

May 28, 2013

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

RE: PCAOB Rulemaking Docket Matter No. 40

Dear Office of the Secretary:

McGladrey LLP appreciates the opportunity to comment on the *Proposed Framework for Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Auditing Standards and Rules*. We support the Board's efforts to enhance the usability of PCAOB auditing standards by reorganizing them into a topical structure with a single integrated numbering system. Our comments on possible ways to improve the proposed reorganization framework are discussed below.

Proposed Approach

A Logical Order that Follows the Flow of the Audit Process

We understand the proposed reorganization is intended to present the standards in a logical order that generally follows the flow of the audit process. It would appear that the *audit process* in this context refers to the *financial statement audit process* rather than an *integrated audit process* because the requirements of Auditing Standard (AS) 5 for an audit of internal control over financial reporting that is integrated with an audit of financial statements are all proposed to be self-contained in one *Audit Procedures* subcategory (2300) of the proposed framework rather than the individual requirements being located under the applicable subcategories within the flow of an audit. For example, the requirements in paragraphs 9 through 20 of AS 5 perhaps would be more appropriately located in subcategory 2100 of the framework because those requirements are essential to planning an integrated audit. Likewise, the requirements in paragraphs 85 through 98 of AS 5 perhaps would be more appropriately located in subcategory 3100 of the framework because those requirements are essential to reporting on an audit of internal control over financial reporting that is integrated with an audit of financial statements. We believe that a more logical order for the proposed reorganization would reflect the flow of an integrated audit process. Therefore, we recommend the AS 5 requirements be included at the end of each subcategory as appropriate and separately identified so as to clearly distinguish that they are incremental requirements for an audit of internal control over financial statements.

Topical Structure

We agree that reorganizing the PCAOB auditing standards into a topical structure with subcategories to further organize similar topics is appropriate. However, in attached Appendix 1, we have marked detailed suggestions that we believe will help users navigate the standards more easily. Also, although not marked within Appendix 1, we propose that the PCAOB consider a numbering scheme that uses increments of ten rather than increments of one so as to enable future expansion within each subcategory.

In addition to the changes proposed in Appendix 1, we suggest the Board consider adding a subsection titled *Terms of the Engagement*, which would be consistent with that used in International Standards on Auditing.

Consideration of Alternatives

We understand the Board considered a variety of alternative reorganization approaches, such as adopting the organization structure of another standards setter (*i.e.*, the International Auditing and Assurance Standards Board (IAASB) or the AICPA Auditing Standards Board(ASB)), but ultimately decided to propose its own topical structure. Since the Board is proposing its own topical structure, we believe it would be helpful for the Board to continually provide a detailed comparison of PCAOB auditing standards categories and subcategories to the organizational structure of standards of the IAASB and the ASB.

Further, it would be very helpful if the Board provided an analysis of the incremental PCAOB requirements that are applicable when auditors are asked to audit financial statements in accordance with the standards of the PCAOB, which previously were audited in accordance with standards of the IAASB or the ASB. Converting from one set of auditing standards to another can occur in several situations, including when a client that had terminated its SEC registration decides to become registered again, when an existing private client decides to file with the SEC and all periods presented are required to be audited in accordance with PCAOB standards or when a privately held client is acquired by an SEC registrant and is required to guarantee the debt of the registrant. Providing this type of guidance would assist auditors in focusing on matters that the PCAOB views as incremental to other standards.

Proposed Changes to PCAOB Standards

AU 532, "Restricting the Use of an Auditor's Report"

We believe AU 532 should not be rescinded because it provides an opportunity for an auditor to restrict the use of the auditor's report. This is important when an auditor issues reports as a by-product of a financial statement audit, for example, reports issued on compliance with loan agreement covenants pursuant to AU 623, *Special Reports*.

AU 901, "Public Warehouses – Controls and Auditing Procedures for Goods Held"

We do not believe that all of the recommendations for the audit of the warehouseman detailed in AU 901 are set forth in AU 331, *Inventories*. Therefore we recommend that AU 901 be retained as a supplement to AU 331, rather than being rescinded.

AICPA "Auditing Interpretations" and Other "Interpretive Publications"

We agree with the Board's proposal to present the AICPA auditing interpretations separately from the auditing standards on the Board's website in a manner similar to PCAOB Guidance, such as Staff Audit Practice Alerts, Staff Questions and Answers, Other Staff Guidance and Other Board Releases. So as to assist the auditor in being aware of and considering all of these auditing interpretations, we recommend the framework include a reference to PCAOB Guidance within the applicable sections of the reorganized standards and rules.

