</sup> Early research on the audit expectation gap concludes that 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.<sup>132</sup> Similarly, a more

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<sup>128</sup> See, e.g., Lewis R. Goldberg, *The Structure of Phenotypic Personality Traits*, 48 *American Psychologist* 26 (1993); Paul E. Bebbington, Orla McBride, Craig Steel, Elizabeth Kuipers, Mirjana Radovanovic, Traolach Brugha, Rachel Jenkins, Howard I. Meltzer, and Daniel Freeman, *The Structure of Paranoia in the General Population*, 202 *The British Journal of Psychiatry* 419 (2013); and Ryan Hamilton, Kathleen D. Vohs, Anne-Laure Sellier, and Tom Meyvis, *Being of Two Minds: Switching Mindsets Exhausts Self-Regulatory Resources*, 115 *Organizational Behavior and Human Decision Processes* 13 (2011).

<sup>129</sup> See, e.g., Jonathan H. Grenier, *Encouraging Professional Skepticism in the Industry Specialization Era*, 142 *Journal of Business Ethics* 241 (2017) and Noel Harding and Ken T. Trotman, *The Effect of Partner Communications of Fraud Likelihood and Skeptical Orientation on Auditors' Professional Skepticism*, 36 *Auditing: A Journal of Practice & Theory* 111 (2017).

<sup>130</sup> See PCAOB Rel. No. 2023-001, at 39.

<sup>131</sup> See Reiner Quick, *The Audit Expectation Gap: A Review of the Academic Literature*, 94 *Maandblad voor Accountancy en Bedrijfseconomie* 5 (2020).

<sup>132</sup> See, e.g., Marc J. Epstein and Marshall A. Geiger, *Investor Views of Audit Assurance: Recent Evidence of the Expectation Gap*, 177 *Journal of Accountancy* 60, 64 (1994).



recent multi-country study finds that survey respondents appear to expect much more than reasonable assurance from auditors in order to prevent fraud and company failure.<sup>133</sup>

We believe this cross-section of research, either noted in the proposal or by commenters, aligns with our decision to maintain the core general principles and responsibilities of the foundational standards. The synthesis research supports professional skepticism as foundational to the performance of effective audits. Likewise, the research on audit assurance supports the principle of reasonable assurance as an appropriate level of assurance based on the underlying benefits and costs of an audit engagement.<sup>134</sup> As explained in Section III.B.6, absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. As described in this release, AS 1000 clarifies the general principles and responsibilities without substantially modifying the general principles and responsibilities. Moreover, we do not anticipate that the final standard and related amendments will markedly influence the current audit expectation gap since we are preserving the core concepts while making marginal adjustments to reaffirm the auditor's obligation to protect investors.

### c. Clarity of the foundational standards

As discussed in the proposal, some current features of the foundational standards do not support the most efficient use of the standards.<sup>135</sup> The general principles and responsibilities are currently spread across four standards, which were not developed originally as a cohesive whole. Their current organization continues to reflect their origin as separate requirements that were not drafted to be read together. In addition, the foundational standards contain language that was used in the AICPA's former standards but is outdated and inconsistent for audits conducted today under the standards of the PCAOB. This could undermine users' understanding of the general responsibilities of the auditor for audits conducted in accordance with PCAOB standards. The foundational standards also do not conform to the structure of Board-issued standards, which may hinder an auditor's navigation of the requirements. Finally, the foundational standards do not reflect developments in the auditing environment since their adoption in 2003, including the PCAOB's adoption of standards and rules, such as standards on audit documentation and engagement supervision, and this lack of consistency or alignment may draw attention away from the general principles and responsibilities.

Overall, these current features of the foundational standards may reduce efficient use of the standards by requiring more time and attention than necessary to read, understand, and apply the standards and may lead to inconsistent application, potential misinterpretation, and

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<sup>133</sup> See Association of Chartered Certified Accountants, *Closing the Expectation Gap in Audit* (May 2019) ("ACCA Report").

<sup>134</sup> See, e.g., Ernest L. Hicks, *Materiality*, 2 *Journal of Accounting Research* 158 (1964).

<sup>135</sup> See PCAOB Rel. No. 2023-001, at 40.

ineffective regulatory intervention. Clarity of auditing standards requires effective communication through features such as relevant language, consistency with Board-issued standards and rules, and well-organized presentation, which appear throughout PCAOB and SEC rulemaking initiatives.

Several firms and a firm-related group acknowledged that modernization efforts to streamline and clarify the foundational standards will enhance users' awareness and understanding of the auditor's responsibilities.

### (1) Characteristics of modernized auditing standards

Academic research identifies three characteristics of effective disclosure documents that align well with the features of modernized auditing standards: simplicity,<sup>136</sup> salience,<sup>137</sup> and standardization.<sup>138</sup> Simplicity can be achieved with an auditing standard that eliminates language that is outdated and inconsistent. Salience can be achieved with an auditing standard that emphasizes requirements while including explanations in the Board's release rather than the rule text and that incorporates the latest developments in the auditing environment, including the adoption of Board-issued standards and rules. Standardization can be achieved with an auditing standard that is well-organized, with general principles and responsibilities presented in a single standard that is structured similar to other standards.

In addition, we are aware of other regulatory initiatives that emphasize clear, well-organized writing as characteristics of effective communication with stakeholders. Two examples of other regulatory initiatives are the SEC Plain English Disclosure rule<sup>139</sup> for issuers' prospectuses, and the Plain Writing Act of 2010<sup>140</sup> for government communications with the public. The purpose of the Plain English Disclosure rule was to make financial and business information available to investors in a form they could read and understand, and the rule

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<sup>136</sup> See, e.g., R.E. Nisbett and L. Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* (1980) (finding that individuals have limited cognitive resources to absorb and process information).

<sup>137</sup> See, e.g., Daniel Kahneman, *Thinking, Fast and Slow* (2013) (suggesting that individuals who focus their limited cognitive resources on a subset of information are able to give more weight to the subset when making decisions).

<sup>138</sup> See, e.g., Jeffrey R. Kling, Sendhil Mullainathan, Eldar Shafir, Lee C. Vermeulen, and Marian V. Wrobel, *Comparison Friction: Experimental Evidence from Medicare Drug Plans*, 127 *The Quarterly Journal of Economics* 199 (2012) (finding that standardized information better enables individuals to assess tradeoffs and make coherent, rational decisions).

<sup>139</sup> *Plain English Disclosure*, SEC Rel. No. 33-7497 (Oct. 1, 1998).

<sup>140</sup> *Plain Writing Act of 2010*, Public Law 111-274.

includes specific guidance for clear, concise language.<sup>141</sup> The purpose of the Plain Writing Act was to improve the effectiveness and accountability of federal agencies to the public by promoting clear communication that the public can understand and use, and the statute defines plain writing as writing that is clear, concise, and well-organized, and that follows other best practices appropriate to the subject and the intended audience.<sup>142</sup> While neither the Plain English Disclosure rule nor the Plain Writing Act imposes obligations on the PCAOB, their overall objective to promote effective communication for efficiency of stakeholders' understanding is aligned with the objectives of and approach to our modernization of the foundational standards.

We did not receive comments that provided additional information regarding characteristics of modernized auditing standards.

## (2) Useability of modernized auditing standards

As summarized in Section IV.A.1, we continue to believe that auditors generally understand their responsibilities under the foundational standards. Nonetheless, there could be certain circumstances where some auditors' understanding of the general principles and responsibilities is made more difficult than necessary by the current language and organization of the foundational standards. New entrants, for example, may need to spend more time navigating and distilling the extant general principles and responsibilities than they would with more modernized language and organization. These new entrants may include accounting students seeking to enter the auditing profession. They may also include auditors who are experienced in applying other auditing or attestation standards, such as those of the AICPA for entities other than issuers, but who are seeking to perform an audit under PCAOB standards for the first time and who need to confirm their responsibilities under PCAOB rules.

In addition, the current language and organization of the foundational standards could impede investors' abilities to form accurate expectations about auditor responsibilities under PCAOB standards. Investors form expectations from a number of sources, including potentially

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<sup>141</sup> The economic effects of easy-to-read disclosure documents are quantified in research that demonstrates a decrease in company valuation caused by a decrease in readability of disclosure documents. See Byoung-Hyoun Hwang and Hugh Hokwang Kim, *It Pays to Write Well*, 124 *Journal of Financial Economics* 373 (2017).

<sup>142</sup> Using the Plain Writing Act as an exogenous event, research has found that the Plain Writing Act resulted in improved readability of Form 10-Ks that caused the risk of stock price crash to fall. See Shiyan Yin, Thanaset Chevapatrakul, and Kai Yao, *The Causal Effect of Improved Readability of Financial Reporting on Stock Price Crash Risk: Evidence from the Plain Writing Act of 2010*, 216 *Economics Letters* (2022). Research has also found that while readability of disclosures improved following the Plain English Disclosure rule, improved readability does not appear to influence more experienced market participants, as measured by equity analysts' earnings forecasts. See Samuel B. Bonsall IV, Andrew J. Leone, Brian P. Miller, and Kristina Rennekamp, *A Plain English Measure of Financial Reporting Readability*, 63 *Journal of Accounting and Economics* 329 (2017).

the language of the standards themselves, but also from third parties (e.g., media) who may write about PCAOB standards. Standards that are not modernized could contribute to an expectation gap—in this case, a gap between what investors expect from an audit and what auditing standards require.<sup>143</sup> Such a gap could in principle exist in either direction. Investors could be led to expect more than what an audit is required to deliver, and thereby fail to price the risk appropriately. Alternatively, investors could be led to expect less than what an audit is required to deliver, and thereby fail to appreciate the important functions performed by auditors regarding reasonable assurance.

Audit committees may also form inaccurate expectations about the content of PCAOB standards if the standards are not modernized, via mechanisms similar to investors. Given audit committee members' greater familiarity with auditing through their position and responsibilities with the issuer and other relevant professional background, we believe this is less likely to occur for audit committees than for investors. However, the negative impact of an audit committee member failing to correctly comprehend the auditor's general responsibilities under PCAOB standards could be more severe, given the audit committee's role in supervising the audit and the auditor under Sarbanes-Oxley for the benefit of investors.

We did not receive comments that provided additional information regarding useability of modernized auditing standards.

## ii. Clarification of engagement partner responsibilities

One of the responsibilities of engagement partners is to review the work of engagement team members. Any uncertainty under the standards may give engagement partners an incentive, particularly under time pressures, to de-emphasize or omit the review of workpapers. For example, the Board has found instances in which engagement partners did not fulfill their responsibilities for review.<sup>144</sup> However, engagement partner review of workpapers is a critical step to promote audit quality. As noted in Section IV.A.2, firms have varying policies and tools to facilitate the review required by the engagement partner.

One commenter, an academic, referenced academic studies regarding engagement partner impacts. The commenter reported that one study using data from Taiwan finds

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<sup>143</sup> Research finds evidence of a persistent gap between investors' expectations of an audit and auditors' performance based on requirements under auditing standards. *See, e.g.,* Klaus Ruhnke and Martin Schmidt, *The Audit Expectation Gap: Existence, Causes, and the Impact of Changes*, 44 *Accounting and Business Research* 572, 592 (2014) (finding that the public has expectations of auditors' responsibilities that do not exist under auditing standards, such as conducting a management audit) and ACCA Report (finding that the persistence of the audit expectation gap reflects, in part, the fact that public expectations of audits can grow in line with what auditors can accomplish).

<sup>144</sup> *See, e.g.,* *In the Matter of Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 (Aug. 16, 2022) and *In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Rel. No. 105-2022-033 (Dec. 6, 2022).

evidence that suggests there is variation in the quality of engagement partners and that the market responds to engagement partner quality.<sup>145</sup> In addition, the commenter reported that a group of studies finds evidence that engagement partners can negatively impact audit quality when they do not follow auditing standards, such as by not promoting the need for professional skepticism, ethical behavior, and continuing education.<sup>146</sup> The views shared by the commenter align with our identification of the need to clarify the engagement partner's responsibility to review certain audit documentation.

### iii. Accelerating the documentation completion date

Section III.B.6 and Section III.C.3 emphasize the importance of adequate audit documentation and the auditor's responsibilities for documentation under AS 1215, which currently specifies an audit documentation completion date no more than 45 days after the report release date. PCAOB standards require auditors to complete all necessary auditing procedures, review those procedures, and obtain sufficient appropriate audit evidence prior to the report release date. The extant requirements were established in part because documentation that is added well after the completion of an audit is likely to be of lesser quality than documentation produced contemporaneously when audit procedures are performed because reconstructing and recalling activities related to performing audit procedures long after the work was actually performed can be difficult.<sup>147</sup> Separately, significant advancements in electronic audit tools and the use of audit software have occurred over the last two decades, which facilitate contemporaneous documentation and more timely documentation completion. Based on these observations and some firms' policies and practices summarized in Section IV.A.3, the current documentation completion date that is 45 days after the report release date may provide more time than necessary to complete and finalize the audit documentation.

The PCAOB inspection process generally cannot begin until after the documentation completion date. In cases where the PCAOB would like to initiate inspections earlier, the 45-day period imposes an unnecessarily long lag before the PCAOB can provide notice of inspection and obtain access to audit documentation, which may prevent timely identification and

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<sup>145</sup> See, e.g., Daniel Aobdia, Chan-Jane Lin, and Reining Petacchi, *Capital Market Consequences of Audit Partner Quality*, 90 *The Accounting Review* 2143 (2015).

