



California
Society
Certified
Public
Accountants

February 9, 2009

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

Re: Response to PCAOB Rule-Making Docket Matter No. 026

To the Members of the PCAOB:

The Accounting Principles and Auditing Standards Committee (the AP&AS "Committee") of the California Society of Certified Public Accountants (CALCPA) is pleased to provide our comments to the Public Company Accounting Oversight Board (PCAOB) on PCAOB Rule-Making Docket Matter No. 026.

The AP&AS Committee is the senior technical committee of CALCPA. CALCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

The Committee has submitted its response in the following order: First, the Committee has provided its response on the PCAOB's comments set forth on pages 6-12 of the Release. Second, the Committee has provided its response to the questions in Appendix 9, as well as certain other observations for the PCAOB's consideration.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions further, should the PCAOB have any questions or require any additional information.

Very truly yours,

A handwritten signature in black ink, appearing to read "M. Wille".

Mark F. Wille, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants

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A. Response to the Board's Overall Request for Comments.

Comment 1: *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.*

Response: The proposed standards will eliminate a void in current audit practice for non-integrated audits, which are currently being performed under the PCAOB's interim audit standards in effect when the PCAOB was formed. All audits ought to be risk-based. The proposed standards will not eliminate the need to exercise professional judgment. Accordingly, we believe the proposed standards are sufficiently flexible as well as scalable.

We support the PCAOB's goal of achieving a broad set of audit standards. To further this goal, we would encourage the PCAOB to consider codifying its proposed standards with existing standards for performing interim reviews and AS5 (integrated audits), in a manner similar to standards published by the American Institute of Certified Public Accountants.

Comment 2: *The Board seeks comment on whether these fundamental principles are articulated appropriately in the proposed standards.*

Response: We believe the fundamental principles are appropriately articulated in the proposed standards. To further strengthen the communication process in the transition to a fully integrated risk-based audit approach, we recommend the PCAOB publish the final standards with a supplemental marked up version of the affected original sections of the PCAOB interim audit standards.

We also believe communication would be enhanced if the PCAOB were to integrate the text of each proposed audit standard with the relevant supplemental text contained in Appendix 9.

Comment 3: *The Board seeks comment on whether these fundamental principles 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.*

Response: We believe that AS5 was a much needed revision to AS2, which was difficult to apply in a cost effective manner. Therefore, AS5 appears to be appropriately aligned with the proposed standards.

Comment 4: *The Board seeks comment on whether the proposed standards focus appropriately on the risks of fraud.*

Response: We believe the proposed standards are responsive to the risks of fraud.

Comment 5: *The Board seeks comment on whether the proposed standards appropriately consider the provisions of the ISA's and whether they reflect necessary differences from risk assessment standards applicable outside the United States.*

Response: Until such time as international audit standards ("IAS") are adopted in the United States, it would be helpful if the PCAOB could publish its criteria for considering and/or integrating such standards with those of the PCAOB. We also encourage the PCAOB to avoid terminology that might be inconsistent with current IAS when drafting its standards. There appears to be an excessive amount of "word smithing" between the proposed standards as compared to IAS. Style differences ought to be avoided.

B. Responses to Questions in Appendix 9.

Proposed Auditing Standard – Audit Risk in an Audit of Financial Statements

Question 1: *Does the proposed standard appropriately describe audit risk and its component risks?*

Response: Yes. No specific comment.

Proposed Auditing Standard – Audit Planning and Supervision

Question 2: *Is it reasonable and appropriate to extend the auditing standard No. 5 requirement regarding consideration of matters important to the audit of internal control over financial reporting to audits of financial statements?*

Response: Yes. No specific comment.

Question 3: *Is the direction regarding multi-location engagements reasonable and appropriate?*

Response: Yes. No specific comment.

Question 4: *Is more direction needed regarding multi-location engagements? If so, in what areas is additional direction needed?*

Response: Sufficient guidance is provided in the proposed standard.

Question 5: *Are the responsibilities of the engagement partner for planning and supervision appropriate and reasonable and is the proposed direction clear?*

Response: The responsibilities are appropriate and reasonable in principle, but certain aspects could be clearer:

Paragraph 4, second sentence: The draft cites a planning process that "might begin shortly after (or in conjunction with) the completion of the previous audit." That "might" occur, but the auditor has no responsibility during the period from completion of one audit until engaged to perform the next. The sentence would be better stated: "Planning is not a discrete phase of an audit, but rather a continual and iterative process that begins at engagement acceptance and continues throughout the current audit engagement."

Paragraph 7: Two more items should be added to the matters that may affect the auditor's procedures:

- Information to be furnished by the client to the auditor, and the timing of its delivery to the auditor;
- Timing of performance of certain timing-sensitive audit procedures, such as inventory observations and confirmations.

