NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on April 8, 2010 that related to the Board’s proposed auditing standards related to the auditor’s assessment of and response to risk. The other topics discussed during the April 8, 2010 meeting are not included in this transcript excerpt.

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MR. BAUMANN: Okay, thank you. Well, the final item on our agenda, as we move towards a close, as I mentioned, the proposed and then re-proposed standards on the auditors identification of risk and the auditor's assessment and response to that risk. And these risk assessment standards that go right from planning and supervision, right through collecting of audit evidence, I think there are critical standards foundational in their nature to where our future standard setting goes.

Keith Wilson has been leading the project on the risk assessment standards. As I mentioned the comment period closed on March 2nd. Keith is working closely with the rest of the staff and with me, moving towards a final proposal of -- final issuance of those standards with a target for the
third quarter.

Keith -- I've asked Keith to give an update on the comments that were received as part of the re-proposal.

MR. WILSON: Thank you, Marty. As he mentioned, my objective here is to brief you on the comments that we received so -- on the proposal, and not -- we're still in the process of analyzing them. So we don't have formal conclusions or recommendations to the board at this time, but we wanted to try and give you a bit of a sense of some of the comments that we've received.

I also should preface my remarks by saying that I realize that some of you around this table may have actually participated in drafting comment letters and providing those comments to us. The natural part of this process is we have to winnow some of them for this presentation. So you may not see every comment that you had placed in a comment letter, but please, rest assured that we are carefully looking at each and every comment. And we'll plan to make an appropriate response to
Before I actually get into the individual slides, let me just quickly for those who haven't been following this project as closely, give you a just a quick overview of the standards themselves, what's involved in this suite of seven, as some have called it. And then we'll move right into comments.

The first standard is standard on audit risk, which describes in general terms the components of audit risk and the auditor's consideration of audit risk in both from the assessment and the developing procedures to respond to risk.

Audit planning and supervision in the second standard, as the name implies, it describes the auditor's responsibilities for planning the audit and for supervising engagement team members. And that would include things like deciding which matters are important to audit planning, and setting an appropriate audit strategy and plan.

The third standard called consideration
of materiality in planning and performing an audit
describes the auditor's responsibilities for
applying the established concepts of materiality
and planning the audit and performing audit
procedures and determining in effect the scope of
the audit.

The standard identifying and assessing
risks of material misstatement describes the
auditor's responsibilities for performing
procedures to identify and assess the risks of
material misstatement and the companion standard to
that, the auditor's responses to the risk of
material misstatement describes the
responsibilities for developing overall responses
to the way the engagement is conducted, as well as
developing specific procedures to respond to the
risks that have been identified.

Evaluating audit results is a standard
that describes the process, the auditor's
responsibilities for evaluating the evidence that
they've obtained during the audit and determining
whether or not they've obtained sufficient
appropriate evidence to support their conclusions expressed in the auditor's report.

And finally, the standard on audit evidence talks more about the sufficiency, what sufficiency and appropriateness of audit evidence means and what procedures the auditor might perform to obtain that evidence.

All right. This time, we have -- we've received 23 comment letters down somewhat from the prior year. The profile here as we've described, there are 10 from auditing firms. There are -- we received six comment letters from what I call associations of accountance or firms. So that would be like state societies, three international associations of accountants, and the Center for Audit Quality.

The academics -- one of those commenters in the academic column is the Auditing Standards Committee for -- of the American Accounting Association. And then there was an individual academic.

In the last category, other includes
CALPERS, the Institute of Internal Auditors, the GAO, the U.S. Chamber of Commerce, and an individual who's apparently a consultant.

Just as a general observations, I would say that most of the commenters did acknowledge and recognize that there were improvements in the re-proposed standards as compared to the original standards. And I say that for two reasons. It was -- in some cases, the commenter specifically acknowledged improvements, supported some of the changes that we'd made affirmatively. And also, there was a substantial reduction in the number of comments in these -- to the re-proposal as compared to the original proposal.

In general, the themes that we saw in the comment letters were substantially the same as the comments that we received on the original proposal, but the specific comments may have changed.