<sup>146</sup> See, e.g., Sean A. Dennis and Karla M. Johnstone, *A Field Survey of Contemporary Brainstorming Practices*, 30 *Accounting Horizons* 449 (2016); Harding and Trotman, *The Effect of Partner 111*; Christopher Koch and Steven E. Salterio, *The Effects of Auditor Affinity for Client and Perceived Client Pressure on Auditor Proposed Adjustments*, 92 *The Accounting Review* 117 (2017); and William F. Messier, Jr. and Martin Schmidt, *Offsetting Misstatements: The Effect of Misstatement Distribution, Quantitative Materiality, and Client Pressure on Auditors' Judgments*, 93 *The Accounting Review* 335 (2018).

<sup>147</sup> See PCAOB Rel. No. 2004-006.

resolution of audit deficiencies and delay information on firm performance that is useful to investors for assessing attributes such as audit quality or auditor effort.<sup>148</sup>

As discussed in the proposal, the 45-day period also may pose a greater risk of improper alteration of audit documentation because it provides a lengthy window of opportunity between the release of the audit report and the completion of the audit documentation.<sup>149</sup>

We did not receive comments that provided additional information regarding the need to accelerate the documentation completion date.

## **2. How the Changes Address the Need**

### **i. Modernization of the foundational standards**

The changes modernize the foundational standards by reorganizing and consolidating four standards, eliminating language that is no longer relevant, establishing conformity with the structure of Board-issued standards, and harmonizing with PCAOB standards and rules issued after the adoption of interim standards in 2003. These changes are designed to make AS 1000 a more effective and efficiently used standard through a well-organized presentation with relevant language that is more consistent with other PCAOB standards.

### **ii. Clarification of engagement partner responsibilities**

The changes clarify engagement partner responsibilities by specifying the engagement partner's due professional care responsibilities, explicitly stating that the engagement partner has primary responsibility for the engagement that is not reduced when assistance is provided by other engagement team members, and explicitly stating that audit documentation must clearly demonstrate the person or persons who reviewed the work and the date of such review. Clarification of the engagement partner's responsibility to review certain audit documentation—including review of documentation of significant findings or issues and review of documentation that is required to be reviewed by the EQR—reaffirms the existing minimum

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<sup>148</sup> See, e.g., Jagan Krishnan, Jayanthi Krishnan, and Hakjoon Song, *PCAOB International Inspections and Audit Quality*, 92 *The Accounting Review* 143 (2017) (finding evidence consistent with improvements in audit quality for foreign firms after PCAOB inspections) and Daniel Aobdia, *The Impact of the PCAOB Individual Engagement Inspection Process—Preliminary Evidence*, 93 *The Accounting Review* 53 (2018) (finding increases in auditor effort subsequent to deficiencies found through PCAOB inspections). We note that the results from these studies do not necessarily mean that PCAOB inspections cause higher audit quality.

<sup>149</sup> For examples of improper alteration of audit documentation within the 45-day archiving period, see, e.g., *In the Matter of Deloitte LLP*, PCAOB Rel. No. 105-2021-014 (Sept. 29, 2021) and *In the Matter of Richard J. Bertuglia, CPA*, SEC Rel. No. 84419 (Oct. 12, 2018).

level of responsibilities under due professional care and promotes consistency across audits regarding an engagement partner's oversight of the audit.

### iii. **Accelerating the documentation completion date**

The changes accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date. This change enables PCAOB inspections staff earlier access to audit documentation and reduces the window of opportunity for improper alteration of audit documentation prior to the documentation completion date.

## C. **Economic Impacts**

This section discusses the expected benefits and costs of the changes and potential unintended consequences. The proposal described expected benefits and costs, resulting in comments on each.<sup>150</sup> Two commenters on the proposal noted that the changes will not result in any significant additional costs to auditors or the companies they audit or in any significant benefits to market participants. Some commenters suggested that the economic analysis should more carefully consider potential costs or unintended consequences associated with certain key provisions, as discussed further below. We expect the economic impacts of AS 1000, including both benefits and costs, to be relatively modest, especially for those firms that have already incorporated in practice an engagement partner's responsibility for review and an accelerated documentation completion date.

### 1. **Benefits**

#### i. **Modernization of the foundational standards**

To the extent that current features of the existing foundational standards reduce efficient use of the standards, the changes will help enhance useability by making the general principles and responsibilities of the auditor in conducting an audit in accordance with the standards of the PCAOB easier to read, understand, and apply in practice.

For users trying to navigate and understand the general principles and responsibilities, efficiency gains may be associated with each of the changes as follows:

- The change to reorganize and consolidate the standards into a single standard will reduce time and attention required to navigate several standards to locate the general principles and ensure relevant requirements are met.

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<sup>150</sup> See PCAOB Rel. No. 2023-001, at 45-50.

- The changes to eliminate language that is no longer relevant will reduce time and attention required to read, understand, and apply the standard by facilitating a focus on core requirements of the standard.
- The changes to establish conformity with the structure of Board-issued standards and make certain enhancements will help expedite navigation of the requirements and ensure relevant requirements are met by: (i) providing more uniformity among the PCAOB standards with an introduction and objectives that emphasize the auditor's obligations; (ii) updating the articulations of the concepts of due professional care, professional skepticism, professional judgment, and reasonable assurance; (iii) clarifying auditor responsibilities by expressing the requirements using Rule 3101 terms; and (iv) minimizing explanatory material that is instead included in the release discussion.
- The changes to harmonize with PCAOB standards and rules issued after adoption of the interim standards in 2003 will reduce time and attention required to read, understand, and apply the standard by drawing attention to: (i) changes to auditing requirements through Board-issued standards; (ii) clarifying the meaning of present fairly; (iii) an overarching objective for audits of ICFR; and (iv) new rules issued by the Board.

Auditors learning the general principles and responsibilities for the first time may do so more quickly and easily, thereby reducing the cost of training and potentially facilitating the newer auditor's ability to perform PCAOB audits.

While the obligation of auditors would not change, reaffirming the auditor's obligation to protect investors could serve as a reminder. Especially to the extent that auditors do not currently fulfill this obligation, it may prompt auditors to reflect on a sense of obligation to investors and the public that goes beyond their responsibilities to a specific company under audit. At the margins, the emphasis on investor protection could reinforce support for auditors in circumstances where they face decisions that may require them to prioritize the interests of the public over their own interests or the interests of the company under audit. Further, by highlighting the important role auditors play in protecting investors, it could underscore the value of the auditing profession to capital markets.

In addition, a modernized standard may enhance investors' and audit committees' awareness and understanding of the auditor's responsibilities. Investors could be able to more appropriately assess financial statement risk by better understanding the nature and extent of auditor responsibilities. Audit committees' oversight of the auditor could be enhanced, for example, if enhanced clarity of standards facilitates communication between the audit committee and the auditor. Referencing academic research, one commenter on the proposal explained that the role of the audit committee in ensuring the quality of reported financial



results requires improved and expanded dialogue between the audit committee and the auditor.<sup>151</sup>

## **ii. Clarification of engagement partner responsibilities**

To the extent that engagement partners currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as required under the existing standards,<sup>152</sup> the clarification of engagement partner responsibilities could improve auditor performance and audit quality by: (i) improving the timeliness of the engagement partner's evaluation of significant findings and judgments; (ii) enhancing the ability of the engagement partner to prevent or detect audit deficiencies; and (iii) facilitating improvements in the quality of the work of other engagement team members. As summarized in Section IV.B.1, one commenter referenced academic studies that suggest engagement partners can negatively impact audit quality when they do not follow auditing standards.

## **iii. Accelerating the documentation completion date**

The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will promote contemporaneous documentation and more timely documentation completion. Documentation that is produced contemporaneously when audit procedures are performed and then completed soon thereafter is likely to provide a more accurate and complete audit file for the engagement. The amendment will also support PCAOB efforts to enhance audit quality via timelier identification and potential resolution of audit deficiencies in cases where inspections are initiated earlier. In such cases, the amendment could facilitate earlier issuance of inspection reports and their availability to investors. In addition, the amendment could enhance auditor performance and audit quality for firms that do not currently implement best practices, but will be more inclined to do so, by proactively focusing on sequencing of work, allocation of resources, and other operating practices.

The benefits associated with an accelerated documentation completion date are likely to be greater for firms that currently make use of the entire 45-day period permitted under current PCAOB standards due to current operating circumstances. These firms would need to make more adjustments to their sequencing of work and allocation of effort to meet the accelerated period. Thus, the concomitant benefits to audit quality would therefore be greater. Based on firms' current archiving policies and practices summarized in Section IV.A.3, the

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<sup>151</sup> See, e.g., Jeffrey Cohen, Lisa Milici Gaynor, Ganesh Krishnamoorthy, and Arnold M. Wright, *Auditor Communications with the Audit Committee and the Board of Directors: Policy Recommendations and Opportunities for Future Research*, 21 *Accounting Horizons* 165 (2007).

<sup>152</sup> See, e.g., Jin Tae Kim, PCAOB Rel. No. 105-2022-013 and *KPMG Assurance and Consulting Services LLP*, PCAOB Rel. No. 105-2022-033.

benefits associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs experience operating efficiencies associated with changes in their sequencing of work, allocation of resources, and other operating practices to comply with the documentation completion date.

The benefits associated with an accelerated documentation completion date will be lower for firms that already either: (i) have a policy that requires that documentation be completed in 14 days or fewer or (ii) have a policy that is closer to or equal to the current 45-day period but in practice complete their documentation shortly after releasing the audit report. Specifically, the benefits to audit quality will be lower for these firms, but the benefits to investors of earlier PCAOB inspections will still be achieved in cases where inspections are initiated earlier.

Commenters on the proposal generally agreed that accelerating the documentation completion date is feasible for firms and beneficial to investors. One commenter suggested the ability to inspect audits sooner is a benefit that will not significantly increase costs. Another commenter, an academic, suggested there could be market benefits associated with earlier inspections if inspection reports are publicly available earlier and the content of inspection reports is meaningful. The commenter referenced several academic studies that demonstrate improvements in audit quality after PCAOB inspections.<sup>153</sup> The commenter reported that one study finds improvements in internal control audits after PCAOB inspections<sup>154</sup> and that another study finds increases in auditor effort after PCAOB inspections find audit deficiencies.<sup>155</sup> One commenter questioned whether accelerating the documentation completion date would have any meaningful impact on inspection timelines. Based on the acceleration of the documentation completion date by 31 days, we note that the most an inspection report could be accelerated as a result of the accelerated documentation completion date is 31 days.

## 2. Costs

### i. Modernization of the foundational standards

The primary costs of the modernization efforts reflected in the standard will be one-time costs to firms for updating references within firm methodologies and related guidance to reflect the final standard and related amendments. Larger firms that develop their own methodologies will update references directly in those methodologies. Smaller firms generally purchase methodologies from third-party vendors. The implementation costs of the changes

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<sup>153</sup> See, e.g., Krishnan, et al., *PCAOB International Inspections*. We note that the results from these studies do not necessarily mean that PCAOB inspections cause higher audit quality.

<sup>154</sup> See, e.g., Mark L. DeFond and Clive S. Lennox, *Do PCAOB Inspections Improve the Quality of Internal Control Audits?* 55 *Journal of Accounting Research* 591 (2017).

<sup>155</sup> See, e.g., Aobdia, *The Impact of the PCAOB*.

may be offset over time because a more logical and easy-to-read-and-navigate standard could enable auditors to save time reading, understanding, and applying the standard. Third parties that refer to PCAOB standards (e.g., in textbooks, training, or review materials) will also need to update those materials.

To the extent that auditors are not taking into account PCAOB auditing interpretations, as used in paragraph .15 and the related note of the standard, those firms will also incur one-time and ongoing costs related to methodology and periodic training for PCAOB auditing interpretations.

To the extent that auditors do not currently fulfill their obligation to protect investors, auditors who face decisions that require them to prioritize the interests of the public over their own interests or the interests of the company under audit may make decisions that benefit the public at a potential cost to the auditor, such as alienating or losing a company under audit. There is likely already a balance struck between fulfilling the auditor's obligation to protect investors and the risk of alienating or losing a company under audit. At the margins, the emphasis on investor protection may move the fulcrum closer to the public interest.

We did not receive comments that provided additional information regarding costs of modernization.

## **ii. Clarification of engagement partner responsibilities**

To the extent that engagement partners currently do not fulfill their responsibilities for an appropriate review of the work of other engagement team members as required under the existing standards,<sup>156</sup> those firms may incur one-time costs to update firm methodologies and ongoing costs related to fulfilling their responsibilities. Larger firms that develop their own methodologies will update references directly in those methodologies. Smaller firms generally purchase methodologies from third-party vendors.

While the responsibilities of engagement partners would not change under the new standard, the clarification for engagement partners to perform their duties with due professional care, including their responsibility for performing an appropriate review of the work of other engagement team members, could also impose incremental costs related to fulfilling engagement partner responsibilities to the extent that engagement partners are not currently fulfilling their responsibilities.

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<sup>156</sup> See, e.g., *Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 and *KPMG Assurance and Consulting Services LLP*, PCAOB Rel. No. 105-2022-033.

