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August 12, 2024

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

Via Email to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 056, *Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards*

Dear Office of the Secretary:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's or Board's) Rulemaking Docket Matter No. 056, *Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards* (Proposal).

We support the Board's project to modernize AS 2305, *Substantive Analytical Procedures*, and to strengthen and clarify the existing requirements and elements of substantive analytical procedures. Generally, we believe the Proposal's overall objectives and the principles-based requirements will improve the quality of substantive analytical procedures performed by auditors. Our letter highlights specific areas where we believe additional clarity could enhance the overall effectiveness of the Proposal and avoid practical application challenges.

We respectfully submit, for the Board's consideration, our comments and recommendations, which include, as an Appendix to this letter, responses to certain questions posed in the Proposal.

Clarification of terms within the proposed standard

Developing an expectation – "company's amount"

We support the Board's objective to address the risk of circular auditing in substantive analytical procedures through introducing a new term for the amount that would be compared to the auditor's expectation, "company's amount." However, we are concerned with the lack of specificity surrounding the newly defined term within the Proposal.

We believe the Board's intent with this proposed definition is to distinguish between the amount recorded by the company and the expected amount derived by the auditor, which are separate elements in a substantive analytic procedure. However, Grant Thornton

we have concerns that the term “company’s amount,” as proposed, may be incorrectly interpreted in practice to include ***any*** amount recorded by the company. This would include, for example, prior-year audited amounts or other current-year account balances that are subject to audit, both of which are amounts that are recorded by the company and are often used by the auditor to develop an expected amount in a substantive analytical procedure. Auditors would face significant practical application challenges if they are unable to use prior-year amounts or other current-year amounts that are subject to audit. In order to avoid this confusion and make the defined term more operational, we propose suggested wording within the Appendix to our letter.

If the Board adopts the standard as proposed, we believe additional clarification would be necessary to prevent practitioners from misinterpreting what would be included in “company’s amount” or in “information based on the company’s amount” in order to clearly achieve the Board’s objective.

Identifying a sufficiently plausible and predictable relationship – “beyond inquiry”

Paragraph .05 of proposed AS 2305 requires the auditor to determine whether the relationship used in a substantive analytical procedure is sufficiently plausible and predictable using procedures “beyond inquiry.” We found this proposed language unclear, principally with regard to which, if any, additional procedures would be necessary to fulfill the proposed requirement.

Such language may lead to a wider misinterpretation of which procedures are required depending on the nature of the recorded amount that is being tested by the substantive analytical procedure and the relationship identified. Certain relationships may be less complicated than others, particularly if the auditor is using a prior-year amount in developing an expectation. As proposed, the requirement may lead some auditors to determine that additional test of details procedures are necessary, while others may conclude that risk assessment procedures or tests of controls sufficiently fulfill the requirement.

We believe that the required procedures in proposed paragraph .06 achieve the Board’s objective for the auditor to perform procedures to determine whether the relationship is sufficiently plausible and predictable. We recommend specific edits in the Proposal in order to avoid various interpretations (refer to Appendix A for specific suggested edits).

Threshold for evaluating differences

We support including a requirement for the auditor to determine a threshold to use in evaluating differences between the auditor’s expectation and the company’s recorded amount. On page 26 of the Proposal, the Board cites observations of auditors not appropriately determining such a threshold. We believe that having a requirement to determine a threshold for investigating differences would be beneficial to audit quality. However, we are concerned that prescribing a specific amount for that threshold, such as at or below tolerable misstatement, is not sufficiently principles-based.

Because the decision to perform tests of details, substantive analytical procedures, or a combination of both depends on the particular facts and circumstances of the audit, as well as on the engagement team’s professional judgment, we do not support a prescriptive threshold of tolerable misstatement because it does not take into consideration the nature and extent of the substantive analytical procedure relative to other procedures performed on the financial statement amount or related assertion. There may be instances where the substantive analytical procedure is performed in combination with other audit procedures that, in totality, provide sufficient appropriate audit evidence, thus allowing the auditor to accept a lower level of precision on the substantive analytical procedure.

