



Members of the Investor Advisory Group

Via Email

July 31, 2024

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

PCAOB Rulemaking Docket Matter No. 056, Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards.

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB or Board):

The Members of the Investor Advisory Group (MIAG)¹ appreciate the opportunity to comment on the PCAOB’s “Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards.” (Proposal).² The MIAG supports the Proposal.

At the outset we note that the Proposal would replace AS 2305, *Substantive Analytical Procedures* (Existing AS 2305)³ “in its entirety.”⁴ We understand the Existing AS 2305 “was originally developed by the American Institute of Certified Public Accountants . . . [5], adopted on an interim basis by the Board in 2003, and remains in effect substantially as adopted.”⁶ Thus, we believe pursuing the Proposal is strong step forward to achieving

¹ This letter represents the views of Investor Advisory Group (IAG) and does not necessarily represent the views of all its individual members, or the organizations by which they are employed. IAG views are developed by the members of the group independent of the views of the Public Company Accounting Oversight Board (PCAOB) and its staff. For more information about the IAG, including a listing of the current members, their bios, and the IAG charter, see <https://pcaobus.org/about/advisory-groups/investor-advisory-group>.

² Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards, PCAOB Release No. 2024-006 (June 12, 2024), <https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-056/2024-006-as-2305-proposal.pdf>.

³ AS 2305: Substantive Analytical Procedures (last visited July 9, 2024), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2305>.

⁴ PCAOB Release No. 2024-006 at 4.

⁵ We note that in 2012 the American Institute of Certified Public Accountants issued a standard that enhanced guidance on analytical procedures. See Analytical Procedures, AU-C Section 520 at 633 (Am. Inst. of Certified Pub. Accountants Dec. 15, 2012), <https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00520.pdf>.

⁶ PCAOB Release No. 2024-006 at 4.

the Board's 2022-2026 Strategic Plan and is directly responsive to the views expressed by the IAG in our related September 2022 letter to the PCAOB.⁷ That letter states in relevant part:

Goal 1: Modernize Standards

Adopt Standards That Meaningfully Improve Audit Quality and Enhance Our Ability to Enforce the Standards and Inspect for Compliance. While it isn't explicitly stated as the Board's top priority, we believe it should be. We know that auditors have been working with long-standing "interim" standards since the PCAOB's inception and their modernization is long overdue – yet there is no timeline or date goal set for their replacement, or even various stages of replacement. Setting dates for completion – and achieving them – establishes accountability for the PCAOB.

. . . We recommend that the Board prioritize modernization of interim auditing standards in this five-year plan, with the scalability of standards as a secondary priority.⁸

We share PCAOB Chair Erica Y. Williams' view that Existing AS 2305 "does not reflect developments that have taken place in the auditing environment in the past 35 years, for example, advancements in technology and a greater availability of information that is being used by the auditing profession in obtaining audit evidence [and that] . . . there are certain requirements in the existing standard that are duplicative of other Board-issued standards, such as the requirements related to documentation."⁹

We also support the Proposal because we believe the proposed standard, if adopted, would institute more consistent and higher quality procedures, reducing variability in audit quality. As the Board has indicated, many auditors are already following some aspects of the proposed new requirements which may alleviate regulatory burdens.¹⁰

We also believe the proposed new standards would give the PCAOB's regulatory arm a more robust set of rules to better ensure that all auditors are delivering investors a quality audit. We are pleased that the inspection process informed these proposed new standards,¹¹ which suggests a well-designed PCAOB structure, with the inspection arm informing the standards policy on the best direction to improve audit quality.

⁷ See Letter from Members of the IAG to the Office of the Secretary, PCAOB 2 (Sept. 15, 2022), https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/strategic-plan-comments-2022/10_iag.pdf?sfvrsn=f24d0e63_4.