One commenter reported that research highlights the importance of and variation in the direction, supervision, and review of audit work.<sup>157</sup> The commenter further noted that direction, supervision, and review are functions that are performed by auditors at different levels of experience, not just engagement partners, and cited research that highlights that the effectiveness of the functions can vary across hierarchical levels.<sup>158</sup> While we acknowledge the commenter's points regarding the effectiveness of functions performed by auditors at different levels of experience, our analysis of costs here is limited to costs that are relevant to the economic impacts of the clarification of engagement partner responsibilities.

### iii. Accelerating the documentation completion date

The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will allow less time to assemble the final set of workpapers after the audit report is released. However, the PCAOB requirement to complete necessary auditing procedures, review those procedures, and collect sufficient appropriate audit evidence prior to the report release date could help mitigate costs to implement the amendment because the only activities that remain are assembling a complete and final set of audit documentation. In addition, the widespread use of electronic audit tools and audit software could help mitigate any costs associated with the amendment.

The costs associated with an accelerated documentation completion date are likely to be greater for firms that currently specify by policy an archiving period that is near or equal to the maximum permitted under current AS 1215.15 and that currently take all or nearly all of the full 45-day period to complete their archiving because of operating circumstances that inhibit faster completion. These firms will have to invest additional resources to enhance sequencing of their work, allocation of resources, and other operating practices, or may have to enhance their audit documentation systems, or both, in order to comply with the documentation completion date. Based on firms' current archiving policies and practices summarized in Section IV.A.3, the costs associated with an accelerated documentation completion date are likely to be higher for NAFs than for GNFs in cases where NAFs currently use the entire 45-day period. However, the extended effective date of the 14-day requirement for firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, will allow those firms more time to implement the revised

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<sup>157</sup> See, e.g., J.S. Rich, I. Solomon, and K.T. Trotman, *The Audit Review Process: A Characterization from the Persuasion Perspective*, 22 *Accounting, Organizations & Society* 481 (1997) and Mark Nelson and Hun-Tong Tan, *Judgment and Decision Making Research in Auditing: A Task, Person, and Interpersonal Interaction Perspective*, 24 *Auditing: A Journal of Practice & Theory* 41 (2005).

<sup>158</sup> See, e.g., Robert J. Ramsay, *Senior/Manager Differences in Audit Workpaper Review Performance*, 32 *Journal of Accounting Research* 127 (1994) and Noel Harding and Ken T. Trotman, *Hierarchical Differences in Audit Workpaper Review Performance*, 16 *Contemporary Accounting Research* 671 (1999).

requirement. By contrast, GNFs that already require the completion of documentation within a 14-day period will likely not incur substantial additional costs to comply with the revised requirement.

Electronic audit tools and audit software may facilitate compliance with the requirement by automating, and thereby performing more quickly, certain processes. For firms without electronic systems in place, costs associated with an accelerated documentation completion date may include additional resources, such as in-house personnel or capital investments in audit software, to help assemble a complete and final set of audit documentation in the 14-day time period. PCAOB staff is aware that some small NAFs still use paper-based systems. However, these firms generally perform smaller, less complex audits, such that the firms do not have to mail audit workpapers from multiple locations; therefore, even with a paper-based system, effective sequencing of work, allocation of resources, and other operating practices could enable them to meet the 14-day documentation completion date.

For firms with electronic audit tools and audit software in place, the earlier documentation completion date should not change the functionality or cost of software, which will facilitate a low-cost transition to the new archiving period. Some firms already have policies that require documentation completion within 14 days of the report release date, and some firms require audit documentation to be archive-ready upon completion of interim procedures. These practices suggest that much of the process involved in assembling a complete and final set of audit documentation, such as assembly, cleanup, and retention, is substantially finished in advance of 45 days. Any firms that currently have a policy or practice of completing audit documentation on or near the 45<sup>th</sup> day may do so merely because the current standard allows 45 days, and thus will not incur costs to meet the accelerated documentation completion date. Alternatively, any firms that currently complete audit documentation on or near the 45<sup>th</sup> day because of operating circumstances may incur costs associated with implementing best practices to effectively sequence work, allocate resources, and incorporate other operating practices to comply with the accelerated documentation completion date. In this case, we anticipate that the costs will be offset over time by improvements in operating efficiencies to the extent that operating circumstances are within the firm's control.

An accelerated documentation completion date may also impose costs on multi-firm audits if electronic audit documentation systems are not integrated across firms. GNFs are more likely than NAFs to perform multi-firm audits, but some NAFs do perform multi-firm audits.<sup>159</sup> If electronic systems are not integrated across firms, which is more likely for NAFs, other auditors may need to transmit documentation to the lead auditor to assemble the final set of workpapers. If electronic systems are integrated across firms, the lead auditor may be able to seamlessly archive the work of other auditors.

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<sup>159</sup> See PCAOB Rel. No. 2022-002, at 26-52.

Any costs associated with the requirements may be passed through to investors, or costs may be internalized by firms. While competition in the audit market is characterized by a combination of unique features,<sup>160</sup> issuers that engage firms that pass through any costs may switch firms if the benefits of switching justify the costs of switching.

Some commenters noted potential costs associated with accelerating the documentation completion date. One commenter generally supported accelerating the documentation completion date but noted that firms that use proprietary audit tools and audit software will incur costs related to reprogramming and testing that could be exacerbated for GNFs that are subject to differing jurisdictional requirements. The same commenter also noted that accelerating the documentation completion date may negatively impact smaller firms that do not utilize electronic audit tools to the extent that they are unable to comply with the requirement without considerable investments that may not be economically feasible. Another commenter disagreed with accelerating the date because of human capital factors and a complex auditing landscape. Another commenter reported that academic research investigating the SEC's acceleration of Form 10-K filing deadlines in the 2000s suggests that accelerating the filing deadlines more quickly than 15 days was costly to issuers regarding misstated financial statements.<sup>161</sup> The commenter acknowledged the analogy may not align with the documentation completion date but suggested that it is likely that firms currently requiring more than 29 days to complete audit documentation will likely incur non-trivial compliance costs.

We acknowledge that firms that use proprietary audit tools and audit software will incur costs related to reprogramming and testing. While we also acknowledge that some smaller firms may incur costs related to investments and some firms may incur costs related to human capital or a complex auditing landscape, we believe that most firms will incur incremental costs because they already use electronic audit documentation systems. Likewise, we believe the contrast between the SEC's acceleration of Form 10-K reporting deadlines and our acceleration of the documentation completion date is too stark to be a useful comparison because the auditing standards require that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date. Based on the broad support by commenters for accelerating the documentation

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<sup>160</sup> See, e.g., Joseph Gerakos and Chad Syverson, *Competition in the Audit Market: Policy Implications*, 53 *Journal of Accounting Research* 725 (2015) (explaining that the audit market exhibits a set of features that distinguish it from other markets for business services, including its role in capital market transparency, mandated demand, and concentrated supply).

<sup>161</sup> See, e.g., Lisa Bryant-Kutcher, Emma Yan Peng, and David P. Weber, *Regulating the Timing of Disclosure: Insights from the Acceleration of 10-K Filing Deadlines*, 32 *Journal of Accounting and Public Policy* 475 (2013); Colleen M. Boland, Scott N. Bronson, and Chris E. Hogan, *Accelerated Filing Deadlines, Internal Controls, and Financial Statement Quality: The Case of Originating Misstatements*, 29 *Accounting Horizons* 551 (2015); and Khaled Alsabah, *The 15-Day Debate and the Value of Early Release of Information: Evidence from 10-K Filings*, 42 *Journal of Accounting and Public Policy* 1 (2023).

completion date and the existing requirement that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date, we continue to believe that accelerating the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days after the report release date will provide better protection for investors.

One commenter suggested that keeping the 35-day filing requirement for Form AP in light of accelerating the documentation completion date could create technological and process challenges for firms. Another commenter suggested that firms could incur incremental costs such as process changes and administrative costs. In contrast, some commenters said they would not have difficulty filing Form AP within 35 days of the audit report being filed with the SEC. Two commenters suggested the time to file Form AP should be consistent with the documentation completion date. We are adopting the 14-day deadline for archiving audit documentation. We note that firms, under AS 1215, can add information to the audit documentation after the documentation completion date, if necessary, to record their compliance with Form AP requirements. Consequently, we do not perceive any conflict or a necessity to modify either the 35-day Form AP filing requirement or the proposed 14-day deadline for archiving audit documentation.

### **3. Potential Unintended Consequences**

In addition to the benefits and costs discussed above, the final standard and related amendments could have unintended economic consequences. The proposal described potential unintended consequences, which commenters addressed in their letters.<sup>162</sup> This section discusses the potential unintended consequences we have considered as well as our consideration of such consequences in adopting the final standard and related amendments. The discussion also addresses, where applicable, any mitigating or countervailing factors, including revisions to the proposed standard and related amendments reflected in the final standard and related amendments we are adopting.

#### **i. Modernization of the foundational standards**

The changes to modernize the foundational standards are not intended to impose new requirements on auditors or substantially change the requirements of PCAOB standards.

Commenters noted potential unintended consequences related to the removal of explanatory language or the use of certain language in the proposed rule text or release discussion. Several commenters suggested that removing explanatory language on limitations of an audit may exacerbate the audit expectation gap and cause potential confusion among auditors. Commenters also suggested that the use of certain proposed language or certain proposed clarifications could result in potential confusion or unintended expansion of auditors'

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<sup>162</sup> See PCAOB Rel. No. 2023-001, at 50-51.

responsibilities. For example, one commenter suggested that requiring auditors to “keep in mind their role in protecting investors” could encourage auditors to adopt an investor perspective when making judgments, which research highlights may be detrimental to audit quality.<sup>163</sup>

These potential unintended consequences will be mitigated by changes to language in the adopted rule text or release discussion. Throughout the rulemaking process, we have emphasized that eliminating restrictive provisions does not alter the core principles and responsibilities that are transitioned from the current standards to AS 1000. We removed the reference to “keep in mind their role in protecting investors” from the final standard based on changes made to paragraph .01 of the final standard. While we have emphasized the investor protection obligation, we have clarified that the emphasis does not create any new legal requirements. We do not believe that highlighting the auditor’s existing obligation to protect investors will widen any expectation gap or decrease audit quality. Instead, our goal is to heighten auditors’ awareness and reinforce their existing obligation.

## ii. Clarification of engagement partner responsibilities

An unintended consequence of the amendment to clarify engagement partner responsibilities would occur if, contrary to the Board’s expectation, some firms whose engagement partners currently do more than will be required to meet the minimum requirement for engagement partner review, do less in the future to merely meet the minimum requirement.<sup>164</sup>

This potential unintended consequence will be mitigated by the extent to which engagement partners are aware that the engagement’s performance is primarily their responsibility. Furthermore, in contrast to a highly specific minimum threshold, we note that engagement partners under AS 1000 are bound to broad due professional care responsibilities that are less likely to incentivize engagement partners to merely meet a precise set of criteria without exceeding those criteria. In addition, economic reasons that generate enhanced performance in the first place, such as partner compensation, inspections, and litigation threat, help to mitigate this potential unintended consequence.

One commenter suggested that the amendment to clarify engagement partner responsibilities is reasonable and clear but could present unintended consequences by limiting

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<sup>163</sup> See, e.g., Elizabeth C. Altiero, Yoon Ju Kang, and Mark E. Peecher, *Motivated Perspective Taking: Why Prompting Auditors to Take an Investor’s Perspective Makes Them Treat Identified Audit Differences as Less Material*, 39 *Contemporary Accounting Research* 339 (2022) and Lei Dong, Lei Wang, and Wen-Wen Chien, *The Joint Effect of Supervisor Influence and Investor Perspective: Unintended Consequences on Assessing Accounting Estimates*, 37 *Managerial Auditing Journal* 151 (2022).

<sup>164</sup> See, e.g., Aobdia, *The Impact of the PCAOB* (finding that auditor effort declines subsequent to PCAOB inspections of engagements that do not receive a Part I finding).



firms' abilities to attract and retain talent, which could potentially result in lower audit quality if people leave the profession. We anticipate that the amendments related to engagement partner responsibilities will be unlikely to significantly affect firms' abilities to attract or retain talent, or to disincentivize individuals from being willing to serve as engagement partners because AS 1000 clarifies existing engagement partner responsibilities. As outlined in the rest of the economic analysis, we acknowledge that some marginal economic impacts could follow from these amendments, but we do not agree with the commenter that those effects will be dramatic.

### iii. Accelerating the documentation completion date

Unintended consequences of accelerating the documentation completion date would occur if, contrary to the Board's expectation, (i) auditor time prior to the report release date that was previously spent focusing on audit procedures is now spent on assembling final workpapers or (ii) the archiving period results in higher costs that cause firms with paper-based documentation systems to exit the audit market or to not enter the audit market.

These potential unintended consequences will be mitigated by the current requirement that all necessary auditing procedures, review of those procedures, and collection of sufficient appropriate audit evidence be completed prior to the report release date.<sup>165</sup> Furthermore, if firms proactively sequence work, allocate resources, and incorporate other operating efficiencies, they should not experience substantial disruptions and should be able to handle the accelerated archiving deadline without major problems.