Additionally, the proposed threshold for evaluating differences of tolerable misstatement fails to take into consideration possible disaggregation. Therefore, we ask the Board to provide a more principles-based approach to auditors determining a threshold for evaluating differences in proposed paragraph .08, which would allow auditors to use professional judgment and to consider any other factors and context relevant to the risk of material misstatement of the tested amount or company when determining this threshold. Refer to the Appendix to our letter for our response to Question 16 for more details.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or Jeff.Hughes@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP

Appendix: Responses to certain questions within the Proposal

Question 5. Are the introduction and objective sections of the proposed standard clear and appropriate? If not, how should they be clarified?

We support providing a clear introduction and objective within the proposed standard. We also support the Board acknowledging that substantive analytical procedures may be performed alone or in combination with other audit procedures. We believe the standard would benefit from carrying this notion through to the requirements related to developing the auditor's expectation (see editorial and other suggestions in our responses to relevant questions below).

Further, we support creating a defined term of "company amount" to help reduce the risk of circular auditing and to enhance the overall understandability of the requirements. However, we are concerned that the defined term as proposed may be too broad and could lead to confusion in practice. Refer to our response to Question 14 below for specific suggestions to enhance and clarify the "company's amount" as well as other conforming edits.

Question 7. Are the factors that affect precision clear and appropriate? If not, how should they be clarified? Are there other factors upon which a substantive analytical procedure's level of precision depends? If so, what are they?

We believe that the relevance of the information used, the plausibility and predictability of the relationship, and the threshold for evaluating differences are all appropriate factors that affect the precision of substantive analytical procedures. We propose two additional factors that we believe are important to consider relative to precision:

- The level of disaggregation may impact the level of precision of a substantive analytical procedure. The auditor may disaggregate the amount subject to the substantive analytical procedure in order to create a more precise expectation or if there are various plausible and predictable relationships within an account or a financial statement line item. For example, an auditor may use disaggregation for a payroll substantive analytic when there are multiple categories of employees with different characteristics (such as salaried employees, hourly employees, and temporary contractors). We believe that explicitly acknowledging disaggregation within the standard as a factor that could impact the level of precision would enable auditors to design better substantive analytical procedures that achieve appropriate precision.

- Whether the substantive analytical procedure is being performed alone or in combination with other audit procedures is another factor that could affect the level of precision in a substantive analytical procedure. When an auditor performs substantive analytical procedures in conjunction with other audit procedures, it could be reasonable and appropriate for the auditor to use professional judgment to accept a lower level of precision, taking into account the risks of material misstatement and the evidence obtained from the other audit procedures performed.

Question 10. Is the proposed requirement that the auditor identify the relationship or relationships to use in the substantive analytical procedure and determine whether each such relationship is sufficiently plausible and predictable clear and appropriate? If not, how should it be clarified?

As noted in the body of our letter, we are concerned that the language in proposed paragraph .05 that requires procedures "beyond inquiry" could lead to inconsistency in practice. We suggest removing the final sentence of paragraph .05, particularly since we believe proposed paragraph .06 appropriately guides the auditor in identifying sufficiently plausible and predictable relationships.

Our recommended edits to proposed paragraph .05 are as follows (deletions in ~~strikethrough~~):

> .05 The auditor must identify the relationship or relationships to be used in the substantive analytical procedures and determine whether each such relationship is sufficiently plausible and predictable. ~~Making the determination should extend beyond inquiry.~~

Question 12. Are the examples of events, conditions, and company activities that are included in proposed paragraph .06 described clearly and appropriately? Are there additional events, conditions, or company activities that may affect the plausibility and predictability of a relationship that should be included in the proposed standard as examples? If so, what are they? If the examples of events and conditions are not clear, how should they be clarified?

Generally, we believe the examples provided in proposed paragraph .06 are described clearly and appropriately and will assist auditors with practical application. However, we urge the Board to remain principles-based within the standard to avoid an auditor inappropriately framing these examples as incremental requirements, which we do not believe is the Board's intent.

