



August 12, 2024

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

**RE: PCAOB Rulemaking Docket Matter No. 056**

Dear Madam Secretary:

We appreciate the opportunity to comment on the PCAOB's, *Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards*, included in PCAOB Release 2024-006 (the “proposal,” the “proposed amendments,” “proposed AS 2305,” or the “proposing release”).

**We generally support the proposal, including the intended principles-based approach to modernization.**

We commend the PCAOB on taking this next step to modernize its standards in light of the evolving and increasing use of technology by auditors in today's environment. As noted in our feedback to the Board on its technology-assisted analysis proposal (“TAA amendments”),<sup>1</sup> audits are becoming more data-driven, and many firms like ours are developing and leveraging automated tools and techniques that are being used to facilitate the performance of audit procedures, including substantive analytical procedures at a more precise level on disaggregated information. These tools and techniques have the potential to further benefit audit quality and, therefore, investors.

We support the PCAOB's efforts to address this evolution in practice through principles-based requirements and additional guidance where appropriate to address the design and performance of substantive analytical procedures. We support the overall direction of the proposal, which is broadly consistent with our current methodology.

However, certain areas merit further consideration before moving forward, in particular the proposed amendments to AS 2301<sup>2</sup> related to external information, which we do not support. There are also areas where certain changes and clarification would be helpful to drive consistent interpretation and execution and better explain the interaction of proposed AS 2305 with other PCAOB standards. When possible, we offer recommendations, including drafting suggestions in the appendix, for the Board's consideration. However, further engagement with stakeholders in these areas appears necessary. Our views are informed by how we are performing substantive analytical procedures today and how we envision their use may evolve as part of our testing approaches in the future as more data becomes available.

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<sup>1</sup> See our [comment letter](#) on PCAOB Release 2023-004, *Proposed Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form* (the “TAA proposal”).

<sup>2</sup> AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.



**There are practical challenges with the proposed description of substantive analytical procedures as well as the interaction with other PCAOB standards.**

In our feedback on the TAA proposal, we supported the PCAOB’s clarification of the definition of a “test of details.” This is a helpful amendment to current standards that will provide clarity and help drive increased consistency in practice, since the concept was not previously defined. We acknowledge the PCAOB’s similar intent in clarifying the descriptions of both “analytical procedures” and “substantive analytical procedures.” We support the changes to paragraph .21 of AS 1105<sup>3</sup> in relation to analytical procedures, as they appropriately note the various ways in which analytical procedures can be used in an audit. However, we have identified practical challenges in the following areas.

*The proposed description of substantive analytical procedures creates potential inconsistencies with other standards.*

The proposed description of substantive analytical procedures in paragraph .02 of proposed AS 2305 and other elements of the proposal as drafted create potential inconsistencies with other standards that need to be resolved to achieve the PCAOB’s objective of more explicitly integrating the standard with other Board-issued standards. For example, the distinction between a substantive analytical procedure as described in proposed AS 2305 and an auditor’s point estimate as described in AS 2501<sup>4</sup> is not sufficiently clear, which could raise questions about whether the PCAOB might have intended for an auditor’s point estimate to meet the definition of a substantive analytical procedure. Notably, AS 2501 only categorizes the potential approaches to obtaining evidence about accounting estimates as “substantive procedures,” and sets out detailed requirements about how the auditor develops an independent expectation. A lack of clarity in the PCAOB standards could lead auditors to assume that the requirements in proposed AS 2305 also need to be applied when developing an auditor’s point estimate, which we do not believe is the Board’s intent and would be a significant change in practice from existing AS 2305. To resolve these concerns, we recommend deleting the proposed definition of substantive analytical procedures in the proposed standard and replacing it with language explaining that analytical procedures may be used as substantive procedures (see proposed changes to paragraph .02 in the appendix).

*Principles-based requirements are necessary to enable the standard to be applied when different types of analytical procedures are used, as well as when various types of technology are used to perform those procedures.*

In our experience, reasonableness testing is the most common type of analytical procedure used as a substantive procedure. Regression analysis is similar to reasonableness testing, in that the model yields a specific explicit prediction using inputs based on the auditor’s knowledge of the factors that affect the account balances. Regression analysis is most effective when data is disaggregated, is appropriately evaluated for relevance and reliability, and has a strong predictable relationship between at least two data elements.

The manner in which the requirements in proposed AS 2305 would be applied depend on the type of analytical procedure (including the level of disaggregation), as well as whether and how technology is being used to perform the substantive analytical procedure. For this reason, principles-based requirements are necessary to enable the standard to be applied. In our view, certain requirements in the

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<sup>3</sup> AS 1105, *Audit Evidence*.

