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May 26, 2010

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

RE: PCAOB Rulemaking Docket Matter No. 030

Dear Office of the Secretary:

McGladrey & Pullen, LLP appreciates the opportunity to comment on the PCAOB's *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*. McGladrey & Pullen is a registered public accounting firm serving middle-market issuers. We support the PCAOB's efforts to continue to strengthen the communications between auditors and audit committees. It is essential that the requirements in this standard be unambiguous. It also is important that there be a clear distinction among the responsibilities of the auditor, management, and the audit committee. We have the following comments on the proposed standard, which we believe would help to clarify certain sections of the proposed standard and enhance its application in practice.

Objectives

The objectives of the auditor as stated in paragraph 3 are primarily focused on the auditor's communications *to* the audit committee. However, we note that the requirement, as stated in paragraph 8, to inquire of the audit committee whether it is aware of matters that may be related to the audit cannot be correlated with any of the existing objectives in paragraph 3. We believe it is important to include an objective for the auditor to obtain from the audit committee information related to the audit, similar to the objective stated in paragraph 9.b. of International Standard on Auditing 260, *Communication with Those Charged with Governance.* We suggest incorporating such an objective with the existing objectives by revising objective 3.b. of the proposed standard to read as follows: "Inquiring of the audit committee as to whether it is aware of matters that may be related to the audit, and communicating to the audit committee an overview of the audit strategy and timing of the audit."

Additionally, we observe that certain of the communication requirements placed upon the auditor by this standard are of the type that should be initially communicated by management to the audit committee as part of the entity's internal control over financial reporting. To maintain a clear distinction among the responsibilities of the auditor, management, and the audit committee, we believe the auditor's starting point in determining the nature and extent of its communications to the audit committee should be its consideration of management's communications to the audit committee. We suggest revising objective 3.d. of the proposed standard to read as follows: "Evaluating the adequacy of the two-way communications between management and the audit committee and between the auditor and the audit committee to support the objectives of the audit."

Significant Issues Discussed with Management Prior to the Auditor's Appointment or Retention

Paragraph 4 requires the auditor to "discuss with the audit committee any significant issues discussed with management in connection with the appointment or retention of the auditor, including any discussions regarding the application of accounting principles and auditing standards." We believe the scope of these required discussions with the audit committee is too broad, and should be limited to those discussions that the auditor believes to be a significant factor in the current appointment or retention of the auditor. Also, in paragraph M. on page 18 of the release, the Board stated, "In determining what information to communicate to the audit committee, "retention" is not meant to limit this communication to discussions that occur shortly before re-appointment, but could include discussions occurring throughout the auditor's relationship with the company." We believe the communication should be limited to those discussions held since the last appointment or reappointment as auditor. To incorporate both of these parameters in the standard, we suggest that paragraph 4 be revised to read as follows: "The auditor should discuss with the audit committee any issues discussed with management prior to the auditor's initial appointment or subsequent to the last appointment or reappointment as auditor that the auditor believes to be a significant factor in the current appointment or reappointment."

Establish a Mutual Understanding of the Terms of the Audit

Paragraph 5 requires the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee, including communicating to the audit committee the responsibilities of the auditor and the responsibilities of management. We believe that the requirements in paragraph 5 should be expanded to include communicating to the audit committee its responsibilities related to the audit of the company's financial statements. If this requirement were added to paragraph 5, then Appendix C, "Matters Communicated in the Audit Engagement Letter," would need to be revised to include matters such as the following:

d. Audit committee's responsibilities:
   1. The audit committee is responsible for providing oversight to the company's financial reporting.
   2. The audit committee is responsible for informing the auditor of matters that may be related to the audit, including for example, knowledge of known or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters.
   3. The audit committee is responsible for adequate communications with the auditor, including, but not limited to the following:
      i. Appropriate and timely actions taken in response to matters raised by the auditor;
      ii. Open communications with the auditor;
      iii. A willingness to meet with the auditor without management present; and
      iv. Probing issues raised by the auditor.