Paragraph 9.b.: The draft stated as "Determine the significant factors that affect the direction of the engagement team." The word "direction" is ambiguous, and could mean supervision, leadership, or objective, among other things. We suggest it be replaced by "focus." A similar change is needed in paragraph 8.

Paragraph 9: Add a fifth consideration in establishing audit strategy:

- Determine skill and experience level required of personnel to be assigned to the audit.

Paragraphs 13 – 15: This section is entitled "Individuals with Specialized Skill or Knowledge." The current focus is solely on IT. The section should be expanded to explicitly include other specialties, such as valuation and actuaries.

Proposed Auditing Standard – Identifying and Assessing Risks of Material Misstatement

Question 6: *Does the proposed standard clearly and adequately describe the auditor's responsibility for performing risk assessment procedures?*

Response: Yes. No specific comment.

Question 7: *Are the additional procedures in paragraph 13 that the auditor should consider performing when obtaining an understanding of the company and its environment reasonable and appropriate for audits of issuers? Should these procedures be specifically required for all audits, or is the responsibility to consider performing the procedures sufficient?*

Response: Yes. The additional procedures as stated are reasonable and appropriate. The responsibility to consider performing the procedures is sufficient, so the procedures should not be individually required. However, the Board should consider including an additional procedure in paragraph 13 that the auditor should consider performing, as follows:

- Reviewing summaries of risks and the company's evaluation of those risks identified through the company's risk management processes.

This addition would direct auditors' attention to the company's own risk management processes and assist the auditors in obtaining the required understanding of the company's operations. If the company has implemented risk mitigation activities, this knowledge would help the auditors assess the risks and internal controls related to financial reporting.

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Question 8: *Is the new requirement to assess certain matters related to the control environment component of internal control over financial reporting reasonable and appropriate? Is the difference between the required performance for an audit of internal controls over financial reporting and an audit of financial statements only clear?*

Response: Yes. The new requirement to assess certain matters is reasonable and appropriate. The difference between the required performance for an audit of internal control over financial reporting and an audit of financial statements only is reasonably clear.

Question 9: *Is the additional direction regarding the period-end reporting process reasonable and appropriate for audits of financial statements only?*

Response: Yes. No specific comment.

Question 10: *Are the requirements and direction regarding the auditor's responsibilities for evaluating design and implementation of controls as part of obtaining an understanding of internal controls over financial reporting sufficient and clear? If not, what additional direction is needed?*

Response: Yes. No specific comment.

Question 11: *Does the additional description of the key engagement team members provide a better understanding of the expected participants in the discussion?*

Response: Yes. No specific comment.

Question 12: *Does the discussion of significant risks in this standard provide sufficient direction to enable auditors to identify significant risks?*

Response: Yes. No specific comment.

Question 13: *Should the proposed standards indicate specific requirements and direction regarding documentation, e.g., summaries of the identified and assessed risks and the linkage to the auditor's responses?*

Response: Yes. No specific comment.

Proposed Auditing Standard – The Auditor's Responses to the Risks of Material Misstatement

Question 14: *Does the proposed standard clearly describe the auditor's responsibilities regarding test of controls in integrated audits and in audits of financial statements only?*

Response: Yes, but refer to additional comments related to Appendix 4 on page 5 of this letter.

Question 15: *Are the requirements and direction regarding tests of controls appropriately aligned with Auditing Standard No. 5?*

Response: Yes, but refer to additional comments related to Appendix 4 on page 5 of this letter.

Question 16: *Does the proposed standard clearly describe the auditor's responsibilities regarding substantive procedures?*

Response: Yes, but refer to additional comments related to Appendix 4 below.

Unnumbered Comment on page A9-26:

The Board seeks comment on whether the list of conditions in Appendix A and the accompanying direction are reasonable and appropriate, and in particular, whether there are conditions in Appendix A that should be added, removed, or modified

Response: Additional specific examples would be helpful. Appendix A lists some items that could not only be an indication that fraud risk assessment needs to be modified, but overall risk assessment should be modified.

Additional Comments Related to Appendix 4:

- Paragraph 15 – The current phrasing of this paragraph may lead auditors to test too many controls that are not important to the conclusion about the effectiveness of the company's internal control over financial reporting. We suggest rather than using the phrase "selected controls" that the guidance provide specific examples of "key" or "relevant" controls.
- Paragraph 18 – Add discussion about "during the entire period of reliance" and what this means.
- Paragraph 19 – Additional guidance is needed with respect to when substantive procedures alone cannot provide sufficient appropriate evidence, specifically when there is heavy reliance on IT.
- Paragraphs 21 and 22 – We suggest the discussion regarding the importance of walkthroughs and the text of paragraphs AS5.37-38 be included in the body of the proposed standard rather than in the footnotes. We suggest the PCAOB include a broader comment regarding the authority of footnotes vs. text of the proposed standard(s) and the protocol for including guidance in footnotes.
- Paragraph 25 – We suggest expanding on the meaning of "tested directly" and also include a discussion about the use of the work of others including receiving direct assistance and use of third parties working under the direction of management/audit committee.

