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Accountability \* Integrity \* Reliability

Comptroller General  
of the United States

United States Government Accountability Office  
Washington, DC 20548

May 18, 2007

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

Subject: PCAOB Release No. 2007-003—*Proposed Auditing Standard—Evaluating Consistency of Financial Statements and Proposed Amendments to Interim Auditing Standards.*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) proposed new auditing standard and amendments to its interim auditing standards. We commend the PCAOB for its efforts to better align its auditing standards with the new accounting standards issued by the Financial Accounting Standards Board (FASB). While we agree with the board's efforts, we continue to have serious concerns about its approach to updating its interim standards.

First, we support enhancing AU sec. 420 and 508 of the PCAOB interim standards to require recognition in the auditors' report of a correction of a material misstatement in previously issued financial statements. *Government Auditing Standards*, January 2007 Revision, has similar auditor requirements, including requiring an explanatory paragraph in the auditors' report. We believe that additional auditor disclosures in this area are necessary and appropriate. The enclosure to this letter includes a discussion of these additional disclosures.

We also agree that the generally accepted accounting principles (GAAP) hierarchy should be removed from the auditing standards. We advocated this position in our June 27, 2005, letters to the FASB and the Auditing Standards Board (ASB) of the American Institute of CPAs (AICPA). In those letters, we discuss the importance of recognizing the responsibility of the reporting entity, and not the auditor, for selecting and applying accounting principles and for the adequacy of financial statement disclosure.

We continue to have concerns about the PCAOB's procedures for updating its interim standards. The PCAOB's proposed amendments to AU sec. 411 of its interim standards contain significant differences from the ASB proposed changes to AU sec. 411 of the ASB standards, which were detailed in the ASB's May 9, 2005, proposed amendment to SAS No. 69. Significant differences also exist between the PCAOB interim standards and ASB core standards such as SAS No. 107: "Audit Risk and Materiality in Conducting an Audit," SAS No. 109: "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," and SAS No. 110:

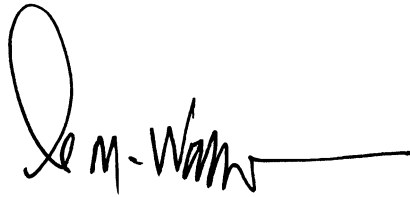
“Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.”

We strongly believe that U.S. auditing standard setters should work together to achieve agreement and consistency on core auditing standards, which are used by almost all auditors of U.S. entities. Where there is a clear and compelling reason, the standard setters should develop additional standards necessary to meet the needs of their constituencies. The nature of any differences from core auditing standards and the basis for the differences also should be communicated. GAO’s *Government Auditing Standards* uses the same core field work and reporting standards as the ASB, and supplements them with additional standards to satisfy the greater accountability needs of government entities. Inconsistencies in such core standards increase audit costs and lead to potential confusion and misapplication of the standards.

In addition to the above matters, we have identified other matters for which we are offering comments. Our comments, which are detailed in the enclosure to this letter, address the following issues:

- enhancing auditor reporting on correction of a material misstatement in previously-issued financial statements,
- acknowledging officially established accounting principles that may be applicable for entities other than listed companies,
- changes in financial statement classification that may be restatements,
- proposed deletion of guidance from PCAOB interim standards,
- clarifying requirements and guidance on auditors’ evaluation of consistency between periods, and
- references for PCAOB interim standards.

We thank you for considering our comments on these very important issues and look forward to working with you to promote high-quality auditing in the United States.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker  
Comptroller General  
of the United States

Enclosure

cc:

The Honorable Christopher Cox, Chairman  
U.S. Securities and Exchange Commission

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

Harold Monk, Jr., Chair  
Auditing Standards Board

**GAO Comments on PCAOB Release 2007-003**Enhancing auditor reporting on correction of a material misstatement in previously-issued financial statements

The proposed amendment to PCAOB interim standard AU sec. 508 “Reports on Auditing Financial Statements,” paragraph 18A, “Correction of a Material Misstatement in Previously Issued Financial Statements” requires an explanatory paragraph in the auditors’ report on the correction of a material misstatement in previously-issued financial statements when there has been such a correction. We recommend enhancing the requirement by requiring that auditors include in the explanatory paragraph a statement that (1) the previously-issued auditors’ report is not to be relied on because the previously-issued financial statements were materially misstated and (2) the previously-issued auditors’ report is replaced by the auditors’ report on the restated financial statements. This disclosure is important to alert financial statement users to these matters.