One commenter acknowledged that accelerating the documentation completion date may enhance audit quality overall but suggested that it could have an initial negative impact on audit quality as a result of accelerating the archiving process into the period when many SEC practice audit professionals need to start working on other issuer audit engagements. Another commenter also acknowledged that accelerating the documentation completion date may enhance audit quality and said it may allow PCAOB inspections to begin sooner after completion of an audit, but issuers may have various filing deadlines or require extensions that will necessitate the full attention of professionals on those engagements. One commenter acknowledged that the acceleration is beneficial and appropriate, but suggested that beginning the inspection process earlier could be detrimental to audit quality because earlier inspections could cause auditors to reallocate their time to the inspection process and away from audits of financial statements. Consistent with the acknowledgements by these commenters, we continue to believe that accelerating the documentation completion date will be facilitated by the widespread use of electronic audit tools and audit software by most firms, which could mitigate potential operating disruptions that firms experience as they adjust to the accelerated date.

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See AS 1215.15.

One commenter stressed the importance of the quality of audit documentation and noted that technology interruptions or cybersecurity matters could impact the ability of a firm to meet the accelerated deadline. However, the possibility of technology interruptions or cybersecurity matters could impact a firm's ability to meet any deadline. Another commenter reported that academic studies find there can be unintended consequences of additional regulation, including new costs associated with extensive audit documentation, auditors taking a "box-ticking" approach to extensive documentation requirements, and reduced auditor retention.<sup>166</sup> However, accelerating the documentation completion date does not add any new documentation requirements.

## D. Alternatives Considered

During the formulation of the proposal and adoption of the final standard and related amendments, we considered a number of alternative approaches to the final standard and related amendments we are adopting, including those suggested by commenters.

### 1. Modernization of the Foundational Standards

We considered whether to update the foundational standards and keep them as individual standards, but we believe that combining the general principles and responsibilities into one standard is more logical and easier to navigate. This approach is also consistent with the approaches of other standard setters. For example, both the IAASB and the ASB address general responsibilities of the auditor in one standard (see IAASB's ISA 200 and ASB's AU-C 200).

We have also considered whether to incorporate the requirements of AS 2815 into AS 1000, but we believe that it is more logical to incorporate the requirements of AS 2815 into AS 2810 because both standards address requirements for concluding audit procedures. This approach also eliminates unnecessary cross-references between the two standards and makes the auditor's responsibilities easier to locate. AS 1000 includes a reference to AS 2810 for the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

### 2. Clarification of Engagement Partner Responsibilities

With respect to engagement partner responsibilities, we considered retaining the language of AS 1010 that describes the use of judgment in the context of the partner's

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<sup>166</sup> See, e.g., Colleen M. Boland, Brian E. Daugherty, and Denise Dickins, *Evidence of the Relationship between PCAOB Inspection Outcomes and the Use of Structured Audit Technologies*, 38 *Auditing: A Journal of Practice & Theory* 57 (2019) and Marion Brivot, Mélanie Roussy, and Maryse Mayer, *Conventions of Audit Quality: The Perspective of Public and Private Company Audit Partners*, 37 *Auditing: A Journal of Practice & Theory* 51 (2018).

responsibilities for supervision. However, we believe that leveraging the requirements of AS 1201, a more recent standard, avoids potential confusion and aligns the engagement partner's responsibilities with Board-issued standards. Other alternatives to the amendments related to engagement partner responsibilities, including comments received, were considered as discussed in Section III.B.4 and Section III.C.2.

### **3. Accelerating the Documentation Completion Date**

For the documentation completion date, we considered a length of time between the current 45-day period and the 14-day period, such as 21 days or 30 days. We believe that a shorter period of time may provide better protection for investors than a longer period: it could permit acceleration of PCAOB inspections and provide the strongest incentives for firms to implement operating efficiencies that may ultimately improve audit quality. Thus, in principle, a shorter documentation completion date could achieve more benefits than a longer period. Our assessment of existing firm practice as described in Section IV.A.3 leads us to believe that 14 days is feasible for firms and that a longer period could therefore be unnecessary and would erode the benefits that would otherwise be achieved.

Investor-related groups suggested the documentation completion date should be reduced to two days for all firms. We continue to believe 14 days is feasible for all firms while not being too restrictive for firms that may require more time. Another commenter asserted that the economic analysis did not adequately consider alternatives other than 14 days and that the analysis did not offer any alternatives to begin inspections earlier other than accelerating the documentation completion date. As noted above, we considered a length of time between the current 45-day period and the 14-day period. Moreover, the need to accelerate the documentation completion date is based on other considerations in addition to cases where the PCAOB would like to initiate inspections earlier. Another commenter asserted that firms' operating efficiencies are not the purview of the PCAOB. However, the need for the amendment is not based on operating efficiencies but may result in operating efficiencies that improve audit quality.

We also considered whether to specify different documentation completion dates for different classes of firms, based on specific firm characteristics that may make compliance with an accelerated documentation completion date especially challenging because of some practical obstacle or because of expenses that are common to that class of firms. For example, we considered specifying a longer documentation completion date for NAFs than for GNFs. However, as noted above, we believe that the 14-day period is a feasible period for all firms; we are not aware of any practical obstacle or expenses that will make compliance with a 14-day period especially challenging for all firms within a particular class. In contrast, a uniform and consistent archiving period for all firms would facilitate implementation and compliance, especially for audits that involve multiple firms that could be subject to different archiving

periods. Finally, having a unified archiving date will enable earlier PCAOB inspections across all registered firms.<sup>167</sup>

## V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups (“JOBS”) Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies (“EGCs”), as defined in Section 3(a)(80) of the Exchange Act, unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.”<sup>168</sup> As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.<sup>169</sup>

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.<sup>170</sup> As of the November 15, 2022 measurement date, there were 3,031 companies<sup>171</sup> that self-identified as EGCs and filed audited financial statements with the SEC

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<sup>167</sup> While we have not specified different documentation completion dates for different classes of firms, the extended effective date of the 14-day requirement for firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, will allow those firms more time to implement the revised requirement.

<sup>168</sup> See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The new standard does not fall within either of these two categories.

<sup>169</sup> We are providing this analysis of the impact on EGCs to assist the SEC in making the determination required under Section 104 to the extent that the requirements apply to “the audit of any emerging growth company” within the meaning of Section 104 of the JOBS Act.

<sup>170</sup> See PCAOB, *Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2022* (Feb. 20, 2024) (“EGC White Paper”), available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2022.pdf?sfvrsn=a8294f3\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2022.pdf?sfvrsn=a8294f3_2).

<sup>171</sup> The EGC White Paper uses a lagging 18-month window to identify companies as EGCs. Please refer to the “Current Methodology” section in the EGC White Paper for details. Using an 18-month window enables staff to analyze the characteristics of a fuller population in the EGC White Paper but may tend to result in a larger number of EGCs being included for purposes of the present EGC analysis

between May 16, 2021, and November 15, 2022, that included an audit report signed by a firm.<sup>172</sup>

As discussed in the proposal, the economic impacts of the standard and related amendments are generally applicable to audits of EGCs.<sup>173</sup> The amendment to accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation from 45 days to 14 days could impact the audits of EGCs more than the audits of non-EGCs to the extent that EGCs are more likely than non-EGCs to be audited by NAFs.<sup>174</sup> As discussed in Section IV.C, NAFs are expected to require more changes than GNFs in their sequencing of work, allocation of resources, and other operating practices to comply with the accelerated documentation completion date. Therefore, all else equal, both the benefits and costs of the amendments, including the amendment to accelerate the documentation completion date, may be higher for EGC audits than for non-EGC audits.

While both the benefits and costs of the amendment to accelerate the documentation completion date may be higher for EGC audits, the costs may be mitigated based on certain characteristics of EGCs. For example, to the extent that EGCs are smaller than non-EGCs, EGC audits may be less complex, which potentially facilitates expeditious assembly of the final workpapers.<sup>175</sup> In addition, to the extent that EGCs are audited by firms that issued audit reports with respect to 100 or fewer issuers during the calendar year ending December 31, 2024, the extended effective date of the amendment to accelerate the documentation completion date will allow those firms more time to implement the accelerated documentation completion date.<sup>176</sup> Moreover, as EGCs are not large accelerated filers (“LAFs”), the SEC Form 10-K filing deadline for EGCs is either 75 days after the fiscal year end for accelerated filers or 90 days for non-accelerated filers. This provides firms with an additional 15 days for accelerated

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than would alternative methodologies. For example, an estimate using a lagging 12-month window would exclude some EGCs that are delinquent in making periodic filings. An estimate as of the measurement date would exclude EGCs that have terminated their registration or that have exceeded the eligibility or time limits.

<sup>172</sup> See EGC White Paper 17. Based on staff analysis as of the Nov. 15, 2022 measurement date, 86 percent of the 263 firms that issued audit reports for EGCs performed audits for both EGC and non-EGC issuers while 14 percent performed issuer audits only for EGCs.

<sup>173</sup> See PCAOB Rel. No. 2023-001, at 52-54.

<sup>174</sup> PCAOB staff analysis indicates that, compared to exchange-listed non-EGCs, exchange-listed EGCs are approximately 2.6 times as likely to be audited by an NAF (source: EGC White Paper and Standard & Poor’s).

<sup>175</sup> See EGC White Paper, Figure 9 and Figure 12 (indicating that exchange-listed EGCs have lower market capitalization and revenue than exchange-listed non-EGCs).

<sup>176</sup> See EGC White Paper 22. Based on staff analysis as of the Nov. 15, 2022 measurement date, U.S. firms audited 2,548 EGCs, of which 817 were audited by firms that issued audit reports for 100 or fewer issuer audit clients.

filers or 30 days for non-accelerated filers, as compared to the time period for LAFs, to assemble the required final workpapers during a period that may be proportionately less busy.

The amendment to accelerate the documentation completion date could improve efficiency and capital formation for EGCs to the extent that the amendment reduces uncertainty about the reliability of an EGC's financial statements via enhanced audit quality. Investors who are uncertain about the reliability of an EGC's financial statements may require a larger risk premium that reduces the efficient allocation of capital or increases the cost of capital. Thus, any reduction of uncertainty via enhanced audit quality, including from firms' implementation of operating efficiencies, could improve the efficiency of capital allocation, lower the cost of capital, and enhance capital formation for those EGCs.

The amendment to accelerate the documentation completion date could also impact competition in an EGC product market if any indirect costs to audited companies disproportionately affect EGCs relative to their competitors. For example, if EGCs are forced to raise prices in order to remain viable but their non-EGC competitors are not forced to raise prices, this may divert market share toward their non-EGC competitors. This could increase competition in markets where EGCs have a dominant market share and decrease competition in markets where EGCs have a less than dominant market share. However, the incentives for firms to pass costs onto EGCs may also be limited by competition for audits.

The proposal sought comments on the applicability of the proposed requirements to audits of EGCs. Several commenters agreed that the requirements of AS 1000 should apply to the audits of EGCs. One commenter suggested that the audits of EGCs should be subject to stricter requirements because non-accelerated filers have a higher incidence of restatements and because small capitalization issuers have a higher proportion of equity owned by individual investors but less coverage by sell-side analysts.<sup>177</sup> However, we continue to believe the same standard and related amendments should apply to audits of EGCs and non-EGCs to avoid the potential for confusion that could accompany differences within firms' policies and procedures with respect to audits of EGCs and non-EGCs.

Accordingly, and for the reasons explained above, the Board will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the standard and related amendments to audits of EGCs.

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<sup>177</sup> See, e.g., Audit Analytics, *2021 Financial Restatements: A Twenty-One Year Review* (May 2022) and Garnet Roach, *Only Small Caps See Minority of Shares Held by Institutions, Research Shows*, IR Magazine (Jan. 18, 2022).

## VI. EFFECTIVE DATE

In the proposing release, the Board sought comment on the amount of time auditors would need before the proposed standard and related proposed amendments to PCAOB standards would become effective, if adopted by the Board and approved by the SEC. We proposed an effective date of June 30 of the year after approval by the SEC.

A number of commenters, mostly firms, suggested that an effective date be based on a fiscal year end date (e.g., audits of fiscal years ending on or after December 15) rather than the proposed effective date of June 30 in the year after SEC approval. These commenters generally pointed to challenges associated with a mid-year implementation (e.g., need to update firm methodologies for foundational standards and for performance standards amended by this project, provide training). Specific dates suggested by commenters included: (i) audits of periods beginning on or after December 15, 2024 (assuming 2023 SEC approval); (ii) 12 months after SEC approval; (iii) 18 months after SEC approval; and (iv) 24 months after SEC approval.

In addition, a firm and a firm-related group suggested that we consider the effective dates for other standard-setting projects such as QC 1000 when setting the effective date for AS 1000. In response to commenters, and after considering the effective dates for other Board rulemaking projects, we have revised the effective date for the new standard and related amendments.

Subject to approval by the SEC, the new standard and related amendments will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2024, except for the 14-day documentation completion date requirement (AS 1215.15). For that requirement, we are adopting a phased approach to provide smaller firms more time to prepare for implementation. The requirement will take effect as follows:

- For public accounting firms that, during the calendar year ending December 31, 2024, issued audit reports with respect to more than 100 issuers, the 14-day documentation completion requirement will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2024; and
- For all other registered public accounting firms, the 14-day documentation completion requirement will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025.