⁸ *Id.*

⁹ Erica Y. Williams, Chair, PCAOB, Chair Williams' Statement on Proposal To Replace Standard on Substantive Analytical Procedures (July 12, 2024), [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-052/4_miag.pdf?sfvrsn=f77f0fec_4](https://pcaobus.org/news-events/speeches/speech-detail/chair-williams--statement-on-proposal-to-replace-standard-on-substantive-analytical-procedures#:~:text=Chair%20Williams'%20Statement%20on%20Proposal%20To%20Replace%20Standard%20on%20Substantive%20Analytical%20Procedures,-Date%3A%20Jun.&text=Performing%20substantive%20analytical%20procedures%20is,a%20significant%20account%20or%20disclosure; see Letter from the Members of the IAG to the Office of the Secretary, PCAOB 1-2 (Aug. 25, 2023), <a href=) ("We agree with the Board's statement '...the use of information in electronic form and technology-based tools by companies and their auditors to analyze such information has expanded significantly since these standards were developed.'").

¹⁰ PCAOB Release No. 2024-006 at 36 ("Some firms' methodologies already incorporate certain aspects of proposed AS 2305 . . .").

¹¹ See *id.* at 10-13 (discussing: "Current Practice and Observations from PCAOB Oversight Activities"); Erica Y. Williams, Chair, PCAOB, Chair Williams' Statement on Proposal To Replace Standard on Substantive Analytical Procedures ("We observed through our oversight activities that auditors do not always design and perform substantive analytical procedures appropriately."); George R. Botic, Board Member, Statement in Support of Proposed AS 2305, Designing and Performing Substantive Analytical Procedures, and

With the advancement in data analytic techniques, we see an excellent opportunity for technology to improve audit quality and reduce audit costs.¹² However, we continue to have concerns about the misuse of technology in a manner that reduces audit quality. We believe the additional guardrails around substantive analytical procedures contained in the Proposal would help to make technology advancements in auditing more beneficial to investors.

The remainder of this letter includes our comments on three select proposed changes relating to Existing AS 2305:

1. Information from external sources

We support the Proposal’s provisions that “would emphasize the importance of examining information from external sources when an account or disclosure depends on such information.”¹³ We agree with the PCAOB that those provisions are consistent with the views expressed by the “Board’s Investor Advisory Group . . . that auditors’ use of technology-assisted analysis is an area of concern due to auditors’ potential overreliance 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.”¹⁴ We also agree with the PCAOB that the provisions are one example of an appropriate response to the observations from the PCAOB oversight activities that “some auditors did not fulfill their responsibilities under the existing standard when performing substantive analytical procedures.”¹⁵ We believe it is now appropriate to establish a standard that better reflects technology and available information.

2. Plausible and predictably

We also support the Proposal’s provisions “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”¹⁶ We agree with the PCAOB that those requirements “would strengthen and clarify . . .

Amendments to Other PCAOB Standards (June 12, 2024), <https://pcaobus.org/news-events/speeches/speech-detail/statement-in-support-of-proposed-as-2305--designing-and-performing-substantive-analytical-procedures--and-amendments-to-other-pcaob-standards#:~:text=I%20am%20pleased%20to%20support,procedures%20to%20promote%20audit%20quality> (“It takes a standard that is over 30 years old, and has not been substantially changed since being adopted by the PCAOB in 2003, and considers it in light of the observations we have gathered in two decades of oversight activities.”); Anthony C. Thompson, Board Member, PCAOB, Statement In Support of Substantive Analytical Procedures (June 12, 2024), <https://pcaobus.org/news-events/speeches/speech-detail/statement-in-support-of-substantive-analytical-procedures> (“recent inspection results across all of our inspection programs indicate that there continue to be deficiencies in certain aspects of designing and executing substantive analytical procedures”).

¹² See Letter from the Members of the IAG to the Office of the Secretary, PCAOB at 4 (discussing how proposed technology-assisted audit procedures can lead to higher quality audits with benefits in excess of any related cost increases).

¹³ PCAOB Release No. 2024-006 at 15; see *id.* at A2-2 (“.40A Substantive Procedures Applied to Accounts or Disclosures that Depend on Information the Company Received from External Sources.”).