So for example, one of the area -- the key objectives of this project, we were -- as been said, was to try and create better alignment between the standards for assessing and responding
to risk and the board standard for auditing internal control over financial reporting, AS 5.

And there were a number of comments on the original proposal about suggesting ways to improve the alignment. And we made a number of changed in that area for the re-proposal. The commenters seem to -- some of them specifically supported those changes that we made in that area. And we really had a substantial reduction in the number of comments. I think the primary -- we had one commenter who suggested a number of amendments to AS 5 in light of the re-proposed risk assessment standards. But generally, there seem to be an acknowledgement that there is good alignment between the standards now.

Some -- we did have a number of commenters who continued to make statements about supporting -- reducing unnecessary differences with the standards of the IAASB and the ASB. Some used words like "converage." Others, "align." Some said "reducing unnecessary differences," but all in that same sort of vein.
And some -- one area that we receive quite a bit of comment, and maybe the largest single area, in fact, was asking more information - - asking for more information, more explanation about how these re-proposed standards would affect audits. What were we expecting auditors to change? And what's the board's rationale? Just more information about those kinds of questions.

They -- the comments varied in terms of the types of specific information they wanted, the form of the information that they were looking for, but certainly that's an area that's going to require a lot of thinking and study on our part, in terms of coming up with a way to more effectively describe the changes that we would expect these standards to have on audits.

We had -- we did have some commenters that acknowledged that some changes that the board had made in the standard setting process, and efforts to improve transparency such as having a concept release, or in this case, a second proposal of the standards, so some of those -- and just some
general observations about things that we've done
in terms of publishing our agenda and keeping
updated on that.

There were other -- a host of other
recommendations on improving the standard setting
process in general. Probably the most common was a
recurring suggestion to use external tax forces in
the process of drafting standards and various
comments along those lines.

There were -- as a -- as been mentioned a
couple of times already, one of the big areas of
focus in this project was to try and integrate the
requirements for the auditor to assess and respond
to fraud risk as part of this risk assessment
standards. And we -- on the original proposal, we
received a number of comments about this. They
were quite missed. Some were very supportive.
Some had concerns. Some were neutral.

We had fewer comments this time, but we
continued to receive some comments about that. And
again, it's mixed. Some support it quite strongly.
Some are more concerned about that approach.
And we did have -- I think has been mentioned at least a little bit, one of the important points of emphasis in the re-proposal as compared to the original proposal, is a number of new requirements related to -- they were intended to focus the auditor on the area of disclosures.

And so, in some of the standards, their requirements for -- as part of obtaining an understanding of the company and the environment to develop expectations, I'll say, of the types of disclosures that they had expect to see in the financial statements.

In terms of thinking about assessing risk or brainstorming about fraud risk, to think about ways that the financial statements might be misstated by omitting disclosures or providing incomplete disclosures. And then a more focused discussion in the standard on evaluating the financial statements, more discussion about specifically evaluating the disclosures in the financial statements.

Commenters generally supported the new
requirements. We did get some specific comments
for requests for clarification about these -- the
specific requirements that we had. And I'll
discuss those as we get in the particular
standards, but I think generally, commenters seem
to be supportive of those additional requirements.

Training the specific standards, the
audit risk standard, as I mentioned, it describes
the individual components of audit risk, the risk
that the financial -- that the auditor would issue
an inappropriate opinion when the financial
statements are materially misstated.

And we had some requests in the comments
for some additional discussion about some of the
points that we had covered in there.

For example, when we talked about risks
at the financial statement level, the one had more
discussion about how those kinds of risks would
result in misstatement of the financial statements.

So for example, if there was a decline in
the company's industry, how would that potentially
result in material misstatement of the financial
statements? They wanted the standard to talk about that more.

And also, to talk a little bit more about some of the points about how the auditor considers risk and develops procedures to respond to risk.

The planning and supervision standard, as the name suggests, and as the interim -- like the interim standard it would replace, covers both audit planning and supervision. And we received comments that along the lines of these are, in fact, separate topics. They may have some relationship, but they're really separate topics. So they ought to be in separate standards.