We believe that changing the effective date to fiscal years beginning on or after December 15, 2024 responds to commenters who (i) expressed concerns about having a mid-year implementation and (ii) suggested that an effective date be based on a fiscal year-end date. Given the nature of requirements of the new standard and related amendments, as well as the extent of the differences between the new standard and the foundational standards, we believe that the general effective date will provide auditors with reasonable time to implement the new standard and related amendments. Further, extending the effective date for

implementation of the 14-day documentation completion date requirement responds to the need articulated by commenters to provide smaller firms more time to prepare for implementation.

\* \* \*

On the 13th day of May, in the year 2024, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown  
Secretary

May 13, 2024



## APPENDIX 1 – Auditing Standard

### AS 1000: General Responsibilities of the Auditor in Conducting an Audit

#### INTRODUCTION

.01 The auditor has a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports. This responsibility transcends an auditor’s relationship with management and the audit committee of the company under audit, providing the foundation for an objective and independent audit. A properly conducted audit and the related auditor’s report enhance the confidence of investors and other financial statement users<sup>1</sup> in the company’s financial statements and, if applicable, internal control over financial reporting.

Note: The auditor’s obligation to protect investors provides important context to the auditor’s work when applying the requirements of this and other Public Company Accounting Oversight Board (“PCAOB”) standards and rules.

.02 This standard describes the general principles and responsibilities of the auditor in properly conducting an audit in accordance with the standards of the PCAOB. This standard sets out the objectives of the auditor, establishes requirements for the auditor’s professional qualifications and the auditor’s general responsibilities applicable in all audits, and describes auditing principles relevant to conducting the audit.

#### OBJECTIVES OF THE AUDITOR

- .03 The objectives of the auditor are to:
- a. In an audit of financial statements – (1) obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud; and (2) issue an auditor’s report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework;
  - b. In an audit of internal control over financial reporting – (1) obtain reasonable assurance about whether material weaknesses exist as of the date specified in management’s assessment; and (2) issue an auditor’s report that expresses an

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<sup>1</sup> This standard uses “investors and other financial statement users” to include a company’s existing and potential shareholders, bondholders, lenders, other creditors, and others who use the company’s financial statements.

opinion on the effectiveness of the company’s internal control over financial reporting;

- c. Communicate externally in accordance with **applicable professional and legal requirements**;<sup>2</sup> and
- d. Satisfy and fulfill the other general principles and responsibilities described in this standard.

## PROFESSIONAL QUALIFICATIONS OF THE AUDITOR

### Independence and Ethics

.04 The auditor must be independent of the company under audit both in fact and in appearance throughout the audit and professional engagement period.<sup>3</sup> The auditor is not independent with respect to the company under audit if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all matters encompassed within the engagement.<sup>4</sup>

.05 The auditor must satisfy the independence criteria set out in the rules and standards of the PCAOB, and satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) under the federal securities laws.<sup>5</sup>

.06 The auditor must comply with applicable ethics requirements, including the ethics rules and standards of the PCAOB.<sup>6</sup>

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<sup>2</sup> The term is defined in Appendix A, *Definition*, and is set in **boldface type** the first time it appears.

<sup>3</sup> See PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, for the definition of the term “audit and professional engagement period.”

<sup>4</sup> See Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01 for the analogous provision on auditor independence. For the purposes of this standard, the phrase “company under audit” has the same meaning as “audit client” under PCAOB Rule 3501(a)(iv).

<sup>5</sup> See, e.g., Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01, and Section 3, Part 5 of PCAOB rules. To the extent that a provision of one rule is more restrictive than that of another rule, the auditor is required to comply with the more restrictive provision. See PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.

<sup>6</sup> See, e.g., Section 3, Part 5 of PCAOB rules; EI 1000, *Integrity and Objectivity*, which requires auditors to maintain integrity and objectivity.

## Competence

.07 The audit must be performed by an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements. Competence consists of having the knowledge, skill, and ability that enable the auditor to perform their assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures. Competence is measured both qualitatively and quantitatively.

Note: Competence includes knowledge and proficiency in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

.08 The auditor should develop and maintain competence through an appropriate combination of:

- a. Academic education;
- b. Professional experience in accounting and auditing, with proper supervision;<sup>7</sup> and
- c. Training, including accounting, auditing, independence, ethics, and other relevant continuing professional education.

## DUE PROFESSIONAL CARE, INCLUDING PROFESSIONAL SKEPTICISM

.09 The auditor must exercise due professional care in all matters related to the audit.<sup>8</sup> Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements.<sup>9</sup>

.10 For the engagement partner,<sup>10</sup> due professional care also includes (1) being responsible

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<sup>7</sup> Paragraphs .05 and .06 of AS 1201, *Supervision of the Audit Engagement*, describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members.

<sup>8</sup> For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care. The lead auditor's responsibilities for planning the audit and supervising the other auditors' work are set forth in AS 2101, *Audit Planning*, and AS 1201.

<sup>9</sup> See also note to AS 1201.05b.

<sup>10</sup> The term "engagement partner," as used in this standard, has the same meaning as defined in Appendix A of AS 1201.

for the appropriate assignment of responsibilities to,<sup>11</sup> and supervision of,<sup>12</sup> engagement team members;<sup>13</sup> (2) determining that the audit is properly planned<sup>14</sup> and performed to obtain reasonable assurance;<sup>15</sup> (3) evaluating that significant findings or issues are appropriately addressed;<sup>16</sup> (4) determining that significant judgments and conclusions on which the auditor's report is based are appropriate and supported by sufficient appropriate audit evidence;<sup>17</sup> and (5) determining that required communications under applicable professional and legal requirements have been made.<sup>18</sup>

.11 Exercising due professional care includes exercising professional skepticism in conducting an audit. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. The auditor's exercise of professional skepticism includes:

- a. Objectively evaluating evidence obtained in an audit (including information that supports and corroborates management's assertions<sup>19</sup> and information that contradicts such assertions), and consideration of the sufficiency and the appropriateness (i.e., relevance and reliability) of that evidence;<sup>20</sup>
- b. Remaining alert to conditions that may indicate possible misstatement due to error or fraud;
- c. Not being satisfied with evidence that is less than persuasive;

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<sup>11</sup> Paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding the assignment of engagement team members.

<sup>12</sup> See AS 1201.

<sup>13</sup> The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

<sup>14</sup> See AS 2101.03, which describes the engagement partner's responsibility for planning an audit.

<sup>15</sup> See paragraph .13 of this standard.

<sup>16</sup> See paragraph .12 of AS 1215, *Audit Documentation*.

<sup>17</sup> See, e.g., paragraphs .09-.10 of AS 1220, *Engagement Quality Review*. See also AS 2810, *Evaluating Audit Results*.

<sup>18</sup> See paragraph .20 of this standard.

<sup>19</sup> See AS 1105, *Audit Evidence*, for management's assertions regarding the financial statements and internal control over financial reporting.

<sup>20</sup> See AS 1105, which explains what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence.

- d. Not assuming that management is honest or dishonest; and
- e. Considering potential bias on the part of management and the auditor.

## PROFESSIONAL JUDGMENT

.12 The auditor must exercise professional judgment, which involves applying relevant training, knowledge, and experience to make informed decisions and reach well-reasoned conclusions about the courses of action that are appropriate in the circumstances.<sup>21</sup>

Note: Professional judgment is applied in the context of conducting an audit with due professional care in accordance with applicable professional and legal requirements.

## CONDUCTING AN AUDIT

.13 The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to:

- a. Obtain reasonable assurance about whether:
  - (1) In an audit of financial statements, the financial statements are free of material misstatement,<sup>22</sup> whether due to error or fraud;<sup>23</sup>
  - (2) In an audit of internal control over financial reporting, material weaknesses exist as of the date specified in management’s assessment; and
- b. Provide the auditor with a reasonable basis for forming an opinion.<sup>24</sup>

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<sup>21</sup> References to judgment of the auditor in other PCAOB standards have the same meaning as “professional judgment.” See, e.g., AS 1215.07 and AS 1220.02.

<sup>22</sup> The term “misstatement,” as used in this standard, has the same meaning as defined in Appendix A of AS 2810.

<sup>23</sup> See AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, for requirements regarding the auditor’s consideration of materiality in planning and performing an audit. See AS 2401, *Consideration of Fraud in a Financial Statement Audit*. See also paragraph .05 of AS 2405, *Illegal Acts by Clients*.

<sup>24</sup> In circumstances when the auditor is not able to obtain sufficient appropriate audit evidence to provide a reasonable basis for forming an opinion, PCAOB standards require the auditor to disclaim an opinion or withdraw (or resign) from the engagement. See AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, for a financial statement audit and paragraphs .90 through

Note: In an audit of financial statements, the financial statements, including their preparation, are management’s responsibility and the auditor’s responsibility is to express an opinion on the financial statements. In an audit of internal control over financial reporting, management is responsible for establishing and maintaining effective internal control over financial reporting and for assessing the effectiveness of internal control over financial reporting, and the auditor’s responsibility is to express an opinion on the effectiveness of the company’s internal control over financial reporting.

.14 Reasonable assurance is not absolute assurance, but a high level of assurance. It is obtained by reducing audit risk to an appropriately low level through the application of due professional care, including by obtaining sufficient appropriate audit evidence.<sup>25</sup> The auditor obtains reasonable assurance that (1) misstatements are detected that, individually or in combination, would result in material misstatement of the financial statements; and (2) in an audit of internal control over financial reporting, material weaknesses are detected.

.15 The auditor must comply with applicable professional and legal requirements in conducting an audit.

Note: When complying with PCAOB standards, the auditor should also take into account PCAOB auditing interpretations<sup>26</sup> applicable to the audit.

.16 The auditor must prepare audit documentation in connection with each engagement conducted in accordance with the standards of the PCAOB.<sup>27</sup> Audit documentation facilitates the planning, performance, and supervision of the engagement and is the basis for reviewing the quality of the work performed in an audit because it provides the engagement partner and other reviewers with written documentation of the evidence supporting the auditor’s significant conclusions.<sup>28</sup> AS 1215 also sets forth requirements for the assembly and retention

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.98 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and Appendix C of AS 2201, for an audit of internal control over financial reporting.

<sup>25</sup> See paragraphs .03-.04 of AS 1101, *Audit Risk*. In a financial statement audit, audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated, *i.e.*, the financial statements are not presented fairly in conformity with the applicable financial reporting framework.

<sup>26</sup> PCAOB auditing interpretations refer to the PCAOB publications entitled “Auditing Interpretations” as currently in effect.

<sup>27</sup> See, *e.g.*, AS 1215; AS 1301, *Communications with Audit Committees*; and AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

<sup>28</sup> See generally AS 1215.

of audit documentation.<sup>29</sup>

## Auditor Communications

.17 The auditor's report must contain:

- a. In an audit of financial statements, an expression of opinion on the financial statements, taken as a whole, or an assertion that an opinion cannot be expressed; and
- b. In an audit of internal control over financial reporting, an expression of opinion on the effectiveness of the company's internal control over financial reporting or an assertion that an opinion cannot be expressed.

Note: The auditor's report also contains other elements, such as those included in the basis for opinion or basis for disclaimer of opinion sections, and, if applicable, critical audit matters.<sup>30</sup>

.18 The auditor should express an unqualified opinion only when the auditor has performed the audit in accordance with the standards of the PCAOB and has obtained sufficient appropriate audit evidence to conclude that:

- a. In an audit of financial statements, the financial statements, taken as a whole, are presented fairly,<sup>31</sup> in all material respects, in conformity with the applicable financial reporting framework;<sup>32</sup>
- b. In an audit of internal control over financial reporting, the company maintained,

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<sup>29</sup> See AS 1215.14-.20.

<sup>30</sup> See AS 3101 and AS 3105. AS 3101.18 also includes a list of other PCAOB standards with requirements that, in certain circumstances, the auditor include explanatory language (or an explanatory paragraph) in the auditor's report, while not affecting the auditor's opinion on the financial statements. For example, an explanatory paragraph is required when there is substantial doubt about the company's ability to continue as a going concern.

<sup>31</sup> AS 2810.30-.31 describe the auditor's responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

<sup>32</sup> See AS 3101 for requirements regarding the content of the auditor's written report when the auditor expresses an unqualified opinion on the financial statements. The auditor should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

in all material respects, effective internal control over financial reporting.<sup>33</sup>

.19 When the auditor conducts an audit in accordance with the standards of the PCAOB, some circumstances require that the auditor depart from an unqualified opinion on the company's financial statements or internal control over financial reporting, and state the reasons for the departure from the unqualified opinion.<sup>34</sup>

.20 The auditor must communicate externally in accordance with applicable professional and legal requirements.<sup>35</sup>

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<sup>33</sup> See AS 2201.85-.98 for the form and content of the auditor's report when the auditor conducts an audit of internal control over financial reporting.

<sup>34</sup> See AS 3105 for reporting requirements related to departures from unqualified opinions and other reporting circumstances. See also AS 2201.90-.98 and Appendix C of AS 2201, for special reporting situations in an audit of internal control over financial reporting.

<sup>35</sup> See, e.g., AS 1301; PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.