<sup>4</sup> AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, paragraph 21: “Developing an independent expectation involves the auditor using some or all of his or her own methods, data, and assumptions to develop an expectation of the estimate for comparison to the company’s estimate. The auditor’s responsibilities with respect to developing an independent expectation depend on the source of the methods, data, and assumptions used, as discussed below.”



proposed standard are not sufficiently principles-based and appear to lack sufficient consideration of how substantive analytical procedures are used in practice today – often as part of a more holistic testing strategy for a significant account. Additionally, certain analyses performed in practice may exhibit characteristics of both a substantive analytical procedure and a test of details, and auditor judgment will be necessary to determine whether proposed AS 2305 applies based on the characteristics of the procedure being performed, including when using technology-assisted analysis (given the volume of data that may be available).

Given the way firms are designing tools and approaches to substantive procedures today, firms may reasonably reach different conclusions about whether those approaches are considered tests of details or substantive analytical procedures (and therefore whether AS 2301 or proposed AS 2305 applies in the circumstances). Both standards set out an appropriate approach to investigating differences and determining whether there are misstatements, so we do not believe there is reason to be concerned with this potential variability. However, we encourage the PCAOB to consider whether it may be helpful to acknowledge this potential variability or otherwise provide further criteria for making such determinations.

In summary, we continue to believe that, as technology further evolves and auditors develop innovative techniques to plan and perform audits, procedures will become more difficult to fit into the specific classifications described in the PCAOB’s standards. Placing continued auditor focus on the classification of procedures in PCAOB standards may not be as impactful to audit quality as a broader focus on the sufficiency and appropriateness of audit evidence obtained from performing procedures. A shift away from the strict classifications in the standards, in our view, continues to be worth exploring despite the Board’s reluctance to do so.<sup>5</sup>

*It is unclear how the proposed standard relates to the final TAA amendments.*

The approach taken in the proposal in setting out new paragraph .40A of AS 2301 appears to mirror certain of the Board’s actions in finalizing the TAA amendments in relation to information received from external sources (including new paragraph .10A of AS 1105),<sup>6</sup> although the proposing release is silent as to how these requirements are intended to interact. We further describe our concerns with this proposed requirement and the Board’s rationale in proposing it in a separate section of this letter.

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<sup>5</sup> PCAOB Release 2024-007, *Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form* (the “TAA adopting release”), page 18: “Considering current practice and the nature of audit procedures performed today, we continue to believe that the existing standards are sufficiently clear in describing auditors’ responsibilities for obtaining and evaluating audit evidence. Our ongoing research has not identified specific examples of substantive analytical procedures that, by themselves, would provide sufficient appropriate audit evidence to respond to a significant risk. Commenters also did not provide such examples. Therefore, we believe retaining the categories of procedures as tests of details and substantive analytical procedures continues to be appropriate.”

<sup>6</sup> In our [comment letter](#) on SEC Release 34-100430, *Notice of Filing of Proposed Rules on Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*, we expressed significant concerns with this requirement and how it has been revised and explained in the PCAOB’s adopting release, as well as how it interacts with other requirements in AS 1105 and the auditor’s risk assessment.



**Certain revisions to the requirements are necessary to make them more principles-based in light of how substantive analytical procedures are used today and to enable the standard to remain fit for purpose as their use evolves.**

We appreciate the Board's acknowledgement that the appropriate technology-assisted analysis in well-designed substantive analytical procedures can improve the quality of audit evidence obtained through the audit.<sup>7</sup> As noted in the proposing release,<sup>8</sup> technology-assisted analysis can enable the auditor to identify additional plausible and predictable relationships, and therefore perform multiple substantive analytical procedures for the same account(s) and relevant assertion(s). For significant accounts, substantive analytical procedures are often used in combination with other audit procedures (including tests of details and tests of controls).

The cumulative evidence obtained from the combination of these procedures (including how the results of tests of details and tests of controls can be leveraged in evaluating the inputs used to develop the expectation in a substantive analytical procedure) is used to support the auditor's opinion. As noted in paragraph .37 of AS 2301, the evidence provided by the auditor's substantive procedures depends on the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.

The Board acknowledges this in principle in paragraph .01 of proposed AS 2305, but the implications of using substantive analytical procedures in combination with other audit procedures are not well-articulated in the proposed standard or the proposing release. Paragraph .01 includes limiting language that could be read as implying that a substantive analytical procedure can be used only if that procedure is sufficiently precise to fully respond to an assessed risk of material misstatement. A substantive analytical procedure that may be less precise nevertheless can provide evidence to help address the assessed risks of material misstatement for a relevant assertion (although this evidence is less persuasive and would not be sufficient on its own to address the risk of material misstatement).

For example, a substantive analytical procedure involving the prediction of total rental income on a building divided into apartments, considering the rental rates, the number of apartments, and vacancy rates, can provide persuasive evidence and may eliminate the need to perform tests of details to obtain further evidence, provided the relevance and reliability of these inputs are appropriately considered. In contrast, an analytical procedure based on historical gross margin percentages (e.g., a trend analysis) would not provide sufficient evidence on its own to address risks of material misstatement related to revenue but may provide useful corroboration if used in combination with other audit procedures.