So if we follow those recommendations, I guess we would end up with a suite of eight standards instead of a suite of seven standards.

There were some comments about the role of the engagement partner and the responsibilities in here. And I guess by way of background, the standard starts off early on by saying that the engagement partner is responsible for the engagement and its performance. And therefore,
they're responsible for planning and supervision,
but they may seek assistance from other engagement
team members.

From that point following in the
standard, we use the word "auditor" in the standard
to encompass both the engagement partner and others
who are involved in the process. And there were
some requests to lay out in the standard the
linkage between the engagement partner and auditor
responsibilities as we describe it in the standard.

One area that was a significant area of
change relates to the scoping for multi location
engagements. And that refers to how the auditor
determines how much work to do at individual
locations when there's a multi location engagement.

We had a number of commenters on the
original proposal that essentially said you should
align this -- these requirements more closely with
AS 5. And you should make it more risk based.

So we did that. And there seemed to be
support for that, but there were a couple of points
that they wanted to -- that commenters called our
One is there's a specific requirement in the standard for varying the procedures at locations from year to year. That requirement parallels a similar requirement in AS 5. And commenters suggested that that was too prescriptive, it was unnecessary because we do have another standard that more generally requires the auditor to incorporate an element of unpredictability. And they were suggesting that this specific requirement could be made an example of the more general requirement in our standard.

There were also specific requests, going back to a topic that we covered -- that we talked about yesterday, the -- how would the requirements we have for scoping multi location engagements apply when there's another auditor involved? And specifically, when there's divided reporting responsibility kinds of situations?

So a request for at least an explanation, if not some kind of addition -- modified provisions to address those situations.
Another area that we made a significant change in the re-proposal versus the original proposal is in the area of considering the need for persons with specialized skill or knowledge.

The original proposal had said that -- it required the auditor to consider as part of planning whether or not they needed a person with specialized skill or knowledge in order to effectively conduct the audit in essence. And there were also -- there's also a requirement in there related to the knowledge that the core audit team needed of the subject matter in order to effectively deal with the person with specialized knowledge or skill.

Some of the original requirements were framed in terms of IT specialists, because that was what the -- our existing standard frames the requirement. We had a lot of comments to the original proposal that said broaden it to include anyone with specialized skill or knowledge. And we did that. And so, we seem to get support for that change.
They did have -- and there were a couple of drafting suggestions for it, but one --
commenters also took the opportunity to provide some of their views on when someone -- when a specialist should be under the general requirements for supervision versus when they should be under a separate standard for using an auditor specialist.

So some of those, we're going to analyze those comments. Some of them may be more applicable to the separate specialist project. And if they don't get picked up and addressed as part of this project, certainly they would be something we would consider in the follow-on specialist project.

A -- and on the standard on materiality, there were three significant changes to that -- to the re-proposal, which sparked comments.

The first was a change in the articulation of the concept of materiality. The original proposal we had used a quotation that existed in our existing interim standard, that is from a FASB Concept Statement number 2, that
describe materiality. And we had a footnote that referenced the applicable interpretation of the federal courts in interpreting the securities -- federal securities laws.

And during the intervening time between the original proposal and the re-proposal, of course, FASB released its codification, which as you know, doesn't include the concept statements. So that caused us to pause and reflect on this discussion. And what we came back to was actually the standard that does apply in these situations, which is the standard that's articulated by the courts.

So our standard now says -- now uses the articulation from the federal court decision that states a fact is material if there's substantial likelihood that the fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

So in re-proposal, that's the articulation that we use. And it -- because it is
in fact the standard as I mentioned that's used.

And it does also make clear that the concept of materiality that applies here should reflect the perspective of a reasonable investor.

And comments on this area ranged from some requests for some additional discussion about how this concept is applied in an accounting sense, to some actual just concerns about using a court -- language from the federal courts in an auditing standard.