Additionally, we propose one editorial change to proposed paragraph .06 to align the terminology with that used elsewhere in other PCAOB auditing standards (deletions in ~~strikethrough~~ and additions in ***bold italics***):

> .06 Relationships used in the substantive analytical procedure must be sufficiently plausible and predictable to achieve the objective of the procedure. When determining whether a relationship is sufficiently plausible and predictable, the auditor should take into account all relevant information of which the auditor is aware, including information obtained from:
>
> a. The auditor's understanding of the company and its environment, and
>
> b. Other procedures performed in the audit and in reviews of interim financial information
>
> Note: Events, conditions, and company activities that may affect the plausibility and predictability of a relationship, include ~~specific~~ ***significant*** unusual transactions or events, accounting changes, business changes, or external factors, such as general economic conditions and industry factors.

Question 14. Is the proposed change specifying that the auditor may not develop the expectation using the company's amount or information that is based on the company's amount clear and appropriate? If not, what changes should be made?

As noted in our response to Question 5 above, the terms "company's amount" and "information that is based on the company's amount," as proposed, might be too broad, rendering the application of the defined terms in the requirements impracticable. We do not believe the "company's amount" should be interpreted to mean ***any*** amount recorded by the company, nor do we believe this was the Board's intent with the introduction of this defined term.

When designing and performing substantive analytical procedures, auditors often utilize other amounts recorded by the company to develop their expectation, such as prior-year audited amounts, amounts that correlate to the amount that is subject to the substantive analytical procedure, or other amounts subject to audit. For example, an auditor may develop an expectation for the current-year prepaid rent expense balance by using the prior-year prepaid rent expense balance, due to the fixed nature of the rental agreements from the prior year. Additionally, an auditor may develop an expectation in an interest expense substantive analytic using the company's outstanding long-term debt balance. The debt balance correlates to interest expense based on the debt agreement and therefore would indicate a plausible and predictable relationship. Finally, in a commissions expense substantive analytic, the auditor may use the company's revenue balance to develop an expectation based on the company's commission rate policy. The company's revenue balance is subject to other audit procedures that are not related to the commissions expense balance.

In the examples above, the amounts utilized by the auditor to develop an expectation would be considered a "company's amount" based on the Board's proposed definition, which, again, we do not believe was the Board's intent. Unless the notion of "company's amount" is clarified, auditors would be unable to use these amounts to develop expectations for substantive analytical procedures, which would limit an auditor's use of substantive analytical procedures in an audit.

Therefore, we recommend the following edits to paragraphs .02 and .07 and suggest adding the following footnote below paragraph .07 to clarify the definition (deletions in ~~strikethrough~~ and additions in ***bold italics***):

> .02 A substantive analytical procedure involves comparing a recorded amount or an amount derived from recorded amounts (as applicable, the "company's amount") to an expectation of that amount developed by the auditor to determine whether there is a misstatement. ***The company's amount refers to the recorded amount, or an amount derived therefrom, that is being tested by the substantive analytical procedure.*** The auditor's expectation when performing a substantive analytical procedure is based on one or more plausible and predictable relationships among financial or nonfinancial data.
>
> .07 The auditor should develop an expectation of the company's amount based on the relationship(s) identified pursuant to paragraphs .05 and .06. The auditor may not develop an expectation using the company's amount or ***other amounts derived from*** ~~information that is based on~~ the company's amount.
>
> > ***Note: The company's amount refers to the recorded amount, or an amount derived therefrom, that is being tested by the substantive analytical procedure.***

Question 16. Is the proposed requirement that the auditor determine a threshold to evaluate the difference between the auditor's expectation and the company's amount clear and appropriate? If not, what changes should be made?

As noted in the body of our letter, a prescriptive threshold may not be appropriate in all circumstances where an auditor chooses to perform substantive analytical procedures. Additionally, we foresee potential operational challenges if a prescriptive amount is approved, as proposed:

- As noted above in our response to Question 7, an auditor may perform a substantive analytical procedure in conjunction with other audit procedures using professional judgment. In these cases, a higher threshold may be acceptable for the substantive analytical procedure since the evidence provided by the substantive analytical procedure is combined with evidence obtained from the other auditor procedures. We provide specific language in proposed paragraph .08 below to address this.
- It is unclear how a bright-line threshold would be operationalized for multi-location audits. Because aggregation risk is usually addressed by setting a lower tolerable misstatement threshold for each location, a prescriptive threshold for substantive analytical procedures would not be operational for a complex multi-location audit where multiple substantive analytical procedures are performed across locations. If

the Board adopts this requirement as proposed, we recommend providing specific implementation guidance for multi-location audits.