The auditor's judgments in designing and performing substantive analytical procedures consider matters such as whether the outcome of the substantive analytical procedure represents the totality of the evidence in relation to the relevant assertion or whether, when the substantive analytical procedure is used in combination with other procedures, the auditor is able to obtain sufficient appropriate audit evidence. For this reason, we do not believe the limiting language in paragraph .01 is appropriate and suggest changes in the appendix.

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<sup>7</sup> PCAOB Release 2024-006, page 13.

<sup>8</sup> PCAOB Release 2024-006, page 11.



*The concept of disaggregation of the information used in a substantive analytical procedure could be made more prominent in the standard.*

The more detailed the level at which a substantive analytical procedure is performed, the greater the potential precision of the procedure, which in turn benefits audit quality. The objective of a substantive analytical procedure (i.e., the assessed risk of material misstatement it is intended to address and whether it is used on its own or in combination with other substantive procedures to respond to that risk) will determine whether data for an analytical procedure is disaggregated and to what degree it is disaggregated. Disaggregated analytics can be best thought of as looking at the composition of a balance(s) based on time (e.g., by month or by week) and source(s) (e.g., by geographic region or by product) of the underlying data elements.

While the concept of disaggregation has been highlighted in the TAA amendments,<sup>9</sup> it could be made more prominent in proposed AS 2305 to consider how substantive analytical procedures are performed today, including the varying degree of disaggregation inherent in those procedures. Further clarity in this area may benefit audit quality by better illustrating how disaggregation can enhance the effectiveness of substantive analytical procedures.

We recommend the PCAOB reiterate its views on disaggregation included in the TAA adopting release within the adopting release for proposed AS 2305, including the following:

- The appropriate level of disaggregation or detail of information that the auditor uses as audit evidence is important for obtaining audit evidence that is relevant in supporting the auditor's conclusions.<sup>10</sup>
- The level of disaggregation or detail that is appropriate depends on the objective of the audit procedure.<sup>11</sup>
- The auditor would determine the level of disaggregation or detail of the items within the account or disclosure based on the facts and circumstances of the individual audit engagement, including the assessed risk and the relevant assertion intended to be addressed, and the objective of the procedure.<sup>12</sup>

We also suggest adding examples from the TAA adopting release such as the following: "When performing a substantive analytical procedure and analyzing the plausibility of relationships between revenue and other information recorded by the company, using revenue disaggregated by product type would likely be more relevant for the auditor's analysis and result in obtaining more relevant audit evidence than if the auditor used the amount of revenue in the aggregate."<sup>13</sup>

The level of disaggregation in a substantive analytical procedure will significantly impact the auditor's judgments in identifying plausible and predictable relationships, determining a threshold for evaluating differences, and evaluating any differences between the auditor's expectation and the company's amount. In the appendix, we propose changes to paragraphs .04 and .08 to further emphasize the concept of disaggregation because, as noted in paragraph .19 of existing AS 2305, expectations developed at a detailed level generally have a greater chance of detecting misstatement of a given amount. Appropriately

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<sup>9</sup> Paragraph .07 of AS 1105 was amended to explain that the relevance of audit evidence depends on the level of disaggregation or detail of information necessary to achieve the objective of the audit procedure.

<sup>10</sup> PCAOB Release 2024-007, page 34.

<sup>11</sup> PCAOB Release 2024-007, page 34.

<sup>12</sup> PCAOB Release 2024-007, page 18.

<sup>13</sup> PCAOB Release 2024-007, page 34.



disaggregated analytics increase the precision of the auditor's expectation and therefore benefit audit quality, and accordingly should be encouraged.

*We are generally supportive of the requirements related to identifying a sufficiently plausible and predictable relationship, but recommend they be combined to enhance their understandability.*

We are generally supportive of the Board's approach outlined in the proposing release to establishing requirements in paragraphs .05–.06 of proposed AS 2305 for the auditor to determine whether one or more relationships used in a substantive analytical procedure is sufficiently plausible and predictable. We support the Board's decision not to prescribe the nature, timing, or extent of these procedures in addition to inquiry, to allow auditors to use technology-assisted analysis when determining whether the relationship to be used is sufficiently plausible and predictable. In our view, paragraph .06 is intended to provide context as to what is meant by the phrase "extend beyond inquiry" – namely that the auditor obtains appropriate audit evidence relevant to management's responses and often leverages the results of other audit procedures (in particular, the knowledge gained from understanding the company and its environment) to identify the relationships used in substantive analytical procedures. Accordingly, we recommend combining paragraphs .05 and .06 to enhance the understandability of the requirements.

*We recommend the Board consider an alternative approach to the requirement for determining a threshold for evaluating differences.*

Requiring that the auditor's threshold for evaluating differences between the auditor's expectation and the company's amount be at or below tolerable misstatement (or performance materiality) appears reasonable, in principle. However, based on how substantive analytical procedures may be used, this mandatory threshold may not be workable in all circumstances. For example:

- As substantive analytical procedures in relation to a significant account may often be designed to analyze disaggregated information in a number of different ways (e.g., monthly, geographically, by product type), professional judgment is needed in the auditor's consideration of an appropriate threshold.
- Since substantive analytical procedures may be used in combination with other substantive procedures, the auditor may determine an amount above tolerable misstatement may be appropriate given the evidence obtained from those other procedures.