Another area that drew some comment, we included another sentence in the standard -- the standard requires that when planning the audit, the auditors should establish a materiality level for the financial statements that's appropriate in light of the particular circumstances. And we'd added a statement that said that this includes consideration of the company's earnings and other relevant factors. That was really intended to be just an acknowledgement of the fact that typically, for these kinds of companies, earnings is the most significant factor.
But we did have some commenters asking questions along the lines of well, does that mean you always have to use earnings? Does earnings -- is that required universally in each case? Is our intention -- what did we mean by other relevant factors. So really, that's more asking for I would say clarification on that point.

Then another area that was a change in the re-proposal was we added specific provisions related to determining materiality for -- in multi location audits at the individual component level. So determining the materiality at an individual business unit or location.

And the -- there was a general principle articulated in the requirement to say that the materiality at that individual location or component level cannot exceed and generally should be less than materiality for the financial statements as a whole.

And we received some generally favorable comments for adding this requirement, but there were some requests, again, for specific additional
clarification on, for example, how you would apply
this again in a divided reporting scenario when
there was another auditor involved.

In the identifying and assessing risks of
material misstatement standard, we have received --
continued to receive comments on a requirement to
consider performing additional procedures, which
involve things such as reading public information
about the company, such as analyst reports, reading
transcripts of earnings calls, obtaining
information about trading activity in the company's
securities by significant holders to identify
potentially significant unusual developments.

And most of the comments in this area are
really around scope, what are the expectations? Do
we expect auditors to go out and track down every
single piece of publicly available information
about the company and affirmatively document that
and check off do we intend for them to look at it
or not?

So this, again, is another example of
trying to provide some requests for clarification
1 about what the expectation of performance is.

2 Then for the areas where -- the

3 requirements that I mentioned about obtaining and

4 understanding about necessary financial statement

5 disclosures and some of those requirements that

6 want -- the commenters asked us to be sure to

7 clarify that we're talking about evaluating

8 disclosures in the context of the applicable

9 financial reporting framework.

10 And there were -- in the area of

11 obtaining an understanding of internal control over

12 financial reporting, we have -- in order to

13 determine how -- the extent of the understanding

14 that's needed, the standard outlines certain

15 objectives that the auditor needs to meet overall.

16 And that's supposed to guide the auditor through

17 the process of determining for each component of

18 internal control, how much information that they

19 need. There's still some -- in the area of when we

20 get down to control activities, there's some

21 concern about whether or not -- what our

22 expectations are in terms of how much understanding
of control activities there are? Are we intending
the auditor to look at all control activities? Or
are we really intending there to be a significant
change in practice related to that. So again, a
request for clarification on that point.

And then finally, on this standard, the -
- we have a requirement, which really is carried
forward from our existing requirements for the
auditor to consider information obtained from other
engagements.

And that information, we had two types of
comments on that requirement.

MALE SPEAKER 1: That's other engagements
for the issuer.

MR. WILSON: Yes, other engagements for
the company. Yes. And they -- some people felt
like this was too broad. And there were
suggestions to either go back and use some
additional language that's in our existing
requirement, or to alternatively frame this in
terms of the engagements performed by the
engagement partner, as opposed to by the firm.
So those -- that would, in fact, if we went to engagement partner, that would in fact be a change from our existing standards and our existing requirement.

For the auditor's response standard, there are requirements -- we spent a good bit of time here in trying to frame the auditor's responsibilities around using information from prior audits to -- in the evaluation of the effectiveness of controls. And we have like in some respects AS 5, this standard requires the auditor to obtain evidence each year about controls that they're going to rely on.

But it does allow the auditor to use evidence from prior year and information about risk in determining how much additional information they need in the current year.

And so, we had comments on this requesting that we add some additional language to make clear that this could be -- that the information from prior year could inform the auditor's risk assessments, which in turn drives
the extent of evidence needed in the current year.

And in the area of -- there were -- we have requirements related to situations in which the auditor performs substantive testing at year-end -- at an interim date. For example, in a calendar year-end audit, they might test accounts receivable at October 31. And we have requirements that really are adapted from our existing requirements about going and updating the auditor's conclusions from that interim date to year-end.

And what the standard requires the auditor to perform procedures to cover the remaining period that would provide a reasonable basis for extending those conclusions.