We recommend the following edits to proposed paragraph .08 to (a) eliminate the prescriptive threshold of tolerable misstatement and (b) clarify that this requirement does not mean the auditor must determine that a misstatement exists because we believe the intention of this requirement is to focus on the auditor's consideration of potential misstatements when determining a threshold (deletions in ~~strikethrough~~ and additions in ***bold italics***):

> .08 The auditor should determine a threshold for evaluating the difference between the auditor's expectation and the company's amount. The amount of the threshold should ~~be set at or below tolerable misstatement, taking~~ ***take*** into account the nature of the account or disclosure or, where applicable, the component of the account or disclosure. When determining the threshold, the auditor should address the risk that the difference between the auditor's expectation and the company's amount represents a ***potential*** misstatement that would be material to the financial statements, individually or in combination with other misstatements within the account or disclosure, considering the possibility of undetected misstatements.

Question 19. Are there other scenarios the auditor may encounter when evaluating differences that should be addressed by the proposed standard?

The Proposal generally provides reasonable requirements outlining the auditor's responsibilities for evaluating differences identified when performing substantive analytical procedures. We believe the requirements in proposed paragraph .09 to evaluate the difference between the auditor's expectation and the company's amount and to obtain relevant evidence are reasonable. Depending on the results of the procedures performed in proposed paragraph .09, the auditor may redesign the substantive analytical procedure to accommodate the new information (which is then evaluated for reliability) or determine the difference is a misstatement and evaluate accordingly. We believe that these are consistent with current practice and that it remains necessary to provide for the various scenarios within the standard.

Question 21. Is the proposed amendment to clarify the description of analytical procedures clear and appropriate? If not, what changes should be made?

We believe the proposed amendments to clarify the description of analytical procedures are reasonable and clear.

Question 22. The proposed amendment specifies that when substantive procedures are applied to accounts or disclosures that depend on information received by the company from external sources, such procedures should involve examining relevant information from the external sources. Is this proposed amendment clear and appropriate? If not, what changes should be made?

We have concerns that proposed paragraph .40A in AS 2301 may cause confusion in practice because it is unclear how the proposed new requirement interplays with language recently approved by the PCAOB in its technology-assisted analysis release, specifically paragraph .10A in AS 1105.

We believe that AS 1105 sufficiently reminds and guides the auditor through the expectations associated with testing the relevance and reliability of information obtained from external sources. Therefore, we believe the proposed addition of paragraph .40A in AS 2301 is unnecessary and confusing. We also believe using the word “examining,” as currently written, may be misinterpreted to mean “inspection” or another more specific procedure, thereby restricting the nature of the procedures that could be applied. Further, a specific procedure like inspection may not be possible to perform in all scenarios where external information is applicable to the account or disclosure (for example, receipts of data via application programming interfaces or electronic data interchange).

Additionally, there is a lack of clarity within the proposed language with respect to use of the word “relevant” in relation to “information the company received from one or more external sources.” An auditor may interpret such language to relate to either “the auditor’s substantive procedures” or the overall “accounts and disclosures.” The scope of the external information to potentially examine may vary significantly depending upon how that language is interpreted, as an auditor may design procedures only to evaluate a subset of the total population of external information that an account or disclosure depends upon in accordance with the assessed risk of material misstatement. All external information that an account or disclosure depends on may not present a risk in relation to the assessed risk of material misstatement. We do not believe it would benefit audit quality to retain such a sweeping requirement that could overwhelm auditors in hours and detail where there might not be corresponding risk.

We note that paragraph .10A in AS 1105 and proposed paragraph .40A in AS 2301 both address the reliability of external information used as audit evidence, and we interpret significant overlap in these two requirements. Under the Proposal as currently drafted, an auditor may interpret that the two standards introduce separate and distinct requirements over the reliability of external information, causing auditors to perform redundant procedures to gather similar audit evidence over the external information in a manner that does not result in a commensurate increase in the persuasiveness of the evidence gathered.

Accordingly, we recommend removing proposed paragraph .40A from AS 2301. The Board could add a note that directs the auditor to the relevant requirements already in

AS 1105; we believe adding such a note would sufficiently address the Board’s concerns.