July 23, 2024

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Number PCAOB-2024-03

Dear Ms. Countryman:

We appreciate the opportunity to comment on SEC Release 34-100430, *Notice of Filing of Proposed Rules on Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form* (the "PCAOB standard," "PCAOB adopting release," or "PCAOB Release 2024-007").

We commend the PCAOB (or "the Board") for taking this important step to modernize its standards and establish principles-based requirements that will not impede the evolving use of technology by auditors. We previously provided feedback to the Board on the proposal,[1] requesting clarification on a number of matters, including proposed new paragraph .10A of AS 1105, *Audit Evidence*. We have significant concerns with this requirement and how it has been revised and explained in the adopting release (referred to hereafter as the "