Proposed Auditing Standard – Evaluating Audit Results

Question 17: *Does the proposed standard clearly describe the auditor's responsibilities regarding the evaluation of audit results?*

Response: In general the proposed standards appear to provide additional clarity to the interim standards related to evaluation of audit results.

Paragraphs No. 10 and 11 of this proposed standard might be modified to clarify that any unexpected or unusual results, regardless of whether management's response is vague, implausible, or inconsistent with other audit evidence should be corroborated. (i.e. to make "overall review" standard the same as when performing initial or detailed analytical procedures used as substantive procedures)

It is unclear if the examples of unusual or unexpected analytical relationships listed in Appendix 9 (page A9 – 22) will be included in the final standard? (i.e. will Appendix 9 actually be an integral part of the new standards? (without the questions?))

The wording in the Appendix 9 (page A9 – 22 first paragraph #3) "The conclusions formed from the results of the overall review of the audit are intended to corroborate conclusions formed during the audit of individual accounts and disclosures," appears to capture the objective of this section better than the wording in the proposed standard.

Question 18: *Are the requirements and direction regarding the accumulating identified misstatements and evaluating uncorrected misstatements appropriate and adequate?*

Response: In general the proposed standards appear to provide additional clarity to current standards related to evaluation of audit results.

It would be helpful to footnote "clearly trivial" as synonymous to "clearly inconsequential" as defined in the ISA standard, as done in Appendix 9. We suggest this be done in the body of the proposed standard.

Question 19: *Are the requirements and direction regarding the evaluation of the results of the integrated audit appropriately aligned with Auditing Standard No. 5?*

Response: Yes. No specific comment.

Proposed Auditing Standard – Considerations of Materiality in Planning and Performing an Audit

Question 20: *Are the requirements and direction in this standard appropriately aligned with the concept of materiality as described in the courts' interpretation of the federal securities laws?*

Response: The theoretical elements for determining materiality are sufficiently established within financial reporting frameworks, in particular FASB Concepts Statement No. 2. Inclusion of references to formulations used by the courts in interpreting the federal securities laws, such as those set forth in footnote 2 should be deleted. Guidance provided to auditors ought to be based on promulgated standards as developed within the PCAOB, not the courts. Reference to specific court cases creates a presumption that registered accounting firms ought to become familiar with the myriad of evolving securities litigation, a presumption that is not set forth in the Sarbanes-Oxley Act of 2002, and may require interpretation of legal matters beyond the expertise of registered accounting firms.

Question 21: *Does the proposed standard sufficiently and clearly describe the auditor's responsibilities regarding (a) establishing an appropriate materiality level for the financial statements as a whole and (b) establishing a lower materiality level or levels for particular accounts or disclosures? If not, what additional direction is needed?*

Response: Additional empirical guidance ought to be provided for determining each of the levels of materiality. For example, the discussion contained on page A9-28 in the middle of the first paragraph which discusses the relative importance of net earnings or other financial elements in determining materiality for the financial statements as a whole is useful information that ought to be included in the final standard. In a similar manner, empirical guidance and examples ought to be provided for determining materiality for particular accounts or disclosures. In addition, the PCAOB ought to consider incorporating any previously published interpretive guidance regarding determining materiality, promulgated by itself or the SEC, within the new audit standard.

Question 22: *Is the use of the term "tolerable misstatement" in the proposed standard appropriate and sufficiently clear?*

Response: Footnote 4 of the proposed audit standard refers the reader to paragraph .18 of AU sec. 350, "Audit Sampling." Since the PCAOB is not currently amending this standard, which discusses the concept of tolerable misstatement, we consider the discussion appropriate. However, as set forth in our response to Question 21 above, we recommend that additional empirical guidance or examples be developed for establishing tolerable misstatement as used in tests of details.

Proposed Auditing Standard – Audit Evidence

Question 23: *Does the proposed standard clearly describe the principles necessary for evaluating the sufficiency, relevance, and reliability of audit evidence?*

Response: Yes, the principles are adequately stated.

Question 24: *Are the auditor's responsibilities regarding the authentication of documents reasonable and appropriate?*

Response: Yes, the responsibilities are reasonable and appropriate.

Question 25: *Are the requirements and direction related to selecting items for testing appropriate and clean?*

Response: Yes, the responsibilities are reasonable and appropriate.

Question 26: *Are the five categories of assertions in this standard sufficient or should they be expanded? If so, how would such expansions affect auditor's performance?*

Response: The five identified categories are considered sufficient.