Obtaining Information Related to the Audit

Paragraph 8 requires the auditor to inquire of the audit committee whether it is aware of matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. We believe that the last clause of this requirement could perhaps limit the audit committee's response to the inquiry. We suggest that paragraph 8 be expanded to read as follows: "The auditor should inquire of the audit committee whether it is aware of matters that may be related to the audit including, for example, knowledge of known or potential illegal acts and complaints or concerns raised regarding accounting or auditing matters."

Audit Strategy and Timing of the Audit

Paragraph 10.d. requires the auditor to communicate to the audit committee the roles, responsibilities, and locations of firms participating in the audit. The related discussion of this requirement (in paragraph D. on page 9 of the release) indicates the Board expects this communication to include disclosure of participation by affiliated and network firms. We believe the Board's interpretive guidance in the release should be included in the standard itself, instead of in the release, to avoid any miscommunication. We suggest rewording paragraph 10.d. to read as follows: "…The roles, responsibilities, and locations of firms participating in the audit, including affiliated and network firms, outsourcing arrangements, and non-affiliated firms used to perform audit procedures."

Accounting Policies, Practices, and Estimates

Paragraph 12 requires the auditor to communicate certain matters to the audit committee regarding accounting policies, practices, and estimates. We believe it is the responsibility of management to communicate these matters to the audit committee, and the auditor's starting point in determining the nature and extent of its communications to the audit committee should be its consideration of management's communications to the audit committee. We recommend modifying the standard such that the auditor would be required to:

- Evaluate the nature, extent, and reasonableness of management's communication with the audit committee regarding the matters in paragraph 12 related to accounting policies, practices, and estimates; and
- Communicate to the audit committee any information in paragraph 12 related to accounting policies, practices, and estimates that was not communicated by management to the audit committee.

In addition, we have the following comments related to the specific requirements regarding the accounting policies, practices, and estimates to be communicated:

- Paragraph 12.a.ii. requires the communication of the anticipated application by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting. Although the application of regulatory pronouncements may be something that management communicates with the audit committee, we do not believe it is a communication that should be evaluated by the auditor. We believe the wording of paragraph 12.a.ii. should be aligned with that of SAB 74 so as to read as follows: "The potential effects of adoption of accounting pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting. "
- Paragraph 12.a.iii. requires the communication of the methods used by management to account for significant and unusual transactions. We note that recently issued PCAOB Staff Audit Practice Alert No. 5 uses the terminology *significant unusual transactions.* To eliminate any confusion in terminology, we suggest paragraph 12.a. iii. be revised to refer to significant unusual transactions, instead of significant and unusual transactions.

Auditor's Evaluation of the Quality of the Company's Financial Reporting

Paragraph 13.a.ii. requires the auditor to communicate to the audit committee the results of the auditor's evaluation of the quality of the company's significant accounting policies and practices, including a discussion of the "consistency of the company's disclosures and of its selection and application of significant accounting policies and practices" (emphasis added). The meaning of this paragraph is unclear to us. Please clarify whether this requirement means that the auditor should discuss the consistency of the company's financial statement disclosures with its actual application of significant accounting policies and practices.

Paragraph 13.b.iii. requires the auditor to communicate to the audit committee how current and anticipated future events generally may affect the determination by the auditor of whether certain policies and practices are considered critical. We are unclear as to how an auditor should anticipate future events and determine whether they are relevant and/or likely to affect a company's current policies or practices.

Management Consultations with Other Accountants

When the auditor is aware that management consulted with other accountants about auditing or accounting matters, paragraph 15 requires the auditor to communicate to the audit committee his or her views about significant matters that were the subject of such consultation. Question 12 on page 14 of the release asks whether this requirement should be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms. We believe this requirement should not be expanded because (a) auditors would not necessarily be in a position to know about consultations management had with consulting firms or law firms; (b) such consultations may be in the normal course of business; and (c) such consultations may be privileged.

Going Concern

Paragraph 16(a) requires the auditor to communicate to the audit committee conditions or events that indicate there *could* be substantial doubt about the company's ability to continue as a going concern and the conditions and events that mitigated the auditor's doubt (to the extent that those concerns were mitigated). Paragraph 3(a) of AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* of the PCAOB's interim standards requires the auditor to consider whether the results of audit procedures performed identify conditions or events that indicate there could be substantial doubt about the entity's ability to continue as a going concern. In addition, in such situations, it may be necessary for the auditor to obtain additional evidence that mitigates the auditor's doubt. As proposed under paragraph 16(a) of the standard, the trigger point for auditor communication with the audit committee appears to be the auditor's initial evaluation under the requirements of paragraph 3(a) of AU Section 341.