And then we have some specific procedural requirements that need to be included as part of that work, which again, are carried forward from our existing standard. It was the -- we did get comments and some of the commenters indicated that those specific additional requirements weren't necessary and that we should just go with the more general requirement about performing procedures
that provide a reasonable basis.

In the evaluating audit result standard,
we had -- our reproposed standard requires the
auditor to accumulate misstatements that they find,
other than those that are essential de minimus.
And if they're uncorrected, to communicate those to
management. And if management does not correct
them, to evaluate the reasons why as part of their
assessment of bias.

There were some commenters asked us to
also include a specific requirement for the auditor
to request management to correct the uncorrected
misstatements. And we received that comment on the
initial proposal. Our reaction was that there are
already existing requirements for management to do
that, that it was unnecessary for us to put in an
auditing standard to specifically require the
auditor to ask management to correct those, but we
nevertheless received additional comments that we
should have such a requirement in the standard.

We have a requirement -- another area --
we have a requirement in the area of evaluating
uncorrected misstatements. We have an existing requirement to -- and carried forward in these standards, to evaluate the effects of uncorrected misstatements detected in prior years and misstatements detected in the current year that relate to prior years as part of the overall evaluation of uncorrected misstatements. And some commenters wanted us to include a specific cross reference to SEC Staff Accounting Bulletin Number 108 on the subject of considering the effects of prior year misstatements. So a number of commenters suggested that we add that reference.

Then the last point on this -- in this area was a recommendation, again, as I mentioned that we have specific additional requirements for evaluating disclosures as part of the evaluating the presentation of the financial statements, and specifically, evaluating whether the financial statements include all the required disclosures.

And we had some commenters that requested that we be sure and make a qualification to this requirement, based on materiality.
The audit evidence standard, there were requests for additional explanation about put sufficiency and appropriateness of audit evidence means. And some said create some specific definitions of sufficiency and appropriateness to include as part of the standard. Another said that sometimes in our standards, we use the word persuasive or persuasiveness. Please provide an explanation of how persuasiveness relates to sufficiency and appropriateness. So we receive those kinds of comments.

In the area of amendments to PCAOB standards, the reproposal included some specific additional documentation requirements that weren't in the original proposal. Some of them related to things such as documenting the risk assessment procedures and the responses to the risks, including a summary of identified risk, the auditor's assessment of the risks at the financial statement and assertion levels and the auditors responses, showing the linkage between the risk assessments and the responses.
And we had some commenters -- we had a couple commenters that said that this requirement itself was too prescriptive. Others just questioned whether we should be -- we had proposed this as an amendment to AS 3. Some had suggested that it actually was more appropriate to put these kind of documentation requirements in the respective standards.

And finally, in the area of -- in our -- we had proposed an amendment to the audit sampling standard. And it relates to sample sizes when an auditor's using non statistical sampling methods. And the requirement would say that when a non statistical sampling method is applied properly, the resulting sample size ordinarily will be comparable to or larger than the sample size resulting from an efficient and effectively designed statistical sample.

And we explained in the release that the intent is not that you calculate a statistical sample and a non statistical sample size. The idea is that recognizing that a number of firms already
have methodologies to accomplish this, that were derived from statistical sampling methods that they could just use those. And the idea was to point to that, as opposed to just saying I'll pick three, because -- based on my professional judgment, but to put some more rigor around the process of considering what an appropriate sample size was.

We had requests to put in some qualifiers to specifically say in the standard that we are not intending for auditors to calculate sample sizes under both methods.

So that concludes my remarks on the comments that we received so far. And I suppose we have a couple minutes, if anyone has questions or comments, wants to react to that.

Oh, Doug, come up.

MR. CARMICHAEL: Yeah, just comment. And I -- whenever I bring this up, boy, say well, it's not a problem because management today is correcting all the misstatements that the auditor proposes anyway.

But I think it'd be a good idea to
reinforce the point from the Sarbanes Oxley Act
that management is required to correct all material
adjustments that the auditor proposes just to
remind people of that.

Mr. Wilson: That's a good point.

Thanks.