## APPENDIX A – Definition

.A1 For purposes of this standard, the term below is defined as follows:

.A2 Applicable professional and legal requirements –

- (1) Professional standards, as defined in PCAOB Rule 1001(p)(vi);
- (2) Rules of the PCAOB that are not professional standards; and
- (3) To the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the quality control system, rules of the SEC, other provisions of U.S. federal securities law, ethics laws and regulations, and other applicable statutory, regulatory, and other legal requirements.

## APPENDIX 2 – Amendments to Related PCAOB Auditing Standards

In connection with the adoption of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (“AS 1000”), the Board is rescinding certain of its auditing standards and adopting amendments to several related PCAOB auditing standards.

### Auditing Standards Rescinded

|   |
|---|
| <i>AS 1001, Responsibilities and Functions of the Independent Auditor</i>                                   |
| <i>AS 1005, Independence</i>  |
| <i>AS 1010, Training and Proficiency of the Independent Auditor</i>   |
| <i>AS 1015, Due Professional Care in the Performance of Work</i>  |
| <i>AS 2815, The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”</i> |

### Auditing Standards Amended

| PCAOB Standard | Title                               | Paragraphs Amended                                |
|----------------|-------------------------------------|---|
| AS 1201        | Supervision of the Audit Engagement | .03, .04, .05, .06, and .C4                       |
| AS 1215        | Audit Documentation                 | .02, .03, .06, .06A (new), .07, .11, .12, and .15 |
| AS 2101        | Audit Planning                      | .03, .07, and .09                                 |
| AS 2810        | Evaluating Audit Results            | .17, .30, .30A (new), and .31                     |

### Amendments to AS 1201

- I. AS 1201 is amended by adding footnote 1B and deleting footnote 6 to paragraph .03 to read as follows:

.03 The **engagement partner**<sup>1A</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members<sup>1B</sup> (including engagement team members outside the engagement partner’s firm). The engagement partner also is responsible for compliance with PCAOB standards, including standards regarding: using the work of specialists,<sup>2</sup> internal auditors,<sup>4</sup> and others who are involved in testing controls;<sup>5</sup> and dividing responsibility with another accounting firm.<sup>5A</sup> Paragraphs .05–.06 of this standard describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members. Paragraphs .07–.15 of this standard further describe procedures to be performed by the lead auditor with respect

to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth in this standard.<sup>6A</sup>

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<sup>1B</sup> See also paragraph .10 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for an additional description of due professional care as it relates to the engagement partner.

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[<sup>6</sup>] [Footnote deleted.]

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II. AS 1201 is amended by adding a note to paragraph .04 to read as follows:

.04 The engagement partner may seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in this standard with respect to the supervisory responsibilities assigned to them.

Note: When the engagement partner seeks assistance, the engagement partner nevertheless retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner's responsibility.

III. AS 1201 is amended by revising footnote 7 of paragraph .05a.; revising the note to paragraph .05b.; and adding Note 1 and Note 2 to paragraph .05c., to read as follows:

.05 The engagement partner and, as applicable, other engagement team members performing supervisory activities, should:

a. Inform engagement team members of their responsibilities,<sup>7</sup> including:

<sup>7</sup> Paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding the appropriate assignment of engagement team members. See also AS 1000.10, for an additional description of due professional care as it relates to the engagement partner.

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b. Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards;<sup>9</sup>

Note: In applying due professional care in accordance with AS 1000, each engagement team member has a responsibility to bring to the attention of appropriate persons, disagreements or concerns the engagement team member might have with respect to accounting and auditing issues that he or she believes are of significance to the financial statements or the auditor's report regardless of how those disagreements or concerns may have arisen.

c. Review the work of engagement team members to evaluate whether:

- (1) The work was performed and documented;
- (2) The objectives of the procedures were achieved; and
- (3) The results of the work support the conclusions reached.<sup>10</sup>

Note 1: The review and evaluation must be completed prior to the report release date (see AS 1215.06 and .15).

Note 2: Notwithstanding assistance from other engagement team members performing supervisory activities, the engagement partner, as the individual primarily responsible for the engagement and its performance, must review documentation sufficient to determine that (i) the engagement was performed as planned; (ii) significant judgments were appropriate and significant findings and issues, along with matters brought to the engagement partner's attention pursuant to paragraph .05b, were appropriately addressed; (iii) the conclusions expressed in the auditor's report are appropriate and supported by sufficient appropriate evidence; and (iv) matters requiring communication under applicable professional and legal requirements are appropriately identified and communicated. The engagement partner's review should include review of documentation of significant findings or issues (see AS 1215.12) and review of documentation required to be reviewed by the engagement quality reviewer pursuant to the requirements of paragraphs .09-.10 and .14-.15 of AS 1220, *Engagement Quality Review*.

## IV. AS 1201 is amended by revising footnote 12 to paragraph .06 to read as follows:

.06 To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, the engagement partner and other engagement team members performing supervisory activities should take into account:

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d. The knowledge, skill, and ability of each engagement team member.<sup>12</sup>

<sup>12</sup> See also AS 2301.05a.

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## V. AS 1201 is amended by revising footnote 1 to paragraph .C4 to read as follows:

.C4 Pursuant to paragraph .05a(3) of this standard, the engagement partner and, as applicable, other engagement team members performing supervisory activities should inform the specialist about matters that could affect the specialist's work. This includes, as applicable, information about the company and its environment, the company's processes for developing the related accounting estimate, the company's use of specialists in developing the estimate, relevant requirements of the applicable financial reporting framework, possible accounting and auditing issues, and the need to apply professional skepticism.<sup>1</sup>

<sup>1</sup> See paragraph .11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for further discussion of the concept of professional skepticism.

**Amendments to AS 1215**

## VI. AS 1215 is amended by revising paragraph .02 to read as follows:

.02 *Audit documentation* is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer (e.g., engagement partner or other reviewers) with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

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VII. AS 1215 is amended by revising paragraph .03 and adding footnote 1B to read as follows:

.03 Audit documentation is reviewed by members of the engagement team<sup>1A</sup> performing the work and might be reviewed by others. Reviewers might include, for example:

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e. Internal and external inspection teams that review documentation to assess audit quality and compliance with applicable professional and legal requirements<sup>1B</sup> and the auditor's own quality control policies and procedures.

\*\*\*

<sup>1B</sup> "Applicable professional and legal requirements" is defined in paragraph .A2 of AS 1000, *General Responsibilities of the Auditor in Conducting and Audit*.

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VIII. AS 1215 is amended by revising paragraph .06 and adding paragraph .06A to read as follows:

.06 The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.<sup>2</sup> Audit documentation must clearly demonstrate that the work was in fact performed, who performed the work, the person or persons who reviewed the work, and the date of such review. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions.

.06A Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person or persons who reviewed the work and the date of such review.

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- IX. AS 1215 is amended by adding a footnote 2A to paragraph .07 to read as follows (and by revising the numbering of footnotes 2A, 2B, and 2C to paragraph .12 to read as footnotes 2B, 2C, and 2D, respectively):

.07 In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;
- Extent of judgment<sup>2A</sup> required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;

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<sup>2A</sup> Reference to the judgment of the auditor has the same meaning as “professional judgment” as described in AS 1000.

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- X. AS 1215 is amended by revising paragraph .11 to read as follows:

.11 Certain matters, such as auditor independence, staff competence and training, and acceptance and continuance of engagements, may be documented in a central repository for the public accounting firm (“firm”) or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

- XI. AS 1215 is amended by revising paragraph .15 to read as follows:

.15 Prior to the report release date, (i) the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor’s report, and (ii) the engagement partner and other engagement team members performing supervisory activities must have completed their reviews of audit documentation. A complete and final set of audit documentation should be assembled for retention (i.e., archived) as of a date not more than 14 days after the report release date (*documentation completion date*). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 14 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the

documentation completion date should not be more than 14 days from the date the engagement ceased.

## Amendments to AS 2101

XII. AS 2101 is amended by adding a note to paragraph .03 to read as follows:

.03 The **engagement partner**<sup>1</sup> is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate **engagement team** members (which may include engagement team members outside the engagement partner’s firm) in fulfilling this responsibility. Engagement team members who assist the engagement partner with audit planning also should comply with the relevant requirements in this standard.

Note: When the engagement partner seeks assistance, the engagement partner nevertheless retains primary responsibility for the engagement and its performance. The assistance provided by appropriate engagement team members to supervise, including review, the work of other engagement team members does not replace or reduce the engagement partner’s responsibility.

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XIII. AS 2101 is amended by adding a footnote 4J to paragraph .07 to read as follows:

.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor’s previous experience with the company, and changes in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, the auditor should evaluate whether the following matters are important to the company’s financial statements and internal control over financial reporting and, if so, how they will affect the auditor’s procedures:

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- The auditor’s preliminary judgments<sup>4J</sup> about materiality,<sup>5</sup> risk, and, in integrated audits, other factors relating to the determination of material weaknesses;

<sup>4J</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XIV. AS 2101 is amended by revising footnote 10 to paragraph .09 to read as follows:

.09 In establishing the overall audit strategy, the auditor should take into account:

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d. The nature, timing, and extent of resources necessary to perform the engagement.<sup>10</sup>

<sup>10</sup> See, e.g., paragraph .16 of this standard, and AS 2301.05a.

### **Amendments to AS 2810**

XV. AS 2810 is amended by adding footnote 9A to paragraph .17 to read as follows:

.17 *Evaluation of the Effect of Uncorrected Misstatements.* The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors.<sup>7</sup> (See Appendix B.)

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Note: As a result of the interaction of quantitative and qualitative considerations in materiality judgments,<sup>9A</sup> uncorrected misstatements of relatively small amounts could have a material effect on the financial statements. For example, an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility<sup>10</sup> that it could lead to a material contingent liability or a material loss of revenue.<sup>11</sup> Also, a misstatement made intentionally could be material for qualitative reasons, even if relatively small in amount.

<sup>9A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XVI. AS 2810 is amended by revising the first Note and adding footnote 17B to paragraph .30 to read as follows:

.30 The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.<sup>17B</sup>

Note: The applicable financial reporting framework provides the basis for the auditor’s judgment regarding the presentation of financial position, results of operations, cash flows, and disclosures in financial statements.

Note: The auditor should look to the requirements of the U.S. Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.

<sup>17B</sup> AS 2820, *Evaluating Consistency of Financial Statements*, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.

XVII. AS 2810 is amended by adding a new paragraph .30A and footnotes 17C and 17D to read as follows:

.30A When evaluating whether the financial statements (including the accompanying notes) present fairly the financial position, results of operations, and cash flows, in all material respects, in conformity with the applicable financial reporting framework, the auditor should evaluate whether:<sup>17C</sup>

- a. The financial statements are informative of matters that may affect their use, understanding, and interpretation; and the information in the financial statements is presented and classified appropriately and in a manner that is not misleading;<sup>17D</sup>
- b. The accounting principles selected and applied by the company’s management are appropriate in the circumstances; and
- c. Company transactions and relevant events and conditions are appropriately recognized, measured, and disclosed in the financial statements.

<sup>17C</sup> The concept of materiality is inherent in the auditor’s judgment. That concept involves qualitative as well as quantitative factors (*see* AS 2105).

<sup>17D</sup> Regulation S-X Rule 4-01(a), 17 C.F.R. § 210.4-01(a), requires issuers to include in financial statements any further material information as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading.

XVIII. AS 2810 is amended by revising and moving footnote 18 and deleting a Note to paragraph .31 to read as follows:

.31 As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting

framework.<sup>18</sup> Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

<sup>18</sup> See AS 3105.24–.27 for auditor reporting considerations related to inadequate disclosures.

## APPENDIX 3 – Other Amendments to PCAOB Standards

In connection with the adoption of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, and related amendments, the Board is adopting conforming amendments to its auditing standards, auditing interpretations, and attestation standards. The table below is a reference tool for the amendments.

