ILLINOIS CPA SOCIETY

August 12, 2024

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
comments@pcaobus.org

Re: PCAOB Rulemaking Docket No. 056

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society ("Committee" or "we") appreciates the opportunity to respond to PCAOB Rulemaking Docket Matter No. 056, *Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards,* dated June 12, 2024. The organization and operating procedures of the Committee are reflected in Appendix A attached to this letter. These comments and recommendations represent the position of the Audit & Assurance Services Committee of the Illinois CPA Society rather than any members of the Committee, the organizations with which such members are associated, or the ICPAS Board.

The Committee represents a diverse group of auditors with respect to firm demographic and role, including members of academia and the consulting profession. As such, we feel that we bring a unique perspective to respond to this proposal and appreciate your consideration of our thoughts herein.

GENERAL COMMENTS:

We agree that how auditors perform substantive analytic procedures is ever evolving with technology-assisted analysis and changes in the technological environment. To that end, an improved standard to better address growing audit-quality and execution related risks associated with designing and performing substantive analytical procedures seems reasonable. To aid in efficient and effective implementation, we suggest providing practical implementation guidance inclusive of example substantive analytics that comply with the standard and discussion of how to comply with certain provisions of the standard, which we have outlined further in the specific responses below. Overall, this proposed standard addresses warranted concerns with respect to the quality of audit evidence obtained, and we feel that a standard of this importance requires more application guidance to ensure that it is adopted appropriately and consistently.

PCAOB QUESTIONS AND COMMITTEE RESPONSES:

Question 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?

Response: We believe the factors of persuasiveness and precision within the proposal are not sufficiently clear and are inconsistent with other extant PCAOB standards. The proposal's language commingles the precision of a substantive analytical procedure with the persuasiveness of the evidence it is supposed to yield. Consistent with AS 1105.06, we believe the following edits to paragraph .04 would make the proposed standard clearer:

> "More persuasive audit evidence is obtained from a substantive analytical procedure when the procedure is more precise and uses more <u>relevant and</u> 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, and (ii~~i~~) the amount of the threshold for evaluating differences between the auditor's expectation and the company's amount.

The concepts of relevance and reliability are addressed at the beginning of the paragraph and as a pair in both paragraph .01 and paragraph .03 of the proposed standard and are presented together in many other auditing standards as they both affect the sufficiency and appropriateness of the audit evidence obtained. As currently proposed, the second sentence refers only to relevance and not reliability. The suggested edit above incorporates and pairs the concept of relevance with reliability. Further, the subsequent three sections of the proposed standard discuss "Identifying a Sufficiently Plausible and Predictable Relationship," "Developing an Expectation," and "Determining a Threshold for Differences." Thus, the proposed edits above align more clearly with the later content. Ultimately, we believe that the concepts of relevance and reliability should be standalone as they are fundamental to any audit test and that they are sufficiently addressed elsewhere when discussing the objectives of substantive analytical procedures. If the PCAOB wishes to leave the concept in, we believe that both relevance and reliability should be included to bridge the gap between both the extant and the proposed standard.

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?

Response: We believe that the statement within proposed paragraph .05, "*Making the determination should extend beyond inquiry"* is not necessary and should be removed as we believe that proposed paragraph .06 achieves the objective with the detail included therein on understanding the company and its environment and leveraging other procedures performed. While we agree that inquiry alone is not sufficient in many areas of testing associated with audits of financial statements and internal control over financial reporting, the inclusion of this language may lead to the performance of unnecessary additional procedures. We believe that auditors should be able to exercise professional judgment in determining the extent of procedures required to determine the plausibility and predictability of relationships. Further, we are unsure what the additional procedures would be expected to comply with the aforementioned statement in proposed paragraph .05, as it feels that they may be more akin to substantive tests of details when the auditor intended to use a substantive analytical approach to testing the account balance. Therefore, we propose striking the proposed sentence in paragraph .05 to make the standard more principles based. As noted in the discussion of the proposal, determining the plausibility and predictability of some relationships may require more extensive procedures than for others, and we believe the discussion of considering information related to the understanding the company and its environment described in paragraph .06 is sufficient.

Question 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?