Accordingly, we recommend the Board consider an alternative approach in paragraph .08 of proposed AS 2305. The Board's rationale in not prescribing when a lower threshold should be used – that it should be based on the facts and circumstances of the specific audit engagement, including the assessed risks of material misstatement and the objective of the substantive analytical procedure<sup>14</sup> – equally applies to setting an overall threshold. In our experience, while the reference to tolerable misstatement is an important consideration in determining one or more thresholds for a given analytic, engagement teams consider a number of factors in making judgments about an appropriate threshold and may ultimately conclude a threshold below tolerable misstatement is appropriate. Without explaining these factors in the proposed standard, there is risk that auditors might default to using tolerable misstatement as the threshold when it would be more appropriate to establish a lower threshold, which could negatively affect audit quality. We suggest draft wording in the appendix for the Board's consideration that is intended to balance what we believe is the Board's intent with the potential practical considerations we have identified.

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<sup>14</sup> PCAOB Release 2024-006, page 27.





*We generally support the approach taken in relation to evaluating differences between the auditor's expectation and the company's amount but suggest proposed changes in light of how this is done in practice today.*

We generally support the approach taken in paragraphs .09–.12, with two exceptions:

- The standard should be clear that differences between the auditor's expectation and the company's amount represent either imprecision in the expectation or misstatements of the company's amounts.
- The ordering of the paragraphs does not represent the manner in which these concepts would typically be applied in practice. We suggest they be reordered.

See changes proposed in the appendix.

*Further clarity is necessary in relation to the proposed requirement to address circular auditing.*

The language used in paragraph .07 of proposed AS 2305 related to "information that is based on the company's amount" is not sufficiently clear. We are concerned that this phrase could be misinterpreted to refer to any amount or information prepared by the company, which we do not believe is the Board's intent. Accordingly, revisions to the requirement or additional guidance to explain the Board's intent is necessary.

We agree in principle with what the PCAOB is trying to achieve, but it would be helpful to clarify in the adopting release that this requirement would not prevent an auditor from developing an expectation using other company balances on which the auditor has performed procedures that may be related to, but not directly derived from, the company's amount that is subject to the substantive analytical procedure. Consistent with the intent of paragraph .06 of proposed AS 2305, the principle is that the auditor would need to have an appropriate basis for developing an expectation if using information produced by the company as an input to a substantive analytical procedure. This expectation can be formed on the basis of other financial information that has already been subject to audit procedures. For example, the totality of procedures performed on revenue balances, including procedures in AS 1105 related to accuracy and completeness of that information, would provide an appropriate basis for the auditor to use those balances in setting an expectation related to sales commissions, when coupled with the auditor's understanding of the commissions process and examination of commission agreements to determine the appropriate rate(s) to be used in the substantive analytical procedure; this would not be considered circular auditing. Likewise, use of quantities shipped that were assessed in accordance with AS 1105 could be used as an input to a substantive analytical procedure designed to predict revenue (i.e., a regression analysis). We suggest draft wording in the appendix for the Board's consideration and recommend the Board provide additional examples of circular auditing in the final release based on its observations from inspections, so that it is clear what problems the Board is trying to address.

**We do not support the proposed amendments to AS 2301 related to external information.**

Throughout the proposing release, various reasons are given as to why the proposed new requirement in paragraph .40A of AS 2301 is necessary. For example:

- The proposal cites "growing risks to audit quality associated with designing and performing substantive analytical procedures" associated with the use of technology-assisted analysis as well as "more general risks that would arise, if as we suspect, substantive analytical procedures become



more prevalent because of greater availability of information in electronic form and use of technology-based tools.”<sup>15</sup>

- The proposal also notes the Board “has heard from the IAG [Investor Advisory Group] that auditors’ use of technology-assisted analysis is an area of concern due to the potential overreliance by auditors on company-produced information” and, “[a]s a result, there could be a benefit in having the standards address the need for the auditor to obtain evidence from a source outside of the company.”<sup>16</sup>
- Finally, the proposal notes that “[t]here is a risk that overreliance on information produced by the company may decrease the overall quality of audit evidence obtained because, under PCAOB standards, company-produced information generally provides less reliable evidence than information from a knowledgeable external source. *In other words, when more audit evidence is based on company-produced information, the overall quality of audit evidence in an audit is lower than in an audit where evidence is based on reliable external information*” (emphasis added).<sup>17</sup>

While we understand that additional clarity in the proposing release and ultimately the PCAOB standards might help enhance the consistency of performance and mitigate the potential risks the PCAOB has identified in relation to information produced by the entity (“internal data” for purposes of this letter), we have significant concerns about the manner in which the italicized statement above may be interpreted in the context of audit quality. While it is consistent with AS 1105 insofar as the Board’s views of reliability of evidence,<sup>18</sup> it ignores the possibility that information produced by the company may be more relevant or reliable, or both, than information from external sources, as well as the fact that the auditor’s ability to use technology to analyze full populations of company-produced information as part of the auditor’s approach to obtaining sufficient appropriate audit evidence often results in more persuasive evidence.