### Auditing Standards Amended

| PCAOB Standard | Title  | Paragraph(s) Amended   |
|----------------|--|------------------------|
| AS 1101        | Audit Risk   | .03                    |
| AS 1105        | Audit Evidence   | .B2                    |
| AS 1220        | Engagement Quality Review  | .02 and .12            |
| AS 2201        | An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements | .03, .04, and .09      |
| AS 2301        | The Auditor’s Responses to the Risks of Material Misstatement  | .05 and .07            |
| AS 2305        | Substantive Analytical Procedures  | .09                    |
| AS 2315        | Audit Sampling   | .02                    |
| AS 2401        | Consideration of Fraud in a Financial Statement Audit  | .01, .04, .12, and .13 |
| AS 2405        | Illegal Acts by Clients  | .05                    |
| AS 2410        | Related Parties  | .02                    |
| AS 2501        | Auditing Accounting Estimates, Including Fair Value Measurements   | .27 and .30            |
| AS 2505        | Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments                                    | .13                    |
| AS 2601        | Consideration of an Entity’s Use of a Service Organization   | .32                    |
| AS 2605        | Consideration of the Internal Audit Function   | .19                    |
| AS 2610        | Initial Audits—Communications Between Predecessor and Successor Auditors                                       | .11                    |
| AS 2710        | Other Information in Documents Containing Audited Financial Statements   | .05                    |
| AS 2805        | Management Representations   | .02                    |
| AS 3101        | The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion     | .01, .02, and .11      |

| PCAOB Standard | Title   | Paragraph(s) Amended       |
|----------------|---|----------------------------|
| AS 3105        | Departures from Unqualified Opinions and Other Reporting Circumstances                                      | .50                        |
| AS 3305        | Special Reports   | .03 and .09                |
| AS 4105        | Reviews of Interim Financial Information  | .01 and .07                |
| AS 6105        | Reports on the Application of Accounting Principles   | .07 and .08                |
| AS 6115        | Reporting on Whether a Previously Reported Material Weakness Continues to Exist                             | .21 and .38                |
| AI 11          | Using the Work of a Specialist: Auditing Interpretations  | .04                        |
| AI 18          | Consideration of an Entity’s Use of a Service Organization: Auditing Interpretations of AS 2601             | .03                        |
| AI 23          | Departures from Unqualified Opinions and Other Reporting Circumstances: Auditing Interpretations of AS 3105 | .06                        |
| AI 24          | Special Reports: Auditing Interpretations of AS 3305  | .61                        |
| AT No. 1       | Examination Engagements Regarding Compliance Reports of Brokers and Dealers                                 | 6.                         |
| AT No. 2       | Review Engagements Regarding Exemption Reports of Brokers and Dealers                                       | 5.                         |
| AT Section 101 | Attest Engagements  | .19, .40 and .41 (deleted) |
| AT Section 301 | Financial Forecasts and Projections   | .66                        |
| AT Section 601 | Compliance Attestation  | .31                        |
| AT Section 701 | Management’s Discussion and Analysis  | .29                        |

I. AS 1101 is amended by revising footnote 3 to paragraph .03 to read as follows:

.03 To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement<sup>2</sup> due to error or fraud. Reasonable assurance<sup>3</sup> is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence.

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<sup>3</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of reasonable assurance.

II. AS 1105 is amended by adding footnote 1A to paragraph .B2 to read as follows:

.B2 If in the auditor's judgment<sup>1A</sup> additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results.

<sup>1A</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

III. AS 1220 is amended by adding footnote 1B to paragraph .02 to read as follows:

.02 The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments<sup>1B</sup> made by the engagement team<sup>1A</sup> and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.<sup>1</sup>

<sup>1B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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IV. AS 1220 is amended by revising footnote 6 to paragraph .12 to read as follows:

.12 In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care<sup>6</sup> the review required by this standard, he or she is not aware of a significant engagement deficiency.

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<sup>6</sup> See AS 1000.09 and .11 for a discussion of the concept of due professional care.

V. AS 2201 is amended by revising footnote 5 to paragraph .03 to read as follows:

.03 The auditor’s objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company’s internal control over financial reporting. Because a company’s internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance<sup>5</sup> about whether material weaknesses exist as of the date specified in management’s assessment. A material weakness in internal control over financial reporting may exist even when financial statements are not materially misstated.

<sup>5</sup> See paragraph .14 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of the concept of reasonable assurance in an audit.

VI. AS 2201 is amended by revising paragraph .04 to read as follows:

.04 AS 1000 is applicable to an audit of internal control over financial reporting. That standard requires that the auditor be independent, comply with independence and ethics requirements, be competent, and exercise due professional care, including professional skepticism. This standard establishes the fieldwork and reporting standards applicable to an audit of internal control over financial reporting.

VII. AS 2201 is amended by adding footnote 7B to paragraph .09 to read as follows:

.09 The auditor should properly plan the audit of internal control over financial reporting and properly supervise the engagement team<sup>7A</sup> members. When planning an integrated audit, the auditor should evaluate whether the following matters are important to the company’s financial statements and internal control over financial reporting and, if so, how they will affect the auditor’s procedures –

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- The auditor’s preliminary judgments<sup>7B</sup> about materiality, risk, and other factors relating to the determination of material weaknesses;

<sup>7B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000.

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VIII. AS 2301 is amended by deleting footnote 1 to paragraph .05a and revising footnote 3 to paragraph .05d to read as follows:

.05 The auditor should design and implement overall responses to address the assessed risks of material misstatement as follows:

a. *Making appropriate assignments of significant engagement responsibilities.* The knowledge, skill, and ability of engagement team<sup>1A</sup> members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.

[<sup>1</sup>] [Footnote deleted.]

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d. *Evaluating the company’s selection and application of significant accounting principles.* The auditor should evaluate whether the company’s selection and application of significant accounting principles, particularly those related to subjective measurements and complex transactions,<sup>3</sup> are indicative of bias that could lead to material misstatement of the financial statements.

<sup>3</sup> AS 2110.12-.13 discuss the auditor’s responsibilities regarding obtaining an understanding of the company’s selection and application of accounting principles. *See also* paragraphs .66-.67A of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, and paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*.

IX. AS 2301 is amended by revising footnote 4 to paragraph .07 to read as follows:

.07 Due professional care requires the auditor to exercise professional skepticism.<sup>4</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence. The auditor’s responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence.<sup>5</sup> Examples of the application of professional skepticism in response to the assessed fraud risks are (a) modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management’s explanations or representations concerning important matters, such as through third-party confirmation, use of



a specialist engaged or employed by the auditor,<sup>5A</sup> or examination of documentation from independent sources.

<sup>4</sup> See paragraphs .09 and .11 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a discussion of due professional care and professional skepticism.

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X. AS 2305 is amended by adding footnote 2 to paragraph .09 to read as follows:

.09 The auditor's reliance on substantive tests to achieve an audit objective related to a particular assertion<sup>1</sup> may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedure or procedures to use to achieve a particular audit objective is based on the auditor's judgment<sup>2</sup> on the expected effectiveness and efficiency of the available procedures. For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient. (See paragraph .11 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.)

<sup>2</sup> Reference to the judgment of the auditor has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XI. AS 2315 is amended by adding footnote 2A to paragraph .02 to read as follows:

.02 The auditor often is aware of account balances and transactions that may be more likely to contain misstatements.<sup>2</sup> He considers this knowledge in planning his procedures, including audit sampling. The auditor usually will have no special knowledge about other account balances and transactions that, in his judgment,<sup>2A</sup> will need to be tested to fulfill his audit objectives. Audit sampling is especially useful in these cases.

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<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XII. AS 2401 is amended by revising paragraph .01 to read as follows:

.01 Paragraph .13 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, requires the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence to obtain reasonable assurance about whether the financial statements are free of

material misstatement whether due to error or fraud.<sup>1</sup> This section establishes requirements and provides direction relevant to fulfilling that responsibility, as it relates to fraud, in an audit of financial statements.<sup>2</sup>

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XIII. AS 2401 is amended by revising paragraph .04 to read as follows:

.04 Although this section focuses on the auditor's consideration of fraud in an audit of financial statements, it is management's responsibility to design and implement programs and controls to prevent, deter, and detect fraud.<sup>3</sup> Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. Management, along with those who have responsibility for oversight of the financial reporting process (such as the audit committee, board of trustees, board of directors, or the owner in owner-managed entities), should set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud. When management and those responsible for the oversight of the financial reporting process fulfill those responsibilities, the opportunities to commit fraud can be reduced significantly.

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XIV. AS 2401 is amended by revising paragraph .12 and footnote 7 to read as follows:

.12 As indicated in paragraph .01, the auditor has a responsibility to plan and perform the audit to obtain sufficient appropriate audit evidence for the auditor to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error.<sup>7</sup> However, absolute assurance is not attainable and thus even a properly planned and performed audit may not detect a material misstatement resulting from fraud. A material misstatement may not be detected because of the nature of audit evidence or because the characteristics of fraud as discussed above may cause the auditor to rely unknowingly on audit evidence that appears to be valid, but is, in fact, false and fraudulent. Furthermore, audit procedures that are effective for detecting an error may be ineffective for detecting fraud.

<sup>7</sup> For a discussion of the concept of reasonable assurance, see AS 1000.14.

XV. AS 2401 is amended by revising paragraph .13 to read as follows:

.13 Due professional care requires the auditor to exercise professional skepticism. See AS 1000.09 and .11. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the fraud risks. Professional skepticism is an attitude

that includes a questioning mind and a critical assessment of information related to the audit. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. In exercising professional skepticism in gathering and evaluating evidence, the auditor should not be satisfied with less-than-persuasive evidence and avoid assumptions that management is honest or dishonest.

XVI. AS 2405 is amended by revising paragraph .05 to read as follows:

.05 The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. For example, tax laws affect accruals and the amount recognized as expense in the accounting period; applicable laws and regulations may affect the amount of revenue accrued under government contracts. However, the auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statements assertions rather than from the perspective of legality *per se*. The auditor's responsibility to detect and report misstatements resulting from illegal acts having a direct and material effect on the determination of financial statement amounts is the same as that for misstatements due to error or fraud as described in paragraph .13 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XVII. AS 2410 is amended by revising footnote 2 to paragraph .02 to read as follows:

.02 The objective of the auditor is to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements.<sup>2</sup>

<sup>2</sup> See, e.g., paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*.

XVIII. AS 2501 is amended by revising footnote 23 to paragraph .27 to read as follows:

.27 Events and transactions that occur after the measurement date can provide relevant evidence to the extent they reflect conditions at the measurement date.<sup>23</sup>

<sup>23</sup> Evaluating audit evidence from events or transactions occurring after the measurement date, as contemplated in this standard, is a substantive test that differs from the other auditing procedures performed under paragraph .12 of AS 2801, *Subsequent Events*.

XIX. AS 2501 is amended by revising footnote 28 to paragraph .30 to read as follows:

.30 AS 2810 requires the auditor to evaluate the results of audit procedures performed on accounting estimates. This includes:

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d. Evaluating the presentation of the financial statements, including the disclosures and whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.<sup>28</sup>

<sup>28</sup> See AS 2810.30-31.

XX. AS 2505 is amended by revising footnote 7 to paragraph .13 to read as follows:

.13 A lawyer's refusal to furnish the information requested in an inquiry letter either in writing or orally (*see* paragraphs .09 and .10) would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion (*see* paragraphs .05 and .06 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*).<sup>7</sup> A lawyer's response to such an inquiry and the procedures set forth in paragraph .05 provide the auditor with sufficient evidential matter to satisfy himself concerning the accounting for and reporting of pending and threatened litigation, claims and assessments. The auditor obtains sufficient evidential matter to satisfy himself concerning reporting for those unasserted claims and assessments required to be disclosed in financial statements from the foregoing procedures and the lawyer's specific acknowledgement of his responsibility to his client in respect of disclosure obligations (*see* paragraph .09g). This approach with respect to unasserted claims and assessments is necessitated by the public interest in protecting the confidentiality of lawyer-client communications.

<sup>7</sup> A refusal to respond should be distinguished from an inability to form a conclusion with respect to certain matters of judgment (*see* paragraph .14). Also, lawyers outside the United States sometimes follow practices at variance with those contemplated by this section to the extent that different procedures from those outlined herein may be necessary. In such circumstances, the auditor should exercise professional judgment in determining whether alternative procedures are adequate to comply with the requirements of this section.

XXI. AS 2601 is amended by adding footnote 2A to paragraph .32 to read as follows:

.32 The service auditor should consider conditions that come to his or her attention that, in the service auditor's judgment,<sup>2A</sup> represent significant deficiencies in the design or operation of the service organization's controls that preclude the service auditor from obtaining reasonable

assurance that specified control objectives would be achieved. The service auditor should also consider whether any other information, irrespective of specified control objectives, has come to his or her attention that causes him or her to conclude (a) that design deficiencies exist that could adversely affect the ability to initiate, record, process, or report financial data to user organizations without error, and (b) that user organizations would not generally be expected to have controls in place to mitigate such design deficiencies.

<sup>2A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXII. AS 2605 is amended by adding footnote 6A to paragraph .19 to read as follows:

.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor divides responsibility for the audit with another public accounting firm,<sup>6</sup> this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments<sup>6A</sup> about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor’s report should always be those of the auditor.

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<sup>6A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXIII. AS 2610 is amended by adding footnote 7A to paragraph .11 to read as follows:

.11 The successor auditor should request that the client authorize the predecessor auditor to allow a review of the predecessor auditor’s working papers. The predecessor auditor may wish to request a consent and acknowledgment letter from the client to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized.<sup>6</sup> It is customary in such circumstances for the predecessor auditor to make himself or herself available to the successor auditor and make available for review certain of the working papers. The predecessor auditor should determine which working papers are to be made available for review and which may be copied. The predecessor auditor should ordinarily permit the successor auditor to review working papers, including documentation of planning, internal control, audit results, and other matters of continuing accounting and auditing significance, such as the working papers containing an analysis of balance sheet accounts, those relating to contingencies, related parties, and significant unusual transactions. Also, the

predecessor auditor should reach an understanding with the successor auditor as to the use of the working papers.<sup>7</sup> The extent, if any, to which a predecessor auditor permits access to the working papers is a matter of judgment.<sup>7A</sup>

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<sup>7A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXIV. AS 2710 is amended by revising paragraph .05 and adding footnote 3 to paragraph .05 to read as follows:

.05 If, while reading the other information for the reasons set forth in paragraph .04, the auditor becomes aware of information that he believes is a material misstatement of fact that is not a material inconsistency as described in paragraph .04, he should discuss the matter with the client. In connection with this discussion, the auditor should consider that he may not have the expertise to assess the validity of the statement, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment<sup>3</sup> or opinion between the auditor and client. If the auditor concludes he has a valid basis for concern he should propose that the client consult with some other party whose advice might be useful to the client, such as the client’s legal counsel.