Acknowledging officially established accounting principles that may be applicable for entities other than listed companies

The Board’s proposed amendment to paragraph 2 of PCAOB interim standard AU sec. 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles,” narrowly defines GAAP as those accounting principles recognized in the standards of the FASB or in the standards of any other standard-setting body recognized by the U.S. Securities and Exchange Commission (SEC). To avoid potential confusion by users, the PCAOB standards should include a reference to acknowledge that there are other sources of GAAP for entities other than issuers. Alternatively, the proposed text could be revised to clarify that the GAAP being defined in the PCAOB standard is GAAP for issuers. For example, “Generally accepted accounting principles *for issuers* refer to the accounting principles recognized in the standards of the Financial Accounting Standards Board or in the standards of any other standard-setting body recognized by the U.S. Securities and Exchange Commission.”

Changes in financial statement classification that may be restatements

Paragraph 11, “Change in Classification” on page A1-5 of the PCAOB Release includes a discussion of classification changes in previously-issued financial statements and how these changes affect the evaluation of the consistency of the application of GAAP in the audited financial statements. We support the PCAOB’s proposed changes clarifying that, in some circumstances, a change in financial statement classification also may be a correction of a material misstatement in previously-issued financial statements.

**GAO Comments on PCAOB Release 2007-003**Proposed deletion of guidance from PCAOB interim standards

The revisions in the PCAOB Release would delete several paragraphs from the interim standard that provide useful auditing guidance. Specifically, we are concerned about deleting the following paragraphs:

- PCAOB interim standard 420, paragraph 13, which provides valuable guidance for addressing a change in accounting principle that also involves a change in an accounting estimate.
- PCAOB interim standard 431, paragraph 4, which adds guidance for balancing required financial statement disclosures with the requirements related to confidential information.
- PCAOB interim standard 508, paragraphs 14 and 15, which include requirements and guidance regarding departures from GAAP and incorporate Rule 203 of the AICPA Code of Professional Conduct into the interim standards. If the Board's intent is to remove all reference to the AICPA Code of Professional Ethics from the PCAOB interim standards, then the Board should indicate the professional ethics that auditors should follow when conducting audits in accordance with PCAOB standards.
- PCAOB interim standard 420, paragraphs 1 through 3, which discuss the objectives of the consistency standard and incorporate the second reporting standard into the interim standards.
- PCAOB interim standard 410, paragraph 2, which explains the term "generally accepted accounting principles" and clarifies the first reporting standard.

The board did not explain the reasons for each of these proposed deletions in the introduction to the PCAOB Release, so the board's basis for removing them from the PCAOB interim standards is not clear. We are concerned that the deletion of the guidance language and resulting inconsistency with ASB standards could lead to confusion among auditors. Absent a compelling reason for the deletion, we believe that these paragraphs add value to the interim standards and should not be deleted. If there are compelling reasons, PCAOB should more clearly articulate them.

Clarify requirements and guidance on auditors' evaluation of consistency between periods

The PCAOB should clarify the wording of the third and fourth sentences of paragraph 3 of the proposed standard, "Evaluating Consistency of Financial Statements." As written, the fourth sentence adds confusion, and it is not clear which periods the PCAOB is intending to describe in this discussion.

**GAO Comments on PCAOB Release 2007-003**References for PCAOB interim standards

As noted in our comment letter, we strongly support development of common core auditing standards for use by auditors of U.S. entities. However, if the PCAOB decides to continue its current practice of issuing its own standards for audits of listed companies, then we suggest that the PCAOB adopt alternative numbering/referencing schemes in order to reduce confusion between its interim standards and the AICPA Codification of Statements on Auditing Standards. The PCAOB's current practice of referring to its interim standards by AU section number creates potential for such confusion. This is especially significant now that the ASB has made numerous updates to the AU sections in its codification, while at the same time the PCAOB is making changes to the AU sections that make up the interim standards adopted in April 2003.