¹⁴ *Id.* at 14-15; see Letter from the Members of the IAG to the Office of the Secretary, PCAOB at 2 (“Such evidence should come from inside the audited company as well as external to it.”).

¹⁵ PCAOB Release No. 2024-006 at 12.

¹⁶ *Id.* at 24; see *id.* at A1-2 (“.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 [and] [m]aking the determination should extend beyond inquiry.”); *id.* at A1-2-A1-3 (“.06 Relationships used in the substantive analytical procedure must be sufficiently plausible and predictable to achieve the objective of the procedure [and] [w]hen determining whether a relationship is sufficiently plausible and predictable, 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 reviews of interim financial information [and] [n]ote: 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.”).

existing requirements [and are an appropriate response to] . . . the PCAOB staff . . . observed instances where auditors did not sufficiently evaluate the plausibility and predictability of the relationship used.”¹⁷ As Board member Anthony C. Thompson explained:

The auditor must . . . determine, through more than inquiry alone, whether the relationship to be used in the substantive analytical procedure is sufficiently plausible and predictable. This proposed requirement would strengthen this component in the substantive analytical procedure. The quality of the output from a substantive analytical procedure is dependent upon the sufficiency of the inputs – in this case the plausible and predictable relationship driving the auditor expectation.¹⁸

3. Tolerable misstatement

Finally, we support the Proposal’s provisions that “would require the threshold for evaluating the difference between the auditor’s expectation and the company’s amount to be set at or below tolerable misstatement.”¹⁹ We agree with the PCAOB that the proposed standard “would strengthen and clarify the existing requirements . . . which provide that the auditor should consider the amount of the difference from the expectation that can be accepted without further investigation and that this consideration is influenced primarily by materiality.”²⁰

We also agree with the Board that the proposed standard is an appropriate response to “the PCAOB staff . . . [observation of] instances where auditors did not appropriately determine an amount of difference between the auditor’s expectation and the company’s recorded amount that would require further investigation.”²¹ We, however, note that the proposed standard as written could in some cases potentially have the unintended consequence of auditors increasing engagement level tolerable misstatement to reduce the number of tests of details in a manner that could be inconsistent with improving audit quality and increasing investor protections. As a result, we would not object to the following modest revision to the proposed language of paragraph .08 of AS 2305:

.08 The auditor should determine a threshold for evaluating the difference between the auditor’s expectation and the company’s amount. **Consideration should be given to setting t**~~The amount of the threshold amount should be set~~ **at or below the tolerable misstatement amount,** taking into account the nature of the account or disclosure or, where applicable, the component of the account or disclosure. When determining the threshold, 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.²²

¹⁷ *Id.* at 22.

¹⁸ Anthony C. Thompson, Board Member, PCAOB, Statement In Support of Substantive Analytical Procedures.

¹⁹ PCAOB Release No. 2024-006 at 17; *see id.* at A1-3 (“08 The auditor should determine a threshold for evaluating the difference between the auditor’s expectation and the company’s amount [and] [t]he amount of the threshold should be set at or below tolerable misstatement, taking into account the nature of the account or disclosure or, where applicable, the component of the account or disclosure.”).

²⁰ *Id.* at 26; *see* Anthony C. Thompson, Board Member, PCAOB, Statement In Support of Substantive Analytical Procedures (“Taking into consideration the assessed risk of material misstatement and the objective of the substantive analytical procedures in setting the threshold, strengthens the requirements to include appropriate guardrails in developing a threshold based on the facts and circumstances of each audit.”).

²¹ PCAOB Release No. 2024-006 at 26.

²² *Id.* at A1-3 (tooled with footnotes omitted).

Thank you for considering the comments of the MIAG, who represent the primary customers of audited financial reports. If you, any members of the Board, or your staff have questions or seek further elaboration of our views, please contact Amy McGarrity at amcgarrity@copera.org.

Sincerely,

Members of the Investor Advisory Group

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