Economic Considerations

We agree the primary costs of the proposed changes related to the reorganization would be one-time costs to registered firms of updating references within firm methodologies, related reference materials, and practice aids to reflect the new citations to PCAOB auditing standards. That assumes, however, that the costs truly are "one-time" costs. We recommend that the PCAOB make all necessary reorganizational revisions at one time so that firms do not have to update references a second time at some point due to future revisions related to further reorganization. It also should be noted that other implementation costs besides those discussed in the release are those related to updating the related training and revising references in engagement files.

Application to Audits of Emerging Growth Companies

In considering its proposed reorganization, the Board should consider that there may be future standards that the SEC will determine to not apply to the audits of emerging growth companies and therefore should contemplate how such situations will be designated within the framework.

Scope of the Auditing Standards Reorganization

Other Professional Practice Standards

We agree the organizational structure of the PCAOB's other professional practice standards (*i.e.*, quality control, attestation, and ethics and independence) should be excluded from the scope of the proposed framework, and we support the Board's efforts to undertake additional projects to address the organizational structure of such standards in the future.

Technical Changes to Wording of Individual Standards

As stated above, we recommend the PCAOB make all necessary reorganizational revisions now. Therefore, we recommend the following technical changes to the wording of individual standards be considered as part of the proposed reorganization:

- Eliminating references to generally accepted auditing standards
- Eliminating outdated references to accounting standards
- Eliminating requirements that are not applicable to audits of issuers, for example, the responsibilities of service auditors as set forth in paragraphs 22 through 62 of AU 324, *Service Organizations*
- Changing references for "generally accepted accounting principles" to "applicable financial reporting framework" so as to accommodate audits of financial statements prepared in accordance with International Financial Reporting Standards
- Placing all requirements of the auditor in the body of each standard and using "Notes" to clarify how auditors might implement the requirements. We are concerned that auditors will not readily identify requirements contained in "Notes" to the proposed standard, and that auditors may fail to identify and implement those requirements.

Effective Date

We request the PCAOB provide additional guidance as to its expectations regarding adoption of the proposed framework as of the effective date. This would include expectations as to references to the proposed framework rather than the extant standards in policy manuals, training materials, and individual engagement files. Registered firms will need adequate implementation time of at least a full calendar year to cost effectively make all of the requisite changes in the normal course of business.

We appreciate this opportunity to provide feedback on the proposed framework and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Mike Campana, Partner - National Professional Standards Group, at 612-455-9414.

Sincerely,



McGladrey LLP

Appendix 1 Topical Structure Suggestions

(Proposed deletions are struck through, and proposed additions are shown in red font.)

~~General Auditing Standards~~ **Principles and Responsibilities**¹

~~1000~~ General Principles and Responsibilities

- ~~4004~~**1010** Responsibilities and Functions of the Independent Auditor
- ~~4040~~ **1020** Training and Proficiency of the Independent Auditor
- ~~4044~~**1030** Independence
- ~~4042~~**1040** Due Professional Care in the Performance of Work

~~1100~~ General Concepts²

- ~~1101~~ Audit Risk³
- ~~1102~~ Audit Evidence⁴
- ~~1103~~**1050** Relationship of Auditing Standards to Quality Control Standards

~~1200~~ General Activities²

- ~~1204~~**1060** Supervision of the Audit Engagement
- ~~1202~~ Part of Audit Performed by Other Independent Auditors⁵
- ~~1203~~ Using the Work of a Specialist⁵
- ~~1240~~ **1070** Audit Documentation
- ~~1220~~ **1080** Engagement Quality Review

~~1200~~ Using the Work of Others⁵

- ~~1210~~ Part of Audit Performed by Other Independent Auditors⁵
- ~~1220~~ Using the Work of a Specialist⁵
- ~~1230~~ The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements⁵

~~1300~~ Auditor Communications

Auditor Communications

- ~~1301~~ Communications with Audit Committees
- ~~1302~~ Communications about Control Deficiencies in an Audit of Financial Statements
- ~~2603~~ **Communications Between Predecessor and Successor Auditors**

Audit Procedures

~~2100~~ Audit Planning and Risk Assessment

- ~~1101~~ Audit Risk³
- ~~2101~~ Audit Planning

¹ *General Auditing Standards* is a broad term, which in this category actually is limited to principles and responsibilities. Also, our proposed title is consistent with that used in International Standards on Auditing.

