

August 12, 2024

Ms. Phoebe Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K St, NW
Washington, DC 20006-2803

PCAOB Release No. 2024-006, June 12, 2024: Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards

Dear Secretary Brown and PCAOB Board Members:

Johnson Global Advisory is pleased to submit its comments on the proposed auditing standard related to an auditor's use of substantive analytical procedures, AS 2305, *Designing and Performing Substantive Analytical Procedures*.

Johnson Global Advisory's mission is to be the most innovative and technically excellent advisory firm at the intersection of companies, auditors, and regulators, which improves investor decision-making confidence. We serve a diverse group of audit firms ranging from single office firms to more complex regional firms and the top 20 firms. We help firms interpret, respond, and comply with global auditing and financial reporting standards and regulatory requirements, including those standards set by the PCAOB. Our team of financial reporting quality advisors helps prepare firms to perform high-quality audits using innovative tools with a shared commitment to implement effective policies, procedures, and controls. We also provide firms with integrated software and service solutions to help them comply with audit quality standards.

Overall, we support the PCAOB's objective to improve audit quality, enhance investor protection, and further the public interest in preparing informative, accurate, and independent public audit reports. The proposal to replace and retitle the existing auditing standard related to the use of substantive analytical review, AS 2305, *Designing and Performing Substantive Analytical Procedures*, is an important step to strengthen and clarify the existing requirements.

We agree that the proposed standard improves the existing standard and clarifies audit requirements to address some of the common inspection observations identified in the past. However, we remain concerned that the proposal does not include sufficient practical guidance to guide auditors on good practices for performing substantive analytical reviews, particularly for smaller firms. We encourage the Board to add an Appendix with some of the more common substantive analytics that auditors could use to illustrate the underlying foundation and the steps

required by the standard. Without robust and complete examples, we expect auditors will continue to avoid using these procedures to avoid increased costs and inspection observations. Illustrations should address identifying a plausible and predictable relationship and developing an expectation. These two audit procedures are typically the most challenging, requiring more education and guidance. While the proposal references various examples throughout the discussion, the same example is not followed through or illustrated for each step of the analytic.

The Board indicates in the proposal that firms in the non-affiliated group (which tend to be smaller firms) have varied methodologies and may have the most changes to make to comply with the new standard. We encourage the Board to consider options that would facilitate compliance with the new standard by expanding the proposal to provide more robust examples and application guidance.

We further encourage the Board to explore actions with other stakeholders (including educators and financial analysts) that would help enhance auditors' knowledge related to analytics and help remove the barriers that keep auditors from using these tools. With the advancements in technology that the Board has described in the proposal, auditors have better access to volumes of data to perform analytics. Technology-assisted analytics will become necessary to perform quality audits as technology evolves. Auditors need to explore these paths to help develop a better understanding of their client and execute more effective audit work and we encourage the Board to lead this effort. While the standard is clearer, we do not believe that, on its own, this will move the needle and encourage auditors to use these procedures.

We set out our comments on selected questions posed by the Board in the proposal in the attached Appendix.

We appreciate the opportunity to provide our comments and support the PCAOB's efforts to improve auditing standards to enhance audit quality and better protect investors. We would be pleased to discuss our comments with you at your convenience. Please direct any questions to Jackson Johnson, President (jjohnson@igacpa.com), Geoff Dingle, Managing Director and Shareholder (GDingle@igacpa.com), or Santina Rocca, Managing Director (SRocca@igacpa.com). They may be reached at (702) 848-7084.

Sincerely,

*Johnson Global
Advisory*

Johnson Global Advisory

Appendix A

Current Practice

1. **Does the description of current audit practice accurately depict the state of practice? If not, what clarifications should be made? Are there other aspects of current audit practice that we should consider?**

The description of current audit practice appears mainly focused on the larger firms both from a methodology and technique perspective. For example, the text notes that the PCAOB Board observed an increased use of technology-assisted analysis in audits, however, it does not indicate the extent of the use in the large and small firms.

We encourage the Board to consider expanding the description of current practice to:

- address the challenges auditors face in using the analytics.
- include additional examples around the use of technology-assisted analysis in audits that the PCAOB Board has observed.

In our experience, we have observed that smaller firms tend to limit their use of substantive analytical procedures citing the increased cost and risk that the procedure may not be effective and give rise to inspection observations.

Observations from PCAOB Oversight Activities

2. **Are there other areas of concern relating to auditors' use of substantive analytical procedures that are not described above? If so, what are the areas of concern and what changes should be made to address them?**

We have observed the auditors may not have sufficient knowledge to identify when analytics would be appropriate to use and could benefit from additional guidance and education related to analytical reviews.

3. **Does the proposal adequately describe the extent and frequency of auditors' use of substantive analytical procedures in audits? Please provide supporting information, such as the types of accounts generally tested using substantive analytical procedures and other relevant data.**

The proposal appears to adequately describe the extent and frequency of auditors' use of substantive analytical procedures in audits. In addition, we have observed auditors using substantive analytical procedures in audits in areas such as receivables turnover; days outstanding in accounts receivable, bad-debt expense and allowance for uncollectible accounts.

