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

Re: Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other 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 – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards* (the proposal). RSM is a registered public accounting firm serving middle-market issuers, brokers and dealers.

Overall Comments on the Proposal

We recognize that the state of auditing is continuously evolving and innovations in technology are driving changes in our practice. We support the PCAOB's efforts to modernize the standard through consideration of technological innovation and its impact on the substantive audit procedures while still allowing for future scalability by not tying the language to current-day software applications, realizing they may be obsolete in a matter of time. The adaptations of technology-assisted analysis or other technology-based tools have the potential to expand the volume of information used as audit evidence, and the resulting analytics may help identify data relationships that could be used in designing substantive analytical procedures.

There are areas of the proposal on which we request further clarity, either through revisions to the proposed standard or through the Board providing expanded application guidance and examples. Specifically, these areas include the new concept of "precision of a procedure"; determining the plausibility and predictability of relationships used in substantive analytical procedures; the expected documentation expectations to evidence that the auditor has taken into account all relevant information of which the auditor is aware; and which types of information produced by the company, if any, are permissible to use to develop expectations.

We provide further detail on these areas, as well as other comments, in our responses to a selection of the questions as set out below.

Comments on Specific Questions Posed by the Board

5. Are the introduction and objective sections of the proposed standard clear and appropriate? If not, how should they be clarified?

Yes, the introduction and objective sections of the proposed standard are generally clear and appropriate.

6. Are the factors that affect the persuasiveness of audit evidence provided by substantive analytical procedures, specifically the precision of the procedure and the reliability of the information used in it, clear and appropriate? If not, how should they be clarified? Are there other factors that affect the persuasiveness of audit evidence provided by substantive analytical procedures? If so, what are they?

It is clear that the reliability of information used in substantive analytical procedures affects the persuasiveness of audit evidence provided by such procedures. However, we believe the precision of a procedure and the related concepts described in proposed paragraphs .04 through .08 could be clarified.

The current standards require the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.[1] Auditing Standard (AS) 1105, *Audit Evidence*, and extant AS 2305, *Substantive Analytical Procedures*, describe concepts such as sufficiency, appropriateness, relevance and reliability of audit evidence, as well as precision of expectations in analytical procedures and precision of information. The proposal introduces a new concept of *precision* of a *procedure*. The proposal goes on to describe the factors affecting the precision of a procedure, which include, in simplistic terms, relevance of information, plausibility and predictability of relationships, and threshold for evaluation. It is unclear how this new concept of precision of a procedure interplays with the concepts defined in AS 1105. For example, it is unclear whether reliability of information affects the precision of a procedure. Additionally, it is unclear whether the sufficiency of audit evidence obtained through substantive analytical procedures is affected by the threshold for investigation and (or) other factors other than those described in AS 1105.05.

We believe paragraphs .04 through .08 of proposed AS 2305 could be made clearer by explicitly weaving in the concepts of AS 1105 as they apply to substantive analytical procedures. For example, as an opening to this topic, AS 2305 could state, “when planning and performing substantive analytical procedures, the auditor should obtain sufficient appropriate audit evidence through such procedures to provide a basis for his or her opinion.” The standard could then go on to describe the application of each of these concepts, for example:

- How to determine whether audit evidence from substantive analytical procedures is sufficient (e.g., reference back to AS 1105.05 and describe the requirements around the threshold for investigation and any other relevant factors).
- For substantive analytical procedures to result in appropriate audit evidence, expectations should be based on relevant and reliable information (e.g. tie in themes of proposed AS 2305.07). However, please see our response to question 14 regarding this proposed paragraph.
- How plausibility and predictability of relationships used in substantive analytical procedures affect the relevance, and therefore appropriateness, of audit evidence.
- How to evaluate the plausibility and predictability of relationships used in substantive analytical procedures (i.e., factors that affect the plausibility and predictability, similar to the description in paragraphs .05 and .06 of the proposal).

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?

Please see our response to question 6.

[1] AS 1105.04

> 8. Are the requirements for evaluating the relevance and reliability of information used in a substantive analytical procedure in accordance with AS 1105 clear and appropriate? If not, how should they be clarified?

Please see our response to question 6.

> 9. Are there specific considerations related to evaluating the relevance and reliability of information used in a substantive analytical procedure, beyond those in AS 1105, that should be included in the proposed standard? If so, what are those considerations and how should they be incorporated in the proposed standard?

Please see our response to question 6.

> 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 final statement in proposed paragraph .05 ("Making the determination should extend beyond inquiry.") gives rise to two points of confusion.