<sup>3</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXV. AS 2805 is amended by revising footnote 1 to paragraph .02 to read as follows:

.02 During an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit. Written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.<sup>1</sup>

<sup>1</sup> AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, describes the auditor’s general responsibilities, including the responsibility for exercising professional

skepticism, which includes not being satisfied with evidence that is less than persuasive and not assuming that management is honest or dishonest.

- XXVI. AS 3101 is amended by revising paragraph .01, moving footnote 2 to paragraph .01 to paragraph .02, deleting footnote 3 to paragraph .01, and revising footnote 4 to paragraph .02, to read as follows:

.01 This standard establishes requirements regarding the content of the auditor’s written report when the auditor expresses an unqualified opinion on the financial statements<sup>1</sup> (the “auditor’s unqualified report”).

<sup>1</sup> This standard uses the term “financial statements” as used by the U.S. Securities and Exchange Commission (“SEC”) to include all notes to the statements and all related schedules. See Regulation S-X Rule 1-01(b), 17 C.F.R. 210.1-01(b). This and other PCAOB standards often refer to the notes as disclosures; see, e.g., AS 2110, *Identifying and Assessing Risks of Material Misstatement*.

.02 The auditor is in a position to express an unqualified opinion on the financial statements when the auditor conducted an audit in accordance with the standards of the Public Company Accounting Oversight Board (“PCAOB”) and concludes that the financial statements, taken as a whole,<sup>2</sup> are presented fairly, in all material respects,<sup>4</sup> in conformity with the applicable financial reporting framework.<sup>5</sup>

<sup>2</sup> “Taken as a whole” applies equally to a complete set of financial statements and to an individual financial statement with appropriate disclosures.

[<sup>3</sup>] [Footnote deleted.]

<sup>4</sup> Paragraphs .30-.31 of AS 2810, *Evaluating Audit Results*, describe the auditor’s responsibilities related to the evaluation of whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

<sup>5</sup> The auditor should look to the requirements of the SEC for the company under audit with respect to the accounting principles applicable to that company.

- XXVII. AS 3101 is amended by adding footnote 20B to paragraph .11 to read as follows:

*Determination of Critical Audit Matters*

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period’s financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to

the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.<sup>20B</sup> Critical audit matters are not a substitute for the auditor’s departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

<sup>20B</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXVIII. AS 3105 is amended by revising paragraph .50 to read as follows:

.50 During the audit of the current-period financial statements, the auditor should be alert for circumstances or events that affect the prior-period financial statements presented (see paragraph .52) or the adequacy of informative disclosures concerning those statements. (See AS 2810.30-31.) In updating his or her report on the prior-period financial statements, the auditor should consider the effects of any such circumstances or events coming to his or her attention.

XXIX. AS 3305 is amended by revising paragraph .03 and adding footnote 1A to paragraph .03 to read as follows:

.03 An independent auditor’s judgment<sup>1A</sup> concerning the overall presentation of financial statements should be applied within an applicable financial reporting framework (see AS 2810, *Evaluating Audit Results*). Normally, the framework is provided by generally accepted accounting principles, and the auditor’s judgment in forming an opinion is applied accordingly. In some circumstances, however, a comprehensive basis of accounting other than generally accepted accounting principles may be used.

<sup>1A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXX. AS 3305 is amended by revising paragraph .09 to read as follows:

.09 When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other comprehensive basis of accounting as he or she does to financial statements prepared in conformity with generally



accepted accounting principles. Therefore, the auditor's opinion should be based on his or her judgment regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in AS 2810.30A.

XXXI. AS 4105 is amended by deleting footnote 1A and revising paragraph .01 to read as follows:

.01 The purpose of this section is to establish standards and provide guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of *interim financial information* (as that term is defined in paragraph .02 of this section). AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, requires that the auditor be independent, comply with independence and ethics requirements, be competent, and exercise due professional care, including professional skepticism. The same professional qualifications and general principles are applicable to a review of interim financial information conducted in accordance with this section. This section provides guidance on the application of the field work and reporting standards to a review of interim financial information, to the extent those standards are relevant.

XXXII. AS 4105 is amended by adding footnote 5A to paragraph .07 to read as follows:

.07 The objective of a review of *interim financial information* pursuant to this section is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with the standards of the PCAOB. A review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) obtaining corroborating evidence in response to inquiries; or (d) performing certain other procedures ordinarily performed in an audit. A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit. Paragraph .22 of this section provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles. Likewise, the auditor's responsibility as it relates to management's quarterly certifications on internal control over financial reporting is different from the auditor's responsibility as it relates to management's annual assessment of internal control over financial

reporting. The auditor should perform limited procedures quarterly to provide a basis for determining whether he or she has become aware of any material modifications that, in the auditor's judgment,<sup>5A</sup> should be made to the disclosures about changes in internal control over financial reporting in order for the certifications to be accurate and to comply with the requirements of Section 302 of the Act.

<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000.

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XXXIII. AS 6105 is amended by revising paragraph .07 to read as follows:

.07 The reporting accountant should exercise due professional care in performing the engagement and should have the competence to conduct such an engagement. The reporting accountant should also plan the engagement adequately, supervise the work of assistants, if any, and accumulate sufficient information to provide a reasonable basis for the professional judgment described in the report. The reporting accountant should consider the circumstances under which the written report or oral advice is requested, the purpose of the request, and the intended use of the written report or oral advice.

XXXIV. AS 6105 is amended by adding footnote 5A and revising paragraph .08 to read as follows:

.08 To aid in forming a judgment,<sup>5A</sup> the reporting accountant should perform the following procedures: (a) obtain an understanding of the form and substance of the transaction(s); (b) review applicable accounting principles (see AS 2810, *Evaluating Audit Results*); (c) if appropriate, consult with other professionals or experts; and (d) if appropriate, perform research or other procedures to ascertain and consider the existence of creditable precedents or analogies.

<sup>5A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as "professional judgment" as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXV. AS 6115 is amended by revising paragraph .21 to read as follows:

.21 The engagement to report on whether a previously reported material weakness continues to exist must be performed by an auditor who has the competence as an auditor to conduct such an engagement. In all matters related to the assignment, an independence in mental attitude must be maintained. Due professional care must be exercised in the performance of the engagement and the preparation of the report.

XXXVI. AS 6115 is amended by adding footnote 3A to paragraph .38 to read as follows:

.38 AS 2201.18-.19 should be applied in the context of the engagement to report on whether a previously reported material weakness continues to exist. There may, therefore, be some circumstances in which the scope of the audit procedures to be performed in this engagement will be so limited that using the work of others will not provide any tangible benefit to the company or its auditor. Additionally, the auditor should perform any walkthroughs himself or herself because of the degree of judgment<sup>3A</sup> required in performing this work.

<sup>3A</sup> Reference to the judgment of the auditor throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXVII. AI 11 is amended by adding footnote 3A to paragraph .04 to read as follows:

.04 *Interpretation*—During the audit, an auditor may encounter complex or subjective matters potentially material to the financial statements. Such matters may require special skill or knowledge and in the auditor’s judgment<sup>3A</sup> require using the work of a specialist to obtain appropriate evidential matter.

<sup>3A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XXXVIII. AI 18 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 In describing the nature, timing, and extent of the tests applied, the service auditor also should indicate whether the items tested represent a sample or all of the items in the population, but need not indicate the size of the population. In describing the results of the tests, the service auditor should include exceptions and other information that in the service auditor’s judgment<sup>1A</sup> could be relevant to user auditors. Such exceptions and other information should be included for each control objective, whether or not the service auditor concludes that the control objective has been achieved. When exceptions that could be relevant to user auditors are noted, the description also should include the following information:

<sup>1A</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

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XXXIX. AI 23 is amended by adding footnote 1C to paragraph .06 to read as follows:

.06 Thus, the auditor would examine the outside firm’s program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis and apply appropriate tests to the intervening transactions. The independent auditor ordinarily may reduce the extent of the work on the physical count of inventory because of the work of an outside inventory firm, but any restriction on the auditor’s judgment<sup>1C</sup> concerning the extent of his or her contact with the inventory would be a scope restriction.

<sup>1C</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XL. AI 24 is amended by adding footnote 12 and revising paragraph .61 to read as follows:

.61 *Interpretation*—Financial statements prepared on a statutory basis are financial statements prepared on a comprehensive basis of accounting other than GAAP according to AS 3305.04. AS 3305.09 states that “When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used. The auditor should apply essentially the same criteria to financial statements prepared on an other comprehensive basis of accounting as those applied to financial statements prepared in conformity with generally accepted accounting principles. Therefore, the auditor’s opinion should be based on his or her judgment<sup>12</sup> regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation as discussed in paragraphs .30A-.31 of AS 2810, *Evaluating Audit Results*.”

<sup>12</sup> Reference to the judgment of the auditor throughout this interpretation has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLI. Attestation Standard No. 1 is amended by revising paragraph 6 to read as follows:

6. An auditor who performs an examination engagement pursuant to this standard must:
  - a. Have competence in attestation engagements;<sup>10A</sup>

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- d. Exercise due professional care, including the application of professional skepticism,<sup>11/</sup> in planning and performing the examination and the preparation of the report.

Note: Due professional care imposes a responsibility on each engagement team<sup>11A/</sup> member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>11B/</sup> exercised by those assisting in the engagement, including preparing the report. Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>11C/</sup>

<sup>10A/</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

<sup>11/</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. See paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>11A/</sup> The term “engagement team,” as used in this standard for examination engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

<sup>11B/</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000.

<sup>11C/</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

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XLII. Attestation Standard No. 2 is amended by revising paragraph 5 to read as follows:

5. An auditor who performs a review engagement must:

- a. Have competence in attestation engagements;<sup>7A/</sup>

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- d. Exercise due professional care, including the application of professional skepticism,<sup>8/</sup> in planning and performing the review and preparation of the report.

Note: Due professional care imposes a responsibility on each engagement team<sup>8A/</sup> member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment<sup>8B/</sup> exercised by those assisting in the engagement, including preparing the report. Due professional care concerns what the auditor does and how well the auditor does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism; acting with integrity; and complying with applicable professional and legal requirements.<sup>8C/</sup>

<sup>7A/</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

<sup>8/</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules. See paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>8A/</sup> The term “engagement team,” as used in this standard for review engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

<sup>8B/</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000.

<sup>8C/</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in of Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

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XLIII. AT 101 is amended by revising paragraphs .19 to read as follows:

.19 The first general standard is—The engagement shall be performed by a practitioner having competence in the attest function.<sup>fn 6</sup>

<sup>fn 6</sup> See paragraph .07 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, for a description of competence.

XLIV. AT Section 101 is amended by revising paragraph .40 and adding footnote 7A and footnote 7B to read as follows:

.40 Due professional care concerns what the practitioner does and how well the practitioner does it. Due professional care means acting with reasonable care and diligence; exercising professional skepticism;<sup>fn 7A</sup> acting with integrity; and complying with applicable professional and legal requirements.<sup>fn 7B</sup> The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report.

<sup>fn 7A</sup> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of information related to the audit. See paragraph .11 of AS 1000 for further discussion of the concept of professional skepticism.

<sup>fn 7B</sup> The term “applicable professional and legal requirements,” as used in this standard, has the same meaning as defined in Appendix A of AS 1000, which includes professional standards as defined in PCAOB Rule 1001(p)(vi) (i.e., certain accounting principles and other standards) and rules of the PCAOB that are not professional standards. This definition also includes statutes with which the auditor is required to comply. See, e.g., Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1.

XLV. AT Section 101 is amended by deleting paragraph .41 and footnote 8:

[.41] [Paragraph deleted.]

<sup>fn 8</sup> [Footnote deleted.]

XLVI. AT Section 301 is amended by adding footnote 30 to paragraph .66 to read as follows:

.66 If, after discussing the matter as described in paragraph .65, the practitioner concludes that a material misstatement of fact remains, the action he or she takes will depend on his or her judgment<sup>fn 30</sup> in the particular circumstances. The practitioner should consider steps such as

notifying the responsible party in writing of his or her views concerning the information and consulting his or her legal counsel about further appropriate action in the circumstances.

<sup>fn 30</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLVII. AT Section 601 is amended by adding footnote 8A to paragraph .31 to read as follows:

.31 In an engagement to examine compliance with specified requirements, the practitioner seeks to obtain reasonable assurance that the entity complied, in all material respects, based on the specified criteria. This includes designing the examination to detect both intentional and unintentional material noncompliance. Absolute assurance is not attainable because of factors such as the need for judgment, <sup>fn 8A</sup> the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between personnel of the entity and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the practitioner.

<sup>fn 8A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

XLVIII. AT Section 701 is amended by adding footnote 17A to paragraph .29 to read as follows:

.29 In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment <sup>fn 17A</sup> regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery



that a material misstatement exists in the MD&A does not, in and of itself, evidence (a) failure to obtain reasonable assurance; (b) inadequate planning, performance, or judgment on the part of the practitioner; (c) the absence of due professional care; or (d) a failure to comply with this section.

<sup>fn 17A</sup> Reference to the judgment of the practitioner throughout this standard has the same meaning as “professional judgment” as described in AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.