For example, it is possible for auditors to perform a technology-assisted analysis to test 100% of a population (e.g., a 3-way match) in which the procedure is appropriately designed to address the relevant assertion at an appropriate level of disaggregation (in accordance with paragraph .07 of AS 1105, as amended). In performing this analysis, auditors would either test controls over the accuracy and completeness of the information produced by the company (e.g., the input to the test), including, when applicable, information technology general controls (ITGCs) and automated application controls, or test the information itself (e.g., by performing tests of details and agreeing to source documents), in accordance with paragraph .10 of AS 1105. This testing enables the auditor to have a basis for using the internal data as an input to the procedure, which in turn affects the quality of the outcome of the procedure – the information used as evidence (i.e., the internal data) is itself determined to be relevant and reliable. When technology-assisted analysis is used in this way, it is often done as part of an overall testing strategy to address a financial statement line item (including consideration of fraud risk factors) and is often more persuasive than a more traditional non-statistical sampling approach. Testing approaches that facilitate the auditor obtaining more persuasive evidence benefit audit quality and ultimately investors.

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<sup>15</sup> PCAOB Release 2024-006, page 13.

<sup>16</sup> PCAOB Release 2024-006, page 14. The IAG discussion referred to in the proposing release appears to relate to the views of a few IAG members in the context of potential areas of emphasis in the Board’s strategic plan for 2022-2025, rather than a consensus by the IAG as a whole in the context of anticipated standard-setting and research projects.

<sup>17</sup> PCAOB Release 2024-006, page 32.

<sup>18</sup> Paragraph .08 of AS 1105: “In general, evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.”





*The Board's intent in proposing changes to AS 2301 is unclear and potentially undermines the principles-based nature of AS 1105, including the auditor's existing obligations to evaluate relevance and reliability of information used in substantive analytical procedures in accordance with AS 1105.*

We agree that in performing substantive procedures it is necessary for the auditor to obtain a sufficient understanding of the source and relevance of information used as audit evidence and appreciate that the proposing release appears to indicate the Board's intent for this requirement to be principles-based.<sup>19</sup> However, there appears to be a perception by certain of the Board's stakeholders that, in performing substantive analytical procedures (in particular those using large volumes of information produced by the company) or more broadly technology-assisted analysis, auditors do not perform any procedures with respect to that information (which ultimately represents data or inputs in to the analytic or technology tool), or do so insufficiently. However, we note the Board's acknowledgement in the proposing release of the auditor's existing obligation to evaluate the relevance and reliability of information used as audit evidence in accordance with AS 1105<sup>20</sup> and believe this is an important requirement that should be underpinning the use of substantive analytical procedures.

The proposed amendments in AS 2301 emphasize the importance of examining information from external sources when an account or disclosure depends on such information<sup>21</sup> and would apply to both substantive analytical procedures and tests of details, as well as substantive procedures performed in relation to estimates. While we support an enhanced focus on data reliability, we do not support this requirement because it undermines the principles-based nature of AS 1105. Additional outreach and engagement with auditors and preparers could help to determine what is practical to address the risk the PCAOB has identified to the extent that risk is not already being addressed by existing PCAOB standards, including the risk assessment standards and to further clarify the PCAOB's intent.

Our more specific reasons for not supporting this requirement are as follows:

- The interaction with paragraph .10A of AS 1105 related to information from external sources has not been addressed in the proposing release and is therefore unclear. While we continue to believe that requirement is onerous, it is at least focused on "information used as audit evidence." In contrast, proposed paragraph .40A of AS 2301 applies "when the auditor's substantive procedures are applied to accounts or disclosures that depend on information the company received from one or more external sources." Based on how the phrases "depends on" and "relevant information that the company received" are articulated in the proposing release, it could be read to require the auditor to obtain and examine *any* information a company receives related to a significant account or disclosure if the auditor performs substantive procedures in relation to that account or disclosure, even if the auditor ultimately does not design and perform those procedures with the intent to use such information as audit evidence. Requiring examination of all of the information the company received in relation to a significant account or disclosure is significantly more prescriptive than paragraphs .10 and .10A of AS 1105, which allow for the auditor to test controls

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<sup>19</sup> PCAOB Release 2024-006, page 33: "[t]he proposal does not prescribe the nature, timing or extent of substantive procedures that would be necessary to obtain the external information. Doing so would be impractical, considering the multitude of scenarios that auditors encounter in practice. An auditor would determine the appropriate course of action based on the requirements of PCAOB standards and the facts and circumstances of the audit."

<sup>20</sup> PCAOB Release 2024-006, page 33, and page 57, which explains why language from existing AS 2305 on reliability of data was not retained in proposed AS 2305.