First, it is unclear whether the Board expects inquiry to always be performed in the determination of the plausibility and predictability of relationships being used in substantive analytical procedures. We believe inquiry may be appropriate for certain situations but is not always necessary. For example, auditors may perform certain analytical procedures based upon straightforward fixed relationships, such as the relationship between loan balances and interest rates to estimate interest expense or assets under management and fee percentages to estimate fee income. In such cases, we believe it is not always necessary to inquire of the company regarding the plausibility and predictability of these relationships. We request clarification related to this requirement to determine if inquiry is always a required procedure. This could be clarified by striking the proposed sentence and adding a note similar to that in AS 2301.24, such as: "Note: Inquiry alone does not provide sufficient evidence to support a conclusion about the plausibility and predictability of relationships being used in substantive analytical procedures."

Second, it is unclear what types of procedures or documentation the Board expects would satisfy this requirement. We agree with the Board's aim to keep the standard principles-based and not prescribe the nature, timing and extent of the auditor's procedures to determine that a relationship is sufficiently plausible and predictable.[2] However, to help drive consistent interpretation and application of the requirements as the Board intends, we request the Board publish examples and application guidance on what types of procedures would be appropriate in different scenarios. For example, the Board could describe their two examples on page 24 of the proposal in further detail, describing the procedures to determine the plausibility and predictability of the relationships.

> 11. Is the proposed requirement that the auditor take into account all relevant information of which the auditor is aware when determining whether a relationship is sufficiently plausible and predictable clear and appropriate? If not, how should it be clarified?

The use of the phrase "the auditor should take into account all relevant information of which the auditor is aware" gives us some pause. While we recognize the importance of considering information learned in other areas of the audit, the documentation expectations to meet this requirement are not clear. For

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[2] See page 23 of the proposal.

example, in the substantive analytical procedures documentation, it is unclear whether a general statement and reference to documentation of the auditor's understanding of the company and its environment would satisfy proposed paragraph .06a, or if documentation would need to be more robust as to how each piece of relevant information was considered in the substantive analytical procedure, or if the Board expects some other level of documentation regarding this. If the Board expects the auditor to document how each piece of relevant information was considered, this would result in significant duplicatation of documentation. Further, this does not seem practical, as the amount of relevant information of which the auditor is aware may be infinite. It may be more practical to describe the requirement in a form such as, "the auditor should evaluate any relevant information of which the auditor is aware that contradicts such plausibility and predictability" to achieve a more reasonable, consistent and attainable scope.

12. Are the examples of events, conditions, and company activities that are included in proposed paragraph .06 described clearly and appropriately? Are there additional events, conditions, or company activities that may affect the plausibility and predictability of a relationship that should be included in the proposed standard as examples? If so, what are they? If the examples of events and conditions are not clear, how should they be clarified?

Please see our response to question 11.

13. Is the proposed requirement for the auditor to develop an expectation clear and appropriate? If not, what changes should be made?

The proposed requirement for the auditor to develop an expectation is generally clear and appropriate.

14. Is 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 support the Board's intent for the standards to explicitly forbid circular auditing.[3] However, we have concerns that the language used in the proposed standard may be interpreted in a way that would inadvertently forbid auditors from using information that is in reality considered acceptable to use to develop expectations (e.g., prior year amounts, budgets, forecasts, other financial statement area balances).

The Board states in the commentary on pages 24 and 25 of the proposal that it intends to clarify and expand on extant AS 2305, specifically noting that expectations may be "developed from data derived from other sources" and referencing AS 2505.05, which further describes that these other sources include company information such as prior period financial information, anticipated results (e.g., budgets, forecasts), and financial information within the period. Rather than clarifying and expanding on this concept, the proposal removes this guidance and even adds contradictory language, stating in proposed paragraph .07 that "the auditor may not develop the expectation using… information that is based on the company's amount." It is unclear where the Board stands on this topic.

We believe it is acceptable and appropriate for an auditor to develop an expectation using the types of information produced by the company described in extant AS 2305.05, including the prior period balance of the financial statement area being tested, company-produced budgets for the financial statement area

[3] The Board states this intent on page 24 of the proposal, "The proposed requirement is designed to explicitly address the risk of circular auditing."

being tested, and balances equating to or derived from other financial statement areas not being tested in the same substantive analytical procedure.

If the Board agrees with our view, this should be clarified by editing the proposed standard as well as through publishing additional examples. Specifically, we suggest:

- The proposed standard should be clarified by revising the defined term in proposed paragraph .02 from “company’s amount” to “tested amount” or “amount being tested.” Additionally, proposed paragraph .07 should explicitly state that the auditor may develop the expectation using information produced by the company, so long as that information is not the amount being tested or based on the amount being tested. It could further specifically list certain types of information described in extant AS 2305.05.
- The adopting release commentary should be expanded to include the inverse of the commissions example on page 25 of the proposal. Specifically, it should state that while it is not appropriate to use commissions expense to develop an expectation to test revenue, it may be appropriate to use revenue, which is a balance tested through other substantive procedures, to develop an expectation to test commissions expense.