Mr. Baumann: Okay, well, thank you very
much. Keith, thanks for that summary. We did that
because as I've said on numerous occasions, I think
these seven standards are very important for the
performance and execution of an audit. And they
are adding to the framework that already exists
under PCAOB standards, and will be foundational for
future standard setting.

Our goal, as I mentioned earlier, and it
is a goal, it's a lot of work here, is to try to
address all of these comments and try to issue
these standards during the third quarter.
Meeting of the Standing Advisory Group

April 8, 2010
8:30 a.m. – 12:30 p.m.

Risk Assessment-
Summary of Comments Received

Keith Wilson
Associate Chief Auditor,
Office of the Chief Auditor
Risk Assessment

- Profile of Commenters
  - Auditing firms: 10
  - Associations of accountants/firms: 6
  - Academics: 2
  - Other: 5
  - Total: 23

General Observations

- Most commenters recognized improvements in the reproposed standards and release.
- Overall themes in the comment letters were substantially the same as the comments on the original proposal, with some changes to the specific recommendations.
- Some commenters continued to support reducing unnecessary differences with standards of the IAASB and ASB.
- Some commenters requested more detailed information in the release, including more explanation about how the re-proposed standards would affect audits.
General Observations

- Some commenters offered recommendations regarding the Board's standards-setting process, e.g., specific measures to increase transparency in the process and use of task forces in drafting standards.
- A few commenters expressed their views on the integration of fraud considerations into the risk assessment standards.
- Some commenters expressly supported the new requirements regarding consideration of disclosures, and a few requested clarifications regarding some of those requirements.

Comments on Specific Standards

- Audit Risk
  - Requests for clarification or additional explanation of the components of audit risk.
- Planning and Supervision
  - Recommendations to divide the standards into separate standards for planning and for supervision.
  - Requests for clarification of the role of the engagement partner for supervision and review.
Comments on Specific Standards

- Planning and Supervision (cont’d)
  - Regarding the requirements for multi-location engagements:
    - Concerns that the requirements for varying procedures at locations year to year is too prescriptive
    - Requests for direction on applying the requirements to situations when the work and reports of other auditors are used
  - General support for the provisions regarding persons with specialized skill or knowledge, with a variety of recommended enhancements

- Consideration of materiality in Planning and Performing an Audit
  - Concerns regarding the use of the federal courts’ description of the concept of materiality
  - Requests for clarification regarding the new statement about considering the company’s earnings and other relevant factors in making judgments about materiality
  - General support for the provision for determining materiality in multi-location engagements, and requests for explanation about how to apply certain aspects of the new provision for multi-location engagements
Comments on Specific Standards

- Identifying and Assessing Risks of Material Misstatement
  - Requests for clarification of the requirement to consider performing certain procedures while obtaining an understanding of the company, amid concerns that a broad interpretation of the requirements could be unduly burdensome
  - Requests for clarification of certain requirements regarding consideration of necessary financial statement disclosures
  - Requests for clarification of the requirements for obtaining an understanding of control activities
  - Concerns that the wording of the requirement to consider information from other engagements performed for the company was too broad

- Auditor's Responses to the Risks of Material Misstatement
  - Requests for additional clarification of the requirements regarding the use of evidence from past audits when evaluating the effectiveness of controls
  - Concerns that the requirements for updating procedures when substantive tests were performed at an interim date are too prescriptive
Comments on Specific Standards

- Evaluating Audit Results
  - Recommendation to require auditors to request that management correct all misstatements
  - Recommendation to include a reference to SEC Staff Accounting Bulletin 108 in the discussion of evaluation of misstatements
  - Recommendation that the requirement for evaluating disclosures be qualified based on materiality

- Audit Evidence
  - Requests for more explanation of the concepts of "sufficiency" and "appropriateness" of audit evidence

- Amendments to PCAOB standards
  - Auditing Standard No. 3, Audit Documentation (AS 3): recommendation that amendments be placed in the respective risk assessment standards instead of AS 3
  - AU sec. 350, Audit Sampling: requests for clarification regarding new requirements for sample sizes when nonstatistical sampling methods are used