² Use of the terms *General Concepts* and *General Activities* do not lend themselves to intuitive searching of the standards.

³ We believe it is more appropriate to address audit risk in the context of audit planning and risk assessment.

⁴ We believe these subcategories are more appropriately reflected within a new *Audit Evidence* category as they are illustrative of the accumulation of audit evidence.

⁵ We believe these subcategories reference audit procedures that should be categorized as *Using the Work of Others*, rather than as *General Activities* or alternatively, as a *Special Topic* in section 2600.

- 2102 Consideration of Materiality in Planning and Performing an Audit
2103 Identifying and Assessing Risks of Material Misstatement
- 2200 *Audit Procedures in Response to Risks — Nature, Timing, and Extent of Material Misstatement*⁶
2201 The Auditor's Responses to the Risks of Material Misstatement
- 2300 *Audit Evidence*⁴
1102 *Audit Evidence*⁴
2202 Substantive Analytical Procedures⁴
2203 The Confirmation Process⁴
2204 Audit Sampling⁴
2801 *Subsequent Events*⁴
2802 *Management Representations*⁴
- 2300 *Auditing Internal Control Over Financial Reporting*⁷
2301 An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements⁷
~~2302 Reporting on Whether a Previously Reported Material Weakness Continues to Exist⁷~~
- 2400 *Audit Procedures for Specific Aspects of the Audit*
2401 Consideration of Fraud in a Financial Statement Audit
2402 Illegal Acts by Clients
2403 Related Parties and Related Party Transactions
2404 ~~The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern~~
- 2500 *Audit Procedures for Certain Accounts or Disclosures*
2501 Auditing Accounting Estimates
2502 Auditing Fair Value Measurements and Disclosures
2503 Auditing Derivative Instruments, Hedging Activities, and Investments in Securities
2504 Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments
2505 *Auditing Inventories*
- 2600 *Special Topics*
2601 *Considerations Relating to an Entity Using a Service Organizations*
~~2602 The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements⁵~~
~~2603 Communications Between Predecessor and Successor Auditors~~
- 2700 *Auditor's Responsibilities Regarding Other and Supplementary Information*⁸
2701 Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents⁸
2702 Unaudited Supplementary Information Included in Audited Financial Statements⁸
2703 Other Information in Documents Containing Audited Financial Statements⁸

⁶ We suggest keeping this subcategory title consistent with the title of AS 13, *The Auditor's Responses to the Risks of Material Misstatement*.

⁷ As discussed more fully above, we believe the individual requirements of these standards should be relocated under the applicable subcategories within the flow of an audit. If these changes are made, this subcategory could be eliminated.

⁸ Consideration could be given to moving these subcategories to subcategory 3200, which would be a categorization approach similar to that used in International Standards on Auditing.

2800 Concluding Audit Procedures

~~2801 Subsequent Events⁴~~

~~2802 Management Representations⁴~~

2803 Evaluating Audit Results

2804 The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles

2805 Evaluating Consistency of Financial Statements

2900 Post-Audit Matters

2901 Consideration of Omitted Procedures After the Report Date

2902 Subsequent Discovery of Facts Existing at the Date of the Auditor's Report

Auditor Reporting

3100 Reporting on Audits of Financial Statements

3101 Reports on Audited Financial Statements

3105 References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board⁹

3110 Dating of the Independent Auditor's Report⁹

3200 Reserved

3300 Other Reporting Topics

3301 Association With Financial Statements

3310 Special Reports

3311 Special Reports on Regulated Companies

3312 Reporting on Condensed Financial Statements and Selected Financial Data

Matters Relating to Filings under Federal Securities Laws

4101 Responsibilities Regarding Filings under Federal Securities Statutes

4102 Reviews of Interim Financial Information

5000 Reserved

Other Matters Associated with Audits

2302 **Reporting on Whether a Previously Reported Material Weakness Continues to Exist⁷**

6101 Letters for Underwriters and Certain Other Requesting Parties

6102 Reports on the Application of Accounting Principles

6103 Compliance Auditing Considerations in Audits of Recipients of Governmental Financial Assistance

⁹ The requirements of these two subcategories should be reflected within subcategory 3101, *Reports on Audited Financial Statements*.