4. **Does the proposal adequately describe how advancements in technology changed the extent and frequency of auditors' use of substantive analytical procedures? Please provide details, including any information on the use of technology-based tools and the increase in the availability of data to perform substantive analytical procedures.**

In Section C, Reasons to Improve Auditing Standards, the PCAOB Board indicates that the PCAOB standards could be improved to better address growing risks to audit quality associated with designing and performing substantive analytical procedures and that these risks include risks

specifically associated with the use of technology-assisted analysis in substantive analytical procedures. We encourage the inclusion of specific examples to illustrate the risks associated with the use of technology-assisted analysis in substantive analytical procedures. Additionally, the Board provided an example of one account, trade payables, where technology-assisted analysis has enabled auditors to perform substantive analytical procedures over balance sheet accounts. We encourage the Board to provide more specifics on how technology-assisted analysis can be used to test such accounts through substantive analytical procedures.

Introduction and Objective

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

The introduction and objective sections of the proposed standard appear clear and appropriate.

Designing and Performing a Substantive Analytical Procedures to Respond to a Risk of Material Misstatement

- 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?**

The factors affecting 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, are appropriate, however, we encourage the PCAOB to provide more examples/more clarity around live examples for the small firm audit marketplace.

- 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?**

Reference to AS 1105, which outlines the requirements around evaluating the relevant and reliability of information used in a substantive analytical procedure, is appropriate. However, it would be beneficial to small firm practitioners to expand this area with some relevant examples that would further clarify the requirements when evaluating the relevance and reliability of information used in audit procedures.

Identifying a Sufficiently Plausible and Predictable Relationship

- 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 proposed standard does not indicate any guidelines/benchmarks that auditors should use to determine whether relationships are sufficiently plausible or predictable. This would require auditor

judgment and given that different auditors may come to different conclusions, it is not clear how the sufficiency of the plausibility and predictability of relationships can be evaluated.

We encourage the Board to add more robust and specific examples of what is a “sufficiently plausible or predictable” relationship. The proposed standard refers to broad events that may affect the plausibility and predictability – specific unusual transactions or events, accounting changes, business changes, or external factors, such as general economic conditions or industry factors. To help illustrate and clarify for auditors what that might look like needs further explanation and illustrations. We also encourage including examples of what “good looks like” and what “ineffective” looks like.

- 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?**

See above.

- 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?**

See above.

Developing an Expectation

- 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 appears to be 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?**

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 is clear and appropriate. The Board provides examples when circular auditing can occur when the auditor bases the expectation on either the company’s amount or information that is based on the company’s amount. We would recommend that the Board provides examples, to clarify to smaller audit practitioners, on the appropriate application of a substantive analytic.

Determining a Threshold for Evaluating Differences

- 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?**

The proposed requirement that the auditor determine a threshold to evaluate the difference between the auditor's expectation and the company's amount appears to be appropriate. We encourage the Board to provide more detailed examples and scenarios of threshold that can be used to provide more clarity to smaller audit practitioners.

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

- 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 indicate that the auditor should perform audit procedures which should extend beyond inquiry. While we understand the requirement, it would be helpful to small firm practitioners to clarify what procedures they would perform beyond inquiry.

Economic Analysis

- 31. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?**

The Board noted that it believes that the principles-based format of proposed AS 2305 would decrease the probability that auditors would avoid the use of substantive analytical procedures. However, we believe that without providing some illustrative examples of appropriately designed substantive analytical procedures to supplement the changes in the proposed, small audit practitioners may still be less inclined to apply substantive analytical procedures, even though the use of appropriate substantive analytical procedures could potentially, in certain instances, be applied rather than substantive tests of details.

- 35. Proposed AS 2305 does not change the existing requirements of AS 2301, that to address significant risks, including fraud risks, the auditor should perform tests of details specifically responsive to the assessed risk. Should changes be made to this existing requirement? If yes, what changes should be made and are there examples where a substantive analytical procedure would be just as or more effective than a test of details in addressing significant risks? When providing examples, please provide as much detail as possible, including a brief description of the account, relevant assertion, design of the substantive analytical procedure, and discuss how the procedure addresses the specific likely source of potential misstatement.**

While substantive analytical procedures could improve the effectiveness and efficiency of audits, we do not believe, presently, that changes should be made to the existing requirements of AS 2301 that

address significant risks, including fraud risks. We remain concerned that some auditors may not appropriately design the substantive analytical procedure thereby leading to insufficient results that address the audit objectives. Without the Board supplementing the proposal with specific examples illustrating substantive analytical procedures that are appropriately designed at a level of precision sufficient to respond to the assessed risk of material misstatement, concerns around auditors' application of substantive analytical procedures are further compounded.

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?

The PCAOB should consider providing a supplemental guide to the proposed standard which could include specific examples on the use of technology when designing and performing substantive analytical procedures. Substantive analytical procedures that are appropriately designed at a level of precision can improve the efficiency of audits, especially given talent shortages in the accounting profession. By providing a few detailed scenarios (even for illustration purposes only) this can assist auditors, especially small audit practitioners, in using substantive analytical procedures as an audit tool.