<sup>21</sup> PCAOB Release 2024-006, page 33, notes that accounts or disclosures that depend on information the company received from one or more external sources may include, for example, revenue, cash, or financial instruments (including financial instruments valued on the basis of market information).



to evaluate relevance and reliability or otherwise use a risk-based approach to designing procedures to obtain audit evidence and evaluating that evidence.

- The interaction with other standards is unclear in terms of whether the proposed requirement in AS 2301 is incremental to those standards. For example, in the case of auditing a financial instrument, AS 2501 would permit the auditor to test the company's process used to develop the accounting estimate and already addresses relevance and reliability of data and assumptions (including from a third party). Is it the PCAOB's intent that, despite obtaining sufficient appropriate audit evidence from testing the company's process, the auditor would nevertheless have to examine relevant information the company received when investing in the financial instrument? If such information is not available, would there be a presumption that the auditor should perform confirmation procedures in accordance with AS 2310<sup>22</sup> (given the phrase "or that the auditor obtained directly from the external source(s)" used in the requirement)? And what are the alternative procedures if the confirming party does not respond? Similarly, what is the remedy when the company may not have maintained the information initially received from the external source?<sup>23</sup>
- The economic analysis does not address the costs to auditors and preparers as a result of this new requirement, noting only the potential effects of overreliance on information produced by the company.

Based on these concerns, we do not recommend advancing the proposed requirement in AS 2301. The concept of potential overreliance on information produced by the company is not a novel one that arises only when auditors use technology-assisted analysis. If the PCAOB believes this risk needs to be addressed on all audits in relation to all substantive procedures, we recommend the Board further engage with stakeholders as a basis for exploring revisions to the proposed requirement or additional guidance to support paragraph .09 of AS 2301 to describe the potential bias towards using only information produced by the company as audit evidence. Dialogue about the Board's intent in using the phrase "depends upon" may help alleviate our concerns to a degree, as it may be more important for auditors to examine relevant information from external sources when the significant account or disclosure is solely dependent on such external information. Often, the basis for accounts and disclosures is not dependent on only one source of information and may involve a mix of internal and external sources – applying the requirement in the wide range of circumstances to which it would apply (i.e., to all types of substantive procedures) may create confusion or challenges that were not intended.

However, we would support an enhanced and more explicit focus in proposed AS 2305 on data reliability in an appropriate manner that takes into account whether the data is relevant and reliable for purposes of the audit, considering the source, comparability, and nature and relevance of information available. While

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<sup>22</sup> AS 2310, *The Auditor's Use of Confirmation*.

<sup>23</sup> In our comment letter on SEC Release 34-100430, we noted our observation in practice that companies may or may not retain information such as original purchase orders, or these documents may not exist in hardcopy form or be retained centrally (for example, a purchase order could be sent to the company in the form of a PDF attachment in an email or could be submitted through an electronic portal), or the hardcopies themselves may routinely be digitized and discarded upon receipt. A purchase order received via EDI would typically be subject to internal controls that may include ITGCs or automated application controls, whereas information such as PDFs of purchase orders, bank statements, and contracts shared with the auditor are unlikely to be subject to such controls. More broadly, we observe in practice that, even when physical copies of other types of information to be used as audit evidence initially exist (e.g., bills of lading received at a plant location), companies often digitize this information for their own books and records and that electronic information is provided to the auditor.



paragraph .04 includes a note referring to the reliability of information used as audit evidence, the lack of a specific reference to “reliability of data” as in existing AS 2305 could be misconstrued as the Board de-emphasizing this important element of the auditor’s work when using substantive analytical procedures. We recommend the following:

- Reference to paragraph .10A of AS 1105 should be added to the note to paragraph .04 (as drafted in the appendix) so that the need to consider reliability of external information receives equal prominence with that of information produced by the company.
- Given the Board’s emphasis on external information, consideration should be given as to whether a requirement for the auditor to consider whether relevant and reliable data / information from external sources may be readily available to develop expectations for some assertions may be helpful to encourage auditors to look beyond information produced by the company in designing substantive analytical procedures.
- Consideration should be given to retaining the factors that influence the auditor’s consideration of the reliability of data for purposes of achieving audit objectives, as included in paragraph .16 of existing AS 2305.

For example, to support existing requirements in AS 1105, the PCAOB could develop guidance or discussion in the adopting release that explains the following:

- The data used to develop an expectation in a substantive analytical procedure is a form of audit evidence evaluated in accordance with AS 1105.
- The nature and relevance of the information available is taken into account in determining whether the data is reliable for purposes of designing substantive analytical procedures to respond to the assessed risks of material misstatement. Internal accounting data may be more relevant to the substantive analytical procedure than non-financial or external data. For example, the use of loosely or only directionally related industry data may appear more “reliable” due to its external nature, but the lack of sufficient relevance of the data (i.e., its lack of predictive nature) may negate the effectiveness of the substantive analytical procedure using this data.
- Information produced by the company to which the requirement in paragraph .10 of AS 1105 applies includes data from accounting and financial reporting systems as well as data provided from systems and records that are separate and distinct from accounting and financial reporting (e.g., headcount, store square footage, customer service records).

