



Tel: 212-885-8000
Fax: 212-697-1299
www.bdo.com

100 Park Avenue
10th Floor
New York, New York
10017

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Via E-mail: comments@pcaobus.org

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

Re: **PCAOB Release No. 2010-001, Rulemaking Docket Matter No. 030,
*Proposed Auditing Standard Related to Communications With Audit
Committees And Related Amendments to Certain PCAOB Auditing Standards***

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO Seidman, LLP welcomes this opportunity to comment on the PCAOB's Proposed Auditing Standard, *Communications with Audit Committees* (the "proposed standard"), which would supersede the Board's interim standards AU sec. 380, *Communication With Audit Committees*, and AU sec. 310, *Appointment of the Independent Auditor*, and would amend certain other PCAOB auditing standards. Overall, we support the issuance of the proposed standard, which we believe strengthens the functioning of the audit committee by encouraging a more robust discussion between the auditor and the audit committee.

Our comments are organized such that our overall comments are provided first, followed by our responses to the specific questions posed in the release.

Overall Comments

We support the Board's efforts to improve auditor communications with the audit committee, including recognition of the importance of two-way communication between the auditor and the audit committee, specifically as it relates to the audit committee's oversight of the financial reporting process and the external auditor. Given the important role audit committees play in overseeing the financial reporting process, it is essential that audit committee members are active participants. We believe that the proposed standard promotes such participation. Effective communication, which includes discussions regarding significant risks, critical accounting estimates, and the overall clarity of the financial statements, among other matters, helps ensure the integrity of the financial reporting process.

Consideration of the Requirements of the Relevant Standards of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB)

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We support the PCAOB's efforts to converge with the IAASB's International Standards on Auditing (ISAs) when it is appropriate to do so in the context of the public company audit. Furthermore, we are pleased to see the comparison of the objectives and requirements of the proposed auditing standard with the ISAs, in addition to the ASB's Statements on Auditing Standards, as set out in Appendix 3.

We note that this analysis does not cover the application and explanatory material in the IAASB and ASB standards. We encourage the PCAOB to consider such guidance and cover it in the release accompanying the final standard, because while the application guidance does not impose requirements on the auditor, it does provide important guidance about how to implement those requirements. ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, emphasizes the importance of application guidance to the proper application of the requirements. In particular, ISA 200, paragraph 9, states "The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly."

Development of Guidance to Enhance the Effectiveness of Audit Committees

While we recognize the importance of effective two-way communication and support the efforts of the PCAOB to strengthen such communication, we are also aware that the PCAOB does not have jurisdiction over audit committees. As such, efforts to strengthen communication may require additional actions by other regulators and professional organizations. In that regard, we encourage the PCAOB to initiate efforts to work with others such as the National Association of Corporate Directors in the development of guidance to enhance the effectiveness of audit committees.

A. Objectives of the Auditor

- 1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?**

Overall, we believe that the objectives set out in the proposed standard are appropriate and satisfactorily emphasize communications from the auditor to the audit committee. However, we believe that effective communication requires not only participation by the auditor, but also participation by the audit committee, and as such, suggest adding an additional objective of the auditor relating to obtaining information relevant to the audit from the audit committee. We believe that including this additional objective will foster a constructive interaction between the auditor and the audit committee to enhance audit quality and the financial reporting process.



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We note that a similar objective is included within ISA 260, *Communication with Those Charged with Governance*, and the ASB's Statement on Auditing Standard No. 114, *The Auditor's Communication With Those Charged with Governance* (SAS 114).

Further, we note that one objective of the auditor within this proposed standard is to *evaluate* the adequacy of the two-way communications between the auditor and the audit committee, whereas the corresponding objective in ISA 260 and SAS 114 is to *promote* effective two-way communication. Given that the emphasis of this standard is to foster more effective two-way communication, we believe that this objective should more closely align with the ISA and state that the objective of the auditor is to "promote effective two-way communication."

Moreover, we believe that the necessity to evaluate the adequacy of the two-communication is more akin to a requirement than an objective and suggest including such guidance (similar to ISA 260) within the requirements section of the proposed standard as follows:

"The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor should evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and take appropriate action."

Additionally, similar to ISA 260 and SAS 114, we recommend supporting such a requirement with implementation guidance that would explain how to perform such an evaluation.

2. Are the objectives adequately articulated? Should the articulation of the objectives focus on the outcome that should be achieved by performing the required procedures?