Response: We believe that the proposed paragraph .06 - "*the auditor should 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, and (b) other procedures performed in the audit and in the reviews of interim financial information"* - while logical, should be further refined. The proposed paragraph also provides specific items to consider in determining relationships, including *"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."* Given this description of factors, we are concerned the consideration may be overly broad or too subjective. Further, we considered the guidance in AS 2501 which focuses on accounting estimates in "significant accounts and disclosures" and the underlying "significant assumptions" made when determining those accounts and disclosures. The introduction of the concept of "all relevant information" within this proposed standard seems to contradict other auditing standards which focus the auditor on items of significance. We believe it should be clarified to include only relevant information that is *significant* to the relationship, meaning that a change would have a material or meaningful impact on the outcome.

Question 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?

Response: We support the prohibition of circular auditing in the context of substantive analytical procedures. However, we do not fully understand the proposed changes regarding the use of company's amounts or information that is based on the company's amounts. When contemplating this question, we focused on the proposed removal of the guidance in extant AS 2305 paragraph .05 that includes references to the use of comparable prior period information, budget and forecasted information, etc.

While not the sole foundation for plausible relationships and expectations in a strong analysis, information such as prior period balances often serves as a relevant datapoint to form the basis of a substantive analytic. For example, when auditing payroll expense, if a company has had no changes in total headcount and the auditor has obtained evidence to support current period headcount along with pay and benefit increases via board approvals and benefit company contracts, we believe that the auditor would be able to utilize prior year payroll information as a starting point, making appropriate adjustments based on significant information of which the auditor is aware that would impact the expected balance for the current period. However, with the removal of the language noted above, it is unclear whether considering this (or similar relationships) is appropriate when developing analytics. Further, we are unclear if the removal was intentional because this information would now be considered a company's amount or information that is based on the company's amount. Accordingly, while we acknowledge that there is a definition of company's amount provided in paragraph .02 of the proposed standard, application guidance is necessary. The definition feels quite limiting without context and may imply that only external data points can be used.

We believe that general and industry-specific examples of appropriate use of company's amounts or information that is based on the company's amounts in the design and performance of substantive analytics would be helpful to better demonstrate what inputs would be reasonable. As part of these examples, we appreciated the example included on page 25 of the proposed standard related to revenue and commissions. We suggest that, as part of the proposed standard or application material, that this example (and others) be memorialized along with examples of those that would be appropriate. For example, leveraging the aforementioned example, we propose adding language akin to the following:

> "The risk of circular auditing occurs when the auditor's expectation and the company's amount are derived from the same sources of information. The proposed standard addresses scenarios in which circular auditing can occur when the auditor bases the expectation on either the company's amount (i.e., the amount to which the expectation will be compared) or information that is based on the company's amount. For example, the auditor may inappropriately develop an expectation of revenue using commissions that are calculated as a percentage of revenue (i.e., information based on the company's amount). In this case, it would be inappropriate to estimate revenue based on recorded commissions when the commission themselves were derived from revenue figures. However, assuming sufficient audit procedures were performed over the revenue balances recorded, it may be appropriate to develop an expectation of commissions based on revenue and the terms of the agreements governing commissions (e.g., percentages earned, key metrics, etc.)."

Overall, we believe the use of a company's amounts or information based on a company's amounts may be employed as inputs to substantive analytics as long as appropriate audit procedures are performed to substantiate the completeness and accuracy of these inputs, including consideration of relevance of the company information as a basis to set expectations for the results, if the information is subject to potential management bias and if any form of circular auditing is occurring.

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?

Response: We believe that the bright-line threshold of tolerable misstatement should be removed from the proposed standard as it contradicts the goal of a principles-based standard as well as other existing guidance around the evaluation of a difference from expectation. For example, AS 2501 and AS 2810 include discussion on the comparison of an auditor's independent expectation to the company's accounting estimate and utilize language such as "reasonable." We believe that this allows for appropriate auditor judgment in setting firm methodologies, including when analytics are not the predominant source of audit evidence. The extant standard (paragraphs .10, .17 and .20) includes the following language, as adjusted and combined, which we believe should be reintroduced into the proposed standard:

> "The auditor considers the level of assurance, if any, he wants from substantive testing for a particular audit objective and decides, among other things, which procedure, or combination of procedures, can provide that level of assurance. For some assertions, analytical procedures are effective in providing the appropriate level of assurance. For other assertions, however, analytical procedures may not be as effective or efficient as tests of details in providing the desired level of assurance. An expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate. As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements.
>
> In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount."

