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By email: comments@pcaobus.org

Office of the Secretary
PCAOB
1666 K Street NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 056: *Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards* (PCAOB Release No. 2024-006)

Dear Office of the Secretary:

Crowe LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or "the Board") proposed Auditing Standard (AS) 2305, *Designing and Performing Substantive Analytical Procedures*, amendments to AS 1105, *Audit Evidence*, and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, and related conforming amendments.

General Observations

We support the PCAOB's efforts to modernize its standards by replacing the existing auditing standard related to an auditor's use of substantive analytical procedures with a new standard, AS 2305, *Designing and Performing Substantive Analytical Procedures* to strengthen and clarify the auditor's responsibilities when designing and performing substantive analytical procedures. It is important for the PCAOB's auditing standards to provide clear requirements and guidance to auditors that support the design and performance of substantive analytical procedures to enhance audit quality, especially when addressing growing risk associated with the use of technology-assisted analysis. Generally, we believe the proposed standard and amendments will achieve that outcome. While we are generally supportive of the proposed standard, there are some concerns about certain proposed requirements for designing and performing substantive analytical procedures. Refer to the responses below to select questions from the proposal for further specific feedback on the proposal.

Specific Areas of Comment

Designing and Performing a Substantive Analytical Procedure to Respond to a Risk of Material Misstatement (paragraph .04)

Question 7

***Are the factors that affect precision clear and appropriate? If not, how should they be clarified?
Are there other factors upon which a substantive analytical procedure's level of precision depends? If so, what are they?***

While we find the factors included in the proposed standard that affect the precision of a substantive analytical procedure to be appropriate, we believe the concept of disaggregation should be retained from the extant AS 2305.19 and explicitly incorporated into the proposed standard.

We note that in the newly adopted release related to *Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*, AS 1105 is amended by revising paragraph .07 to state that the relevance of audit evidence also depends on “The level of disaggregation or detail of information necessary to achieve the objective of the audit evidence”. However, it is not clear whether or how this factor related to disaggregation interplays with proposed AS 2305.04, which includes relevance as a factor that affects the precision of a substantive analytical procedure. Given the increased use of technology when performing substantive analytical procedures, we believe it is important to have disaggregation explicitly stated as a factor affecting precision. As such, we recommend the following edits to proposed AS 2305.04 (addition marked as underlined and deletions are ~~struck through~~):

.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 [FN excluded]. 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 of the information used in designing and performing the procedure, (ii) the plausibility and predictability of the relationship on which the procedure is based, (iii) the level of disaggregation at which the procedure is performed, and (iv) ~~the~~ 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.

Identifying a Sufficiently Plausible and Predictable Relationship (paragraphs .05-.06)

Question 10

Is the proposed requirement that the auditor identify the relationship or relationships to use in the substantive analytical procedure and determine whether each such relationship is sufficiently plausible and predictable clear and appropriate? If not, how should it be clarified?

The release notes that “...a more explicit requirement, including a clarification that the auditor's determination should extend beyond inquiry, would drive auditors to more consistently identify relationships that are sufficiently plausible and predictable...”. While we are supportive of emphasizing the importance of determining relationships that are sufficiently plausible and predictable, additional clarification is needed on the application of the requirement that “making the determination should extend beyond inquiry”. Specifically, it is not clear what procedures would be expected to comply with this requirement.

For example, as noted in the release, “the relationship between interest income and loans receivable is typically governed by interest rates and loan maturities that are specified in contractual arrangements with bank customers”. In this example, the relationship between interest income and loans receivable is straightforward and can be identified based on the inherent nature of such relationship. In order to comply with the proposed requirement, it seems appropriate to rely on other audit procedures performed that may

be relevant for evaluating the relationship, such as the inspection of loan agreements as part of the auditor's walkthrough procedures to obtain an understanding of the company and its environment.

We believe examples are needed in the release document to provide additional clarity regarding the types of procedures auditors may perform to determine whether the relationship is sufficiently plausible and predictable based on the nature of the relationship.

Developing an Expectation (paragraph .07)

Question 14

The proposed change specifying that the auditor may not develop the expectation using the company's amount or information that is based on the company's amount clear and appropriate? If not, what changes should be made?

We are supportive of the PCAOB's intent to address the risk of circular auditing with the requirement to not use the recorded amount (that is being tested in the substantive analytical procedure) or an amount derived from that recorded amount to develop an expectation. However, we have concerns that the term "information that is based on the company's amount" as currently stated may lead to differing interpretations and application in practice.