We think the objective should focus on the outcome that should be achieved - which is effective communication.

B. Establish a Mutual Understanding of the Terms of the Audit

3. Is it appropriate for the proposed standard to require that an engagement letter be prepared annually? If not, why?

We believe it is appropriate to require that an engagement letter be prepared annually to avoid any misunderstandings about the scope of work and to reconfirm the responsibilities of each party in the financial reporting process. Additionally, obtaining an engagement letter each year ensures that changes in client circumstances that may affect the audit are appropriately reflected.



However, we believe that the guidance in the proposed standard is not clearly stated. For example, paragraph 6 requires the auditor to record the understanding of the terms of the audit engagement in an engagement letter and provide that letter to the audit committee; however, there is no mention that the engagement letter should be provided annually. Only later, in paragraph 25, does the proposed standard state that all communications should be made annually. To clarify that an engagement letter should be provided annually, we suggest revising paragraph 6 to state that the auditor should record the understanding of the terms of the audit engagement in an engagement letter and provide the letter to the audit committee *annually*.

4. Are there other matters that would enhance investor protection that should be added to an engagement letter? If so, what other matters should be included in an engagement letter?

Paragraph 5 explains that in establishing a mutual understanding of the terms of the audit engagement, the auditor should communicate (a) the objective of the audit, (b) the responsibilities of the auditor, and (c) the responsibilities of management. While we agree that these communications are essential to the establishment of a mutual understanding of the terms of the engagement, we believe that it is important to also include in the engagement letter the responsibility of the audit committee to communicate any matters of which it is aware that may be related to the audit.

C. Obtaining Information Related to the Audit

5. Is the proposed requirement to inquire of the audit committee appropriate? What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

We agree that it is appropriate to inquire of the audit committee about matters that may be related to the audit, including complaints or concerns raised regarding accounting or auditing matters. However, we believe that the auditor's inquiry should be broader and should encompass other matters that may be related to the audit. As such, we recommend adding the following additional matters as examples of inquiries the auditor may make:

- Strategic decisions that may affect the nature, timing or extent of audit procedures
- Suspicion or detection of fraud or incentive for bias in the financial statements
- Concerns related to the integrity or competence of senior management
- Known and potential illegal acts



D. Overview of the Audit Strategy and Timing of the Audit

6. Are the requirements to provide information on the auditor's audit strategy and timing of the audit appropriate? Does the auditor need more guidance related to the requirement to provide information on the auditor's audit strategy? If so, what type of guidance would be helpful?

Overall, we agree that the requirements to provide information on the audit strategy and timing of the audit are appropriate. We recognize that the note to paragraph 9 explains that the overview of the auditor's strategy for the audit is not intended to provide specific details about the audit that might compromise the effectiveness of the audit procedures; however, we believe that additional guidance about the extent of the information would be helpful.

7. Is it sufficiently clear which types of arrangements should be communicated to the audit committee related to the roles, responsibilities, and locations of firms participating in the audit?

Paragraph 10(d) requires the auditor to communicate, when applicable, the roles, responsibilities, and locations of firms participating in the audit. However, we believe the definition of the term "firm" is not sufficiently clear since, as noted in the release accompanying the proposed standard, some firms operate within a network of affiliates and the reference to "firm" may or may not be clear. To clarify the definition, we suggest including the definition of "firm" for purposes of this standard in Appendix A.

E. Accounting Policies, Practices, and Estimates

8. Are the proposed requirements regarding the auditor's communication responsibilities with respect to accounting policies and practices sufficiently clear in the proposed standard (e.g., is the difference between a critical accounting policy and a significant accounting policy or practice adequately described)?

We believe that the proposed standard has not adequately described the auditor's role as it relates to communications with respect to accounting policies and practices as described in paragraph 12. We believe the auditor's responsibility should be focused on providing an objective perspective of management's judgments. As explained in the note to paragraph 12, management may have communicated the matters set out in paragraph 12, in which case, the auditor would determine whether such items were adequately described, and if not, communicate any omitted or inadequately described matters to the audit committee.

We believe that it is management's responsibility to communicate the matters outlined in paragraph 12 to the audit committee, and that the auditor's role is to ensure that those matters were appropriately communicated. As such, the auditor's consideration of management's communications should be the starting point in determining the nature and



extent of the auditor's communication related to a company's accounting policies, practices, and estimates. Accordingly, we suggest revising the requirement in paragraph 12 such that the auditor evaluates the sufficiency of management's communications.

