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United States Government Accountability Office
Washington, DC 20548

February 18, 2009

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

Subject: PCAOB Release No. 2008-006, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) proposed new auditing standards on assessing and responding to risk during an audit.

We appreciate the PCAOB's efforts to update its auditing standards on assessing and responding to audit risk for registered companies and agree that this process is a critical element of an effective audit. However, we continue to have serious concerns about the PCAOB's approach to updating its interim standards and believe it will increase the likelihood of misinterpretations, inconsistent application of the standards, and higher costs for all users with a disproportionate burden on smaller and mid-sized firms.

Currently PCAOB standards consist of (1) certain pre-existing standards developed by Auditing Standards Board (ASB) of the American Institute of CPAs (AICPA) as of April 16, 2003, which the PCAOB adopted as interim standards on an initial, transitional basis, and (2) standards developed by the PCAOB to satisfy requirements of Section 103 of the Sarbanes-Oxley Act of 2002 (the Act). Now the PCAOB proposes adding a new layer of standards by revising or supplementing certain core interim standards with new standards developed by the PCAOB, resulting in duplication of and inconsistencies between its standards and those of other established independent auditing standard-setting organizations. These new PCAOB standards include, in some cases, modified versions of other established standards without providing clear explanations of the reasons for or meaning of those differences.

For example, the PCAOB has adapted and included in its proposed standards only selected provisions of the International Auditing and Assurance Standards Board's (IAASB) audit risk standard and omitted much of the useful guidance. The differences between these two sets of standards are difficult to detect and understand because the PCAOB does not identify or offer a clear explanation of (1) the changes and omitted provisions, (2) why the changes and omissions are necessary, and (3) the implications for users. Unlike the corresponding International Standards on Auditing (ISA), which include discreet application and other material sections, the PCAOB standards combine requirements with application and other material, making it more difficult to identify the

ISA guidance that is not included in the PCAOB proposed standards. In addition, many of the PCAOB changes appear to be simple word choice preferences, but it is unclear whether the PCAOB is proposing more substantial changes. These inconsistencies in core standards are likely to increase audit costs and lead to confusion and misapplication of the standards.

Our second concern is that these proposed standards will needlessly create another version of standards related to important core auditing procedures and cause users to incur increased costs related to understanding and implementing two or more sets of standards. Users likely will incur increased staff training costs and may need to revise their auditing methodologies and develop crosswalks to identify differences between PCAOB standards and other base standards. Keeping up with multiple versions of standards and guidance from numerous sources is expensive for all firms and will have a disproportionate impact on small and mid-sized firms, as firms need to revise guidance for their staff or purchase prepared guidance material from external sources when new standards are issued.

Rather than revising or supplementing its standards with new standards developed by the PCAOB, we suggest using a more comprehensive, systematic approach of:

- adopting a base set of relevant existing and prospective standards of another established independent auditing standard-setting organization,
- developing any additional, incremental standards and requirements as necessary and appropriate for audits of U.S. registered companies and clearly explaining the nature of and reasons for the additional standards, and
- assuring that the entire set of PCAOB standards are widely available in an easy to use format.

The PCAOB could adopt as a base the standards of the IAASB, which is a standard-setting body designated by, and operating independently under the auspices of, the International Federation of Accountants (IFAC). An alternative is to adopt the standards of the ASB, which is the standard-setting body of the AICPA.

While PCAOB standards are used mostly for audits of U.S. publicly traded companies, more than 100 countries now use or are in the process of adopting or incorporating ISAs issued by the IAASB into their national auditing standards or are using them as a basis for preparing national auditing standards. ISAs have been translated into many different languages and are intended for use in audits of all types of entities, including publicly traded companies, private entities, not-for-profit organizations of all sizes, and government entities at all levels. These standards are subject to due process that is overseen by the independent Public Interest Oversight Board. In the U.S., the ASB standards are applied to financial audits of U.S. entities other than publicly traded companies. The ASB is in the process of converging its standards with those of the IAASB while trying to avoid unnecessary conflict with PCAOB standards.

As we've stated in previous comment letters, we strongly believe auditing standard setters should work together to achieve core auditing standards that are universally

accepted. Where there is a clear and compelling reason, the individual standard-setting bodies should develop additional, incremental standards and requirements necessary to meet the needs of their respective constituencies. The nature of any differences from core auditing standards and the basis for the differences also should be clearly communicated.

For instance, GAO's *Government Auditing Standards* incorporates the ASB field work and reporting standards and supplements them with additional standards to satisfy the unique accountability needs of government entities. The SEC recognizes the financial accounting and reporting standards issued by the FASB, relying on the private sector for this function to the extent that the private sector demonstrates the ability to fulfill this responsibility in the public interest.

The climate surrounding auditing standards has dramatically changed since the PCAOB decided to adopt interim standards and supplement them with new PCAOB-developed standards. The IAASB has strengthened its due-process procedures, and its auditing standards are globally accepted and translated into dozens of languages. The PCAOB has issued or proposed standards addressing all specific rule requirements mandated in Section 103 of the Act. The PCAOB should consider adopting a rule that allows for adoption of a base set of standards on an existing and prospective basis unless action is taken to specifically exclude or modify them. This approach appears acceptable under the existing authority in section 103 of the Act and could lower the cost and burden on the PCAOB and on users of its standards.