Specifically, while the new term "company's amount" is defined in proposed AS 2305.02 as "a recorded amount or an amount derived from recorded amounts", the term "information that is based on the company's amount" goes beyond this definition. This term is broad and could be interpreted as all information produced by the company, which we don't believe is the intent of the Board.

We believe it is important to use consistent terms throughout the proposed standard. As such, we recommend the following edits to proposed AS 2305.07 (additions marked as underlined and deletions are ~~struck through~~):

.07 The auditor should develop an expectation of the company's amount based on the relationship(s) identified pursuant to paragraphs .05 and .06. The auditor may not develop the expectation using the company's amount, including an amount derived from ~~or information that is based on~~ the company's amount.

Determining a Threshold for Evaluating Differences (para 08)

Question 16

Is the proposed requirement that the auditor determine a threshold to evaluate the difference between the auditor's expectation and the company's amount clear and appropriate? If not, what changes should be made?

While we find it appropriate to take into account the nature of the account or disclosure or, where applicable, the component of the account or disclosure in determining the threshold to evaluate the difference between the auditor's expectation and the company's amount, we have concerns about the requirements that "the amount of the threshold should be set at or below tolerable misstatement".

First, this proposed requirement does not allow for situations in which setting the threshold above tolerable misstatement for further investigation may be appropriate based on the desired amount of audit evidence the auditor intends to obtain from the substantive analytical procedure. For example, if an auditor performs a substantive analytical procedure as the sole audit procedure to address the assessed risks of material misstatement, setting a threshold at or below tolerable misstatement might be appropriate based on the assessed risks of material misstatement and the need to obtain more persuasive audit evidence from the substantive analytical procedure as it is the sole audit procedure. However, when a substantive analytical procedure is performed in combination with tests of details that provide persuasive audit evidence to

address the same audit objective, the probability of undetected misstatements that could be material is lower after considering the amount of audit evidence obtained from tests of details. Therefore, a threshold above tolerable misstatement for the substantive analytical procedure may be appropriate to provide sufficient and appropriate audit evidence to address the assessed risks of material misstatement in combination with other substantive procedures when those procedures are addressing the same audit objective.

In addition, the proposal notes that when the auditor performs a substantive analytical procedure for a component of a significant account or disclosure, “determining the amount of the threshold may involve consideration of, for example, the size of the component in relation to the size of the account.” The proposal also notes that “if the auditor is performing a substantive analytical procedure over disaggregated amounts, a lower threshold may be necessary to achieve the objective of the procedure.” While we agree with those concepts, we have a concern that the proposed requirement may lead to differing interpretations of whether the total threshold used across all disaggregated amounts should be set at or below tolerable misstatement. We believe that when the threshold is determined for a substantive analytic procedure being performed over a component of a significant account or disaggregated amounts, an auditor would consider an appropriate threshold for each component or disaggregated amount based on the relevant factors pursuant to the proposed AS 2305.08 and it may be appropriate for the total threshold used across all components or disaggregated amounts to exceed the tolerable misstatement based on different facts and circumstances.

Based on the above concerns, we believe a more principles-based framework for developing a threshold under the extant standard should be included in the final standard to allow an auditor to apply professional judgment in determining an appropriate threshold for further investigation. Specifically, we believe tolerable misstatement can be incorporated as a relevant factor to be taken into account in determining an appropriate threshold, rather than mandating setting the threshold at or below tolerable misstatement.

Amendments to Other PCAOB Standards

Question 22

The proposed amendment specifies that when substantive procedures are applied to accounts or disclosures that depend on information received by the company from external sources, such procedures should involve examining relevant information from the external sources. Is this proposed amendment clear and appropriate? If not, what changes should be made?

The proposed requirement mandates an auditor to examine relevant external information received by the company or obtained by the auditor directly as audit evidence when testing an account or disclosure that depends on information the company received from external sources. While we understand the PCAOB’s intent to mitigate the risk related to auditors’ potential overreliance on company-produced information, especially with the increased use of technology-assisted analysis, we have several concerns about the proposed requirement in AS 2301.40A.

We have concerns that the proposed standard appears to indicate that when an account or disclosure depends on information the company received from external sources, obtaining sufficient appropriate audit evidence can *only* be achieved by examining the relevant external information. However, it is not clear how the proposed AS 2301.40A interrelates to the newly amended AS 1105 *Audit Evidence* with respect to obtaining sufficient and appropriate audit evidence. Specifically, AS 1105 is a principles-based standard indicating that the sufficiency and appropriateness of audit evidence are affected by many factors, including the risk of material misstatement and the quantity and quality of evidence. In addition, AS 1105.08 notes that “the reliability of evidence depends on the nature and source of the evidence” and “evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources”. While evidence obtained from external sources is more reliable, the newly amended AS 1105.08 also states that “information produced by the company is more reliable when

the company's control over that information including, where applicable, its information technology general controls and automated application controls are effective". Therefore, consistent with the newly amended AS 1105, we believe an auditor should have the ability to apply professional judgment to determine the nature and source of the evidence needed to obtain sufficient appropriate audit evidence.