We note that the definition of a critical accounting policy is provided in Appendix A and that additional guidance is provided in the note to paragraph 13(b) which explains how critical accounting policies differ from significant accounting policies. This guidance states that management's selection of significant accounting policies and practices involves consideration of a broader range of transactions and events over time, while the description of critical accounting policies and practices should be tailored to specific events in the current year. However, we note that a definition of a significant accounting policy is missing from the definitions included within Appendix A, and believe that without a definition a clear distinction cannot be made. Accordingly, we suggest including such a definition.

Paragraph 12(a) (ii) requires the auditor to communicate 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. We believe the reference to "regulatory pronouncements" is not sufficiently clear and that the guidance set out in SEC Staff Accounting Bulletin No. 74 (SAB 74) regarding the effect of an enacted but not yet adopted accounting standard is more specific. We therefore suggest revising this requirement to align more closely to SAB 74.

9. Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

We believe it is helpful to consolidate audit committee communications required by the SEC and the PCAOB into the proposed standard for ease of reference.

10. Is the definition of critical accounting estimates appropriate for determining which estimates should be communicated to the audit committee?

Yes, we believe the definition is appropriate.

11. Are the communication requirements regarding critical accounting estimates appropriate? If not, how should the proposed standard be modified to provide appropriate information to the audit committee?

We note that paragraph 12(b) (iii) requires the auditor to communicate to the audit committee "a description of the reasons for the changes [to assumptions or processes made by management to critical accounting estimates]." We believe this paragraph should clarify that the auditor should communicate its evaluation of management's basis for significant changes to properly reflect management's responsibility for the company's financial statements. This clarification would more clearly emphasize that such information is



management's responsibility, while still addressing the auditor's responsibilities with regard to the information.

F. Management Consultations with Other Accountants

12. Should this requirement be expanded to include consultations on accounting or auditing matters with non-accountants, such as consulting firms or law firms?

We do not believe the proposed standard should be expanded to include management consultations with non-accountants. Given that auditors are not likely to be aware of *all* management discussions with its various professional service providers and that many of such communications may not be relevant to the audit, we do not believe this requirement would be useful in helping the audit committee in its oversight role.

Additional Consultation Requirements

Paragraph 13(f) requires the auditor to communicate to the audit committee significant accounting matters for which the auditor has consulted outside the engagement team. We agree that it is important to provide audit committees with information regarding areas of a company's financial reporting that are complex or assessed as high risk, which is already a requirement; however, we do not believe it is necessary to communicate all consultations that may occur during an audit. For example, the structure of the consultation process is likely to be different from firm to firm and may result in communications that are not important with respect to the audit committee's oversight role. Additionally, the level of consultation may vary on similar issues across audit engagements due to the expertise within the audit team and specific firm policies. Given the varied manner in which engagement teams and firms may consult on issues, we are concerned that audit committees may place undue weight on certain matters where consultations do or do not take place.

G. Going Concern

13. Is the communication requirement on going concern clear? If not, how could the requirement be clarified?

We do not believe that the communication requirements, as set out in paragraph 16, are clear. For example, the proposed standard requires the auditor to communicate certain matters to the audit committee when conditions and events indicate there *could* be substantial doubt; however, it is unclear when the "could" threshold would be met. We recognize that AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, uses the term "could" in its discussion regarding the auditor's evaluation of whether there is substantial doubt, but we believe that the context of that discussion differs from the proposed standard, in that it is based on the results of procedures



performed as part of planning and gathering audit evidence and not simply in terms of “if conditions and events indicate.”

H. Corrected and Uncorrected Misstatements

14. Are the requirements appropriate regarding the communications for uncorrected misstatements?

We believe that the requirements regarding communications for uncorrected misstatements are appropriate.

15. Should all corrected misstatements including those detected by management be communicated to the audit committee?

We do not believe that communicating all corrected misstatements, including those detected by management, is appropriate; rather, we believe that only those corrected misstatements that were not detected by the entity’s financial statement close process should be communicated. During the course of the audit, it is not unusual for management to identify adjustments that need to be recorded as part of the normal financial statement close process. An auditor may not have knowledge of all misstatements detected by management, and of those, which were the result of the effective operation of the controls within the financial statement close process or as a result of deficiencies in those controls, depending on the timing of the audit (e.g. interim work). Establishing a requirement to communicate all corrected misstatements, including those detected by management, could cause the auditor to spend significant time in identifying misstatements detected by the company through its routine processes. Further, we do not believe that such communication would significantly enhance the audit committee’s oversight of the financial reporting process and may detract from the more important communication of those misstatements not detected by the entity’s internal control over financial reporting.