The concerns we have noted above about the PCAOB's approach to setting standards are consistent with the views we previously expressed through the following means:

1. previous comment letters to the PCAOB dated May 12, 2008, May 18, 2007, and February 26, 2007;
2. our comment letter to the U.S. Securities and Exchange Commission (SEC) dated July 12, 2007; and
3. remarks at the April 4, 2007, SEC Open Meeting on Proposed Management Guidance for Section 404 of the Sarbanes-Oxley Act and the PCAOB's Proposed Revisions to Auditing Standard No. 2.

Similar concerns about the PCAOB's standard-setting approach also were raised by several attendees at the October 22-23, 2008, PCAOB Standing Advisory Group meeting. The standards that the PCAOB now proposes heighten rather than resolve these concerns.

PCAOB's Requested Comments

In the introduction to the release that accompanies the proposed auditing standards, the PCAOB has requested comments on specific aspects of the proposed standards. Our comments on these matters are noted below.

The Board seeks comment on how the proposed standards would change current practice, whether the proposed standards allow sufficient flexibility, and whether they are appropriately scalable. [page 6 of PCAOB Release 2008-006]

Studying and implementing the PCAOB standards will likely increase user costs and create a disproportionate burden for smaller and mid-sized firms, who may need to revise their auditing methodologies and develop crosswalks to identify differences between IAASB and PCAOB standards.

The Board seeks comment on whether these fundamental principles [i.e., the fundamental aspects of the audit process] are articulated appropriately in the proposed standards. [page 7 of PCAOB Release 2008-006]

We believe that the fundamental principles of the audit process are not appropriately addressed in the proposed PCAOB standards. The ED does not include the essential guidance in the ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with the ISAs*, which is critical to understanding what an audit is and underlies the risk assessment standards.

The Board seeks comment on whether these fundamental principles [re: integrated audits] from Auditing Standard No. 5 have been incorporated appropriately in the proposed standards, whether the proposed standards are appropriately aligned with Auditing Standard No. 5, and, accordingly, whether the proposed standards would improve the effectiveness and efficiency of integrated audits. [page 7 of PCAOB Release 2008-006]

We appreciate and understand the reasons for including Auditing Standard No. 5 considerations in the proposed standards, but we believe that the fundamental principles related to an integrated audit could be incorporated in the proposed standards more efficiently by issuing supplemental standards to address audit risk issues related to integrated audits of publicly traded companies. Such supplemental standards would accompany a common, core set of standards, such as the ISAs or the ASB standards.

The Board seeks comment on whether the proposed standards focus appropriately on the risk of fraud. [page 8 of PCAOB Release 2008-006]

As noted above, the PCAOB's current approach to including fraud considerations in the proposed standards creates another version of the standards for practitioners to learn and implement, and likely will lead to misinterpretations and inconsistent application of the proposed standards. More importantly, we believe that maintaining a discrete fraud standard rather than incorporating fraud considerations throughout other standards heightens the auditor's focus on this important topic.

The Board seeks comment on whether the proposed standards appropriately consider the provisions of the ISAs and whether they reflect necessary differences

from risk assessment standards applicable outside the United States. [page 9 of PCAOB Release 2008-006]

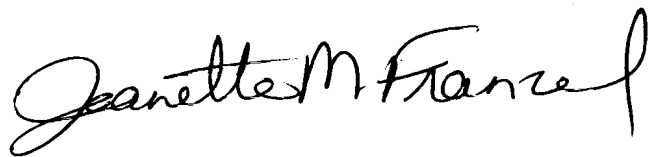
The proposed standards do not appropriately consider the provisions of the ISAs. Instead, they differ significantly from the IAASB audit risk standards without a clear explanation of what those differences are, why they are necessary, and the implications for users. In addition, as noted above, the ED does not include the fundamental guidance in ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with the ISAs*. These differences likely will increase costs for all firms and will have a disproportionate impact on small and medium-sized audit entities.

The Board requests comment on all aspects of the proposed standards and the conforming amendments to PCAOB interim standards, including, in particular, responses to the questions in Appendix 9. [page 11 of PCAOB Release 2008-006]

Because we believe that the public interest would be better served if the PCAOB adopted a base set of auditing standards, supplemented as necessary to address unique aspects of audits of publicly traded companies, we have not addressed the detailed questions posed in Appendix 9 of the ED.

We thank you for considering our comments on this very important issue.

Sincerely yours,

A handwritten signature in black ink that reads "Jeanette M. Franzel". The signature is written in a cursive, flowing style.

Jeanette M. Franzel
Managing Director
Financial Management and Assurance

Enclosures

cc:

The Honorable Mary L. Schapiro, Chairman
Securities and Exchange Commission

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board

Mr. Harold Monk, Jr., Chair
Auditing Standards Board