In addition, the proposed standard applies to both tests of details and substantive analytical procedures. The proposal specifically notes that "when performing substantive analytical procedures, examining external information would be necessary when evaluating the plausibility and predictability of the relationship on which the procedure is based, developing the auditor's expectation, or evaluating the difference between the auditor's expectation and company records." However, when performing a substantive analytical procedure, there are situations where examining external information received by the company or obtained by the auditor directly may not be a relevant audit procedure. For example, when an auditor performs a substantive analytical procedure to test interest income, an account that depends on, among other items, the contractual agreements and interest payment received by the external customer, the proposed AS 2301.40A seems to imply that the auditor must perform an audit procedure to examine such interest payment in order to obtain sufficient appropriate audit evidence. In practice an auditor may examine the contractual loan agreement produced by the company to determine the plausible and predictable relationship in accordance with the proposed AS 2305, but examining the interest payment would likely not be a relevant audit procedure for the purpose of performing a substantive analytical procedure. Based on the example provided, we are concerned that the proposed AS 2305.40A may lead to an unintended consequence that an auditor may choose not to perform a substantive analytical procedure for an account or disclosure that depends on information the company received from external sources, even though when performing such substantive analytical procedure would be the most effective audit approach to address the assessed risks of material misstatement with sufficient appropriate audit evidence.

Further, a company's account or disclosure may depend on several pieces of external information. It is not clear based on the requirement whether an auditor would be expected to examine all pieces of external information used in the company's process or only the external information that is relevant to the auditor's substantive audit procedures. Although the proposal does not prescribe the nature, timing or extent of substantive procedures that would be necessary to obtain the external information, it is not clear whether the Board expects incremental procedures to examine external information based on existing PCAOB standards, including the newly amended AS 1105.

We believe the auditor's responsibilities related to external information is sufficiently addressed by existing PCAOB standards. For example, the release notes that "PCAOB standards require that responding to significant risks of material misstatement involves performing tests of details", which may include examining external information relevant to items within the account or disclosure that depend on external information. It is also noted in the release that "...in some situations, the auditor is required by PCAOB standards to obtain information directly from the external source(s), e.g., by confirming cash and accounts receivable with third parties." Additionally, the requirement related to auditor's evaluation of the nature and source of evidence, including the use of external information, is sufficiently included in AS 1105.

Based on the concerns raised above, we are not supportive of the proposed requirement as written in AS 2301.40A and the Board should consider removing it. If the proposed requirement is retained, we believe it is important to allow the auditor to exercise professional judgment in determining the audit evidence necessary to address the risks of material misstatement including clearly indicating that examination of information from the external source is considered when such information is relevant to the substantive procedure designed by the auditor.

Effective Date

Question 38

Would the proposed effective date present challenges for auditors? If so, what are those challenges, and how should they be addressed?

The PCAOB proposed that auditors would need to adopt the proposed standard for audits of fiscal years beginning on or after December 15th of the year after SEC approval. If the final standard is approved by the SEC in 2025, the standard would be effective for audits of fiscal years beginning on or after December 15, 2025. We are concerned about firms' ability to effectively implement the proposed standard within this time frame. Implementing the amendments will include updating methodology and related tools and developing and conducting training for the entire audit practice. Additionally, there are several other PCAOB standards that will be effective around the same time. In order to allow sufficient time to implement the new standard appropriately and thoughtfully, we recommend that the effective date of the standard be no earlier than for audits of fiscal years beginning on or after December 15, 2026.

We also strongly encourage the Board to take a holistic view of the standard-setting activity when evaluating an effective date. Firms will need time to evaluate and implement changes to methodologies, training, and tools for each standard that the Board adopts; to the extent there are multiple standards being implemented concurrently, firms will need to devote substantial resources to those efforts. Allowing sufficient time for the implementation period of each new standard will support firms' abilities to effectively implement the new standards.

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We appreciate the opportunity to share our perspectives on the Board's proposed auditing standard. We would be pleased to discuss our comments with the Board or its staff. If you have any questions, please contact Kyle Owens, National Office Partner at kyle.owens@crowe.com or Matthew Schell, National Office Managing Partner at matthew.schell@crowe.com.

Sincerely,

/s/ Crowe LLP

Crowe LLP