## **Other matters**

### *Effective date*

The Board will need to establish an appropriate effective date that gives firms sufficient time to update their methodologies and training as well as to enable preparers to respond to enhanced auditor expectations with regards to external information provided to the auditor in electronic form. Because of the interaction between proposed AS 2305 and the TAA amendments, we encourage the Board to consider deferring the implementation of the TAA amendments until proposed AS 2305 becomes effective to enable firms the opportunity to implement both at the same time.



*Topics addressed in existing AS 2305 that could be retained*

In comparing existing AS 2305 to proposed AS 2305, we noted the following paragraphs of existing AS 2305 that could be helpful to address or acknowledge in the final standard or the adopting release:

- Paragraph .05, which includes examples of sources of information used for developing expectations
- Paragraph .09, which notes that the decision about which procedure(s) to use to achieve a particular audit objective is based on the auditor's judgment on the expected effectiveness and efficiency of the available procedures
- Paragraph .10, which discusses how the risk of management override of controls could affect the use of analytical procedures, and sets out the view that substantive analytical procedures alone are not well suited to detecting fraud
- Paragraph .19, which discusses how disaggregation may be helpful
- Paragraph .22, which discusses expectations related to documentation

\* \* \* \* \*

We appreciate the opportunity to express our views and drafting suggestions. As noted previously, additional outreach and engagement with auditors and preparers is necessary to clarify certain aspects of the proposed new requirement in AS 2301 and the interaction with the TAA amendments. We would be pleased to discuss our concerns, share our practical experience, or answer any questions. Please contact Brian Croteau at [brian.t.croteau@pwc.com](mailto:brian.t.croteau@pwc.com) regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP



## Drafting suggestions

**Note:** Proposed AS 2305 is reproduced herein in its entirety, footnotes are omitted unless proposed to be changed.

## AS 2305: Designing and Performing Substantive Analytical Procedures

### INTRODUCTION

- .01 This standard establishes requirements regarding designing and performing substantive analytical procedures.<sup>1</sup> AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, requires the auditor to design and implement appropriate responses that address the assessed risks of material misstatement. This may include using substantive analytical procedures to address the assessed risks of material misstatement for certain relevant assertions of significant accounts and disclosures. When designed and performed appropriately, substantive analytical procedures can provide relevant and reliable audit evidence. Substantive analytical procedures are appropriate ~~only~~ when designed and performed, alone or in combination with other audit procedures, at a level of precision sufficient to respond to an assessed risk of material misstatement.<sup>2</sup> ~~When designed and performed appropriately, substantive analytical procedures can provide relevant and reliable audit evidence.~~ [edit suggested to improve readability]
- .02 Analytical procedures<sup>FN</sup> can be used as substantive procedures to address a risk of material misstatement. Doing so in accordance with this standard ~~A substantive analytical procedure~~ involves:
- Developing an expectation based on one or more plausible and predictable relationships among financial or nonfinancial data, and
  - eComparing that expectation to a recorded amount or an amount derived from recorded amounts (as applicable, the "company's amount that is being tested") to an expectation of that amount developed by the auditor to determine whether the company's amount is misstated. ~~there is a misstatement. The auditor's expectation when performing a substantive analytical procedure is based on one or more plausible and predictable relationships among financial or nonfinancial data.~~

<sup>FN</sup> See AS 1105.A21.

### OBJECTIVE

- .03 The auditor's objective when designing and performing a substantive analytical procedure is to obtain relevant and reliable audit evidence about one or more relevant assertions of a significant account or disclosure. [No changes proposed to this paragraph.]

### DESIGNING AND PERFORMING A SUBSTANTIVE ANALYTICAL PROCEDURE TO RESPOND TO A RISK OF MATERIAL MISSTATEMENT

- .04 Under AS 2301, in designing and performing audit procedures, the higher the auditor's assessment of risk, the more persuasive audit evidence the auditor should obtain.<sup>3</sup> More persuasive audit



evidence is obtained from a substantive analytical procedure when the procedure is more precise ~~and uses more reliable information~~. The precision of a substantive analytical procedure depends on (i) the relevance and reliability of the information used in designing and performing the procedure, including the level of disaggregation at which the procedure is planned to be performed, (ii) the plausibility and predictability of the relationship on which the procedure is based, and (iii) the amount of the threshold for evaluating differences between the auditor's expectation and the company's amount.

Note: When designing and performing a substantive analytical procedure, the auditor should evaluate the relevance and reliability of information used in accordance with AS 1105. This includes, when such information is produced by the company, testing the accuracy and completeness of the information or testing the controls over the accuracy and completeness of that information in accordance with paragraph .10 of AS 1105. When the information used in a substantive analytical procedure is from one or more external source(s), the evaluation of relevance and reliability is in accordance with paragraph .10A of AS 1105 and may include examination of relevant information that the company received, or that the auditor obtained directly, from the external source(s).