If the Board disagrees with our view and intends to significantly scale back the type of information allowed to be used in developing expectations, we request the Board perform additional outreach to various stakeholders, as this would significantly affect the practicality of performing substantive analytical procedures. This would likely result in fewer substantive analytical procedures being performed.

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?

Yes, the proposed requirement that the auditor determine a threshold to evaluate the difference between the auditor’s expectation and the company’s amount is generally clear and appropriate. However, we believe the auditor should be able to apply professional judgment when determining an appropriate threshold to evaluate differences when performing substantive analytical procedures. There may be scenarios where a threshold greater than tolerable misstatement is appropriate; this is not permissible in accordance with proposed paragraph .08, which specifies the threshold “be set at or below tolerable misstatement.” For example, when substantive analytical procedures are combined with substantive tests of details or tests of controls, it may be appropriate to use a higher threshold. We suggest the Board update the language to apply a more principles-based approach and allow auditors greater flexibility in determining an appropriate threshold for evaluating differences.

17. Are the proposed requirements for evaluating the difference between the auditor’s expectation and the company’s amount clear and appropriate? If not, what changes should be made?

The proposed requirements for evaluating the difference between the auditor’s expectation and the company’s amount are generally clear and appropriate.

> 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?

We believe further clarification is needed to the proposed amendment, as it is currently unclear. The proposed language in AS 2301.40A does not appear to have any linkage to the level of risk and (or) other evidence obtained when depending on external information for performing substantive procedures. Accounts and disclosures will depend on external information to various degrees, and this proposed amendment does not allow the auditor to take a risk-based approach for dealing with external information. We believe the auditor should be able to apply judgment and take a risk-based approach when determining if examining the external information is necessary or practical, as it may not be in all scenarios.

For instance, the example on page 33 of the proposal describes that in the year after an asset acquisition, a company's determination of depreciation expense "may depend only on internal records and the company's depreciation policy." The example does not describe how an auditor would apply the new requirement when performing a substantive analytical procedure over depreciation expense, taking into consideration the common scenario where a company may have acquired significant assets in the prior year and only a trivial amount of new assets in the current year. Therefore, only a trivial portion of the balance being tested through the substantive analytical procedure depends on information from external sources. We request clarification about whether the auditor would be required to bifurcate the population in this scenario and specific examples of how this requirement would be applied in practice.

We also ask for clarification regarding how the language in PCAOB Release 2024-007, *Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*, will interplay with this proposal. AS 1105.10A indicates that the auditor must assess the reliability of the information by either directly testing the information to determine it has not been modified or by testing the controls over the information whenever external documentation is received in electronic form.

> 23. Are there examples where substantive procedures applied to accounts or disclosures that depend on information received by the company from external sources could be effective in addressing assessed risks of material misstatement by examining only information produced by the company? When providing examples, please provide as much detail as possible, including a brief description of the account, relevant assertion, design of the substantive procedure, and discussion of how the procedure addresses the specific likely source of potential misstatement.

Please see our response to question 22.

> 36. Should proposed AS 2305 explicitly address aspects of the use of technology when designing and performing substantive analytical procedures, including situations where the use of technology might improve the quality of audit evidence obtained from such procedures? If so, how?

We would like to see the PCAOB provide more examples about implementing technology for substantive analytical procedures and use cases. While we recognize the intent of the standard to modernize the requirements and allow for new technology advancements and adaptations, additional application examples would assist auditors in designing and implementing new approaches to substantive analytical procedures.

37. 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?

The Board's position on and response to some of our concerns laid out above, particularly those in question 14, may affect our response to this question. For example, if the Board believes auditors should not be allowed to use any information produced by the company to develop expectations, we believe specific consideration should be given to emerging growth companies (EGCs) and the potential lack of availability of relevant external information for these types of companies, especially for those that operate in emerging industries. Otherwise, we generally believe that this proposal should apply to EGCs the same as other companies.

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

The effective date would be challenging to implement on the timeline expressed in the proposal, especially if the standard would be approved by the Securities and Exchange Commission (SEC) in the second half of the calendar year. The divergence from the American Institute of Certified Public Accountants and the International Auditing and Assurance Standards Board would result in new methodologies being derived, rather than simply updating existing methodologies. New tools would need to be developed and auditors would need to be trained on the new requirements. We recommend the adopted standard and related amendments be effective for audits of fiscal years beginning on or after a date at least one year after SEC approval.

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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 Hallemeyer, Deputy Chief Auditor, at 619.641.7318, or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

RSM US LLP

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