Since auditors are not required in all situations to perform additional procedures to obtain evidence to mitigate the concern, we are concerned that using the threshold "could" may result in the auditor communicating his/her consideration in situations where the auditor does not have a significant doubt about the company's ability to continue as a going concern. We do not believe communications around such situations provide the audit committee with meaningful information. Paragraph 3(b) of AU Section 341 requires that if the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented. We believe that the trigger point for requiring auditor communication with the audit committee should be when the requirements of paragraph 3(b) of AU Section 341 are applicable.

Corrected and Uncorrected Misstatements

We believe this subsection should be reorganized such that paragraph 17 only addresses corrected misstatements and paragraph 18 only addresses uncorrected misstatements. In addition, since the "note" associated with paragraph 18 includes a "should" requirement, we suggest it become part of paragraph 18 directly, instead of being a note to the paragraph. If these two suggestions are considered together, this subsection could be revised to read as follows:

> Corrected and Uncorrected Misstatements
>
> 17. The auditor should communicate those corrected misstatements that might not have been detected except through the auditing procedures performed, including the implications such corrected misstatements might have on the financial reporting process.
>
> 18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that was presented to management.[21] The auditor should communicate to the audit committee the basis for the auditor's determination that the uncorrected misstatements were immaterial, including the qualitative[22] factors considered. In addition, the auditor should communicate that uncorrected misstatements or matters underlying uncorrected misstatements could cause financial

statements to be materially misstated in future periods, even though the auditor has concluded that the uncorrected misstatements are not material to the financial statements for the year under audit.

Question 15 on page 15 of the release asks, "Should all corrected misstatements including those detected by management be communicated to the audit committee?" We believe the standard should not be revised to include the communication of corrected misstatements detected by management. If the company's internal controls over financial reporting detect and correct misstatements, such corrections need not be reported to the audit committee as this would indicate that the related controls are effectively designed and operating.

Form and Content of Communications

Question 16 on page 16 of the release asks whether all or certain matters should be required to be communicated to the audit committee in writing. We do not believe it would be appropriate to require all matters to be communicated to the audit committee in writing. Certain matters are best communicated in writing, others are better communicated through a robust discussion with the audit committee, while some may, in the auditor's opinion, require both oral and written communication. We believe the requirement as stated in paragraph 23 of the proposed standard is appropriate.

Adequacy of the Two-Way Communications

Paragraph 28 requires the auditor to consider taking certain actions if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved. We believe that the auditor first should consider the audit implications of inadequate two-way communications, including determining whether the inadequacy in communication constitutes a control deficiency, a significant deficiency or a material weakness. Also, in an integrated audit conducted pursuant to PCAOB Auditing Standard No. 5 if there are deficiencies that, individually or in combination, result in one or more material weaknesses, the auditor must express an adverse opinion on the company's internal control over financial reporting. This is inconsistent with the requirement in paragraph 28.b.

In addition, if the auditor determines that the two-way communications between the audit committee and the auditor have not been adequate and the situation cannot be resolved, we believe it would be rare that the auditor would not inform the company's full board of directors. Therefore, we recommend the PCAOB elevate the requirement to communicate with the full board of directors to "should" as opposed to "should consider".

As previously noted in our comments regarding the objectives of the standard on page one of this letter, we believe the standard should also address the auditor's evaluation of the adequacy of the two-way communications between management and the audit committee. In making this evaluation, the auditor should consider the audit implications of inadequate two-way communications, including determining whether the inadequacy in communication constitutes a control deficiency, a significant deficiency or a material weakness. If the PCAOB agrees with this recommendation, the proposed standard should be revised to include a paragraph directing the auditor to evaluate the adequacy of two-way communications between management and the audit committee. The purpose of the auditor's evaluation would be to assess the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting as required under existing PCAOB standards.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to either Robert Dohrer (919.645.6819) or Bruce Webb (515.281.9240).

Sincerely,

McGladrey & Pullen, LLP

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