Note: When a substantive analytical procedure is determined to be an appropriate response to an assessed risk of misstatement at the assertion level for a significant account, disaggregation of this amount by time or source (e.g., by geographic region or by product) may be necessary to achieve the objective of the procedure. Disaggregation of financial information results in a more precise expectation and more effective substantive analytical procedures. In such cases, the requirements in paragraphs .05–.08 are to be applied to the disaggregated amounts.

#### Identifying a Sufficiently Plausible and Predictable Relationship

[Note: The recommendation is to combine proposed paragraphs .05–.06.]

- .05 The auditor must identify the relationship or relationships to be used in the substantive analytical procedure and determine whether each such relationship is sufficiently plausible and predictable. ~~.06 Relationships used in the substantive analytical procedure must be sufficiently plausible and predictable to achieve the objective of the procedure. Making This the determination should extend beyond inquiry. When determining whether a relationship is sufficiently plausible and predictable, the auditor should, and take into account all relevant information of which the auditor is aware, including information obtained from:~~

- a. The auditor's understanding of the company and its environment,<sup>4</sup> and
- b. Other procedures performed in the audit and in reviews of interim financial information.

Note: Events, conditions, and company activities that may affect the plausibility and predictability of a relationship, include specific unusual transactions or events, accounting changes, business changes, or external factors, such as general economic conditions and industry factors.

#### Developing an Expectation

- .07 The auditor should develop an expectation of the company's amount that is being tested based on the relationship(s) identified pursuant to paragraphs .05 and .06. The auditor may not develop the expectation using the company's amount that is being tested or other amounts information that is are based on the company's amount that is being tested.





Note: An other amount is based on the company's amount that is being tested when the company's amount that is being tested is used as the basis for the calculation of the other amount. For example, because revenue is used as the basis for calculating commissions expense, it would be inappropriate for the auditor to use commissions expense as the expectation against which revenue (i.e., the company's amount being tested) would be compared. However, it would not be inappropriate for the auditor to use revenue as the basis to form an expectation against which commissions expense (i.e., the company's amount being tested) would be compared, provided that appropriate testing of revenue has occurred.

#### Determining ~~a~~-Thresholds for Evaluating Differences

- .08 The auditor should determine one or more a-thresholds for evaluating the difference between the auditor's expectation and the company's amount. ~~The amount of the threshold should be set at or below tolerable misstatement,<sup>5</sup> taking into account the nature of the account or disclosure or, where applicable, the component of the account or disclosure.<sup>6</sup>~~ When determining the thresholds, the auditor should address the risk that the difference between the auditor's expectation and the company's amount represents a misstatement that would be material to the financial statements, individually or in combination with other misstatements within the account or disclosure, considering the possibility of undetected misstatements.

Note: Thresholds may be defined either as numerical values or as percentages of the items being tested depending on the type of analytical procedure. The auditor's determination of an appropriate threshold takes into account (i) the nature of the account or disclosure, (ii) tolerable misstatement, (iii) the objective of the procedure, including the assessed risk of material misstatement it is designed to address and whether it is used in combination with other substantive procedures to obtain sufficient appropriate audit evidence to address that risk, and (iv) the level of disaggregation at which the procedure is performed including, where applicable, the component of the account or disclosures.

#### Differences Between the Auditor's Expectation and the Company's Amount

- .09 If the difference between the auditor's expectation and the company's amount that is being tested exceeds the threshold described in paragraph .08, the auditor should evaluate the difference, which includes performing audit procedures to determine whether there is a misstatement.<sup>7</sup> These procedures should extend beyond inquiry.

Note: Differences between the auditor's expectation and the company's amount that is being tested represent either imprecision in the expectation or misstatements of the company's amount.

- ~~.10~~ As part of performing the procedures described in paragraph .09, the auditor may identify relevant information of which the auditor was not aware when initially designing the substantive analytical procedure or information that suggests the substantive analytical procedures was not sufficiently precise to achieve the objective of the procedure. When such information is identified, the auditor should:
- a. Evaluate the reliability of that information in accordance with AS 1105;
  - b. Determine whether to modify the design of the substantive analytical procedure in accordance with paragraphs .04-.08 of this standard (e.g., by further disaggregating the information or otherwise refining the auditor's expectation) or perform other substantive procedures to address the assessed risk; and



- c. Determine whether to revise the risk assessment in accordance with AS 2110.74.
- .11 If, after performing the procedures described in paragraphs .09 and .10, the auditor is unable to determine whether there is a misstatement, the auditor should determine the effect on the audit. This includes:
- a. Determining whether to revise the risk assessment in accordance with AS 2110.74;<sup>10</sup> and
  - b. Performing the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the relevant assertion(s).
- ~~.12~~ When the auditor determines that there is a misstatement, the auditor should evaluate the misstatement in accordance with AS 2810, *Evaluating Audit Results*<sup>8</sup> and, in an integrated audit, AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.<sup>9</sup> [No changes proposed to this paragraph.]