Further, we note that paragraph 18 requires auditors to 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. This requirement duplicates the requirements in Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5), and AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements*, and for this reason we suggest clarifying how the requirement in this proposed standard differs, if at all, from the reporting of control deficiencies as set out in those standards.



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J. Form and Content of Communications

16. Like the existing standard, the proposed standard would allow the auditor to communicate many matters orally or in writing. Should the standard require that all or certain matters be communicated to the audit committee in writing? If only certain matters should be communicated to the audit committee in writing, what are those matters?

We believe that the extant requirement set out in AU sec. 380, which permits communications to be oral or written is appropriate since it permits the form of the communications to reflect the nature of the specific issues. Therefore, we do not agree with a requirement for all or certain communications to be in writing. In addition, we believe that communications that are purely in writing may not always achieve the objective of effective two-way communication.

K. Timing

17. Are the requirements in the proposed standard on the timing of the auditor's communications appropriate? Should only certain matters be communicated annually? If so, which ones?

We agree with the requirements regarding the timing of the auditor's communications. However, with respect to interim reviews, we believe that the communication requirements should include discussion of the nature and extent of the interim procedures and as such recognize that the communications at an interim period are based on a level of work less robust than that performed during the year-end audit.

L. Adequacy of the Two-way Communication Process

18. Does the requirement to evaluate the adequacy of the communication process promote effective two-way communications? Is more information on this requirement needed?

See our response to question 1.

Additionally, we believe that the guidance in paragraph 28 should be revised to require communication with the full board of directors when communications between the audit committee and the auditor have been evaluated as inadequate for purposes of the audit; the proposed standard only requires the auditor to *consider* taking this action. We believe the auditor should then be required to consider the proposed actions in 28(b) and 28(c), should the board of directors not respond appropriately.



M. Other Communication Requirements

- 19. Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?**

We note that the release to the proposed standard, on page 18, discusses other communication requirements, specifically, significant issues discussed with management prior to appointment or retention that may have influenced management's views about the auditor or about significant accounting or auditing issues. The release text explains that the discussion with the audit committee should encompass issues the auditor discussed with management throughout the auditor's relationship with the company and should not be limited to discussions that occur shortly before re-appointment. In contrast, paragraph 4 of the proposed standard does not provide similar direction regarding the issues that are expected to be discussed in these circumstances. It is unclear to us how the communication of discussions throughout the audit engagement differs from communications otherwise required by the proposed standard. As such, we suggest that the release be clarified for this issue. In that regard, we believe that such additional guidance should at least clarify that the auditor should communicate those matters deemed significant to the auditor's appointment or reappointment and that have occurred since the auditor's last appointment.

- 20. Are the matters included as significant difficulties in paragraph 21 of the proposed standard appropriate? What other matters should be included as significant difficulties?**

We believe that the matters included as significant difficulties in paragraph 21 of the proposed standard are appropriate; however, we suggest clarifying the last item in this paragraph (item 21(e)) to conform to the guidance included in the ASB's Final Clarified Statement on Auditing Standards, *The Auditor's Communication With Those Charged With Governance* (Redrafted), to more clearly communicate that management is responsible for making an assessment of the entity's ability to continue as a going concern and that the auditor evaluates such an assessment. That guidance states:

-management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

- 21. Are any of the requirements included in the proposed standard inappropriate for auditors to communicate to audit committees based on the size or industry of the company under audit?**



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We do not believe that any of the requirements in the proposed standard would be inappropriate based on the size of the company or industry.

N. Appendices

22. Is the information included in Appendices A - C to the proposed standard sufficiently clear? Should the appendices include other matters, e.g., should other items be included in an audit engagement letter?

Except as noted in our comments to questions 7 and 8, related to definitions, and question 17, related to interim reviews, we believe the information in Appendices A-C are sufficiently clear.

With respect to audit engagement letters, we do not believe that other items should be required.

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Wayne Kolins, National Director of Assurance at 212-885-8595 (wkolins@bdo.com) or Susan Lister, National Director of Audit Policy at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO Seidman, LLP

BDO Seidman, LLP