By introducing a bright-line threshold such as tolerable misstatement, contradicting many existing auditing standards that are more principles-based, we feel that there may be instances in which substantive analytical procedures will not be used when they would otherwise be a meaningful component of audit evidence when combined with tests of controls or other tests of details. Audit firm methodologies should account for the predictability and plausibility of substantive analytical procedures and determine if further audit procedures are required along with the nature, timing and extent of those further audit procedures when necessary. We believe the other additional enhancements noted in the proposed standard will improve the quality of substantive analytics as a whole, including the process for setting expectations and investigating differences, achieving the PCAOB's objectives for this proposal without requiring a bright-line threshold for investigation.

Question 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?

Response: As proposed, we do not believe the requirements for evaluating the difference between the auditor's expectation and the company's amount are clear. General and industry-specific examples would be helpful to better demonstrate what the intended next steps are when a difference is identified. For example, the proposal's discussion outlines an example procedure that may be performed in addition to inquiring of management - inspecting reliable documents that are relevant to the subject matter of the substantive analytical procedure. This alone is helpful guidance that we think should be articulated within the standard itself.

Also, we understand that it was intentional to remove the term “corroborate” to reduce the possibility of auditor confirmation bias. However, we felt that paragraphs .09 through .12 were not clear as to the level of work required to be performed. Paragraph .09 uses the term “audit procedures” while paragraph .12 uses the term “substantive audit procedures.” This disconnect could imply different levels of procedures to be performed.

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

Response: We believe the proposed effective date would provide insufficient time for auditors to effectively design processes to implement the standard. The proposed standard will likely require firms to revisit their audit approach and responses to identified risks of material misstatement. Further, firms may have to develop distinct policies and tools for GAAS, PCAOB, IFRS, etc. As such, we suggest that the standard and related amendments should be required for audits of fiscal years beginning on or after 24 months from the date of approval by the SEC.

CONCLUSION:

We support a proposed standard that provides clarity related expectations of auditors performing substantive analytics, particularly in contemplation of the use of technology-assisted analytics in the audit. Providing auditors clear guidance and examples to ensure ease of compliance is critical to successful implementation. Specifically, providing examples of substantive analytics that comply with this standard, including examples of the types of evidence to obtain in support of the inputs to the analytic, testing to be performed over these inputs, level of assurance obtained, and any other audit procedures expected to be performed to obtain a reasonable level of assurance is key.

The Committee appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Amber Sarb, CPA
Chair, Audit and Assurance Services Committee

Jon Roberts, CPA
Vice Chair, Audit and Assurance Services Committee

ILLINOIS CPA SOCIETY

APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2024 – 2025

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education, and public practice. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:	
National:	
Scott Cosentine, CPA	Ashland Partners & Company LLP
Timothy Delany, CPA	RSM US LLP
Erik De Vries, CPA	CohnReznick LLP
Kara Fahrenbach, CPA	Plante Moran, PLLC
Emily Hoaglund, CPA	KPMG LLP
James R. Javorcic, CPA	Mayer Hoffman McCann P.C.
Kelly Kaes, CPA	Grant Thornton LLP
Alek Michali, CPA	Baker Tilly US, LLP
Michael Potoczak, CPA	Marcum LLP
Jon Roberts, CPA	BDO USA, P.C.
Amber Sarb, CPA	RSM US LLP
Regional:	
Elda Arriola, CPA	Roth & Co., LLP
Andy Kamphuis, CPA	Vrakas CPAs + Advisors
Genevra D. Knight, CPA	Porte Brown LLC
Matthew Osiol, CPA	Topel Forman LLC
Michael Ploskonka, CPA	Selden Fox, Ltd.
Local:	
Kelly, Buchheit, CPA	ORBA
Lorena C. Engelman, CPA	CJBS LLC
Mary Laidman, CPA	DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Carmen F. Mugnolo, CPA	Mugnolo & Associates, Ltd.
Jodi Seelye, CPA	PKF Mueller, LLP
Industry/Consulting:	
Sean Kruskol, CPA	Cornerstone Research
Educators:	
Meghann Cefaratti, PhD	Northern Illinois University
Staff Representative:	
Heather Lindquist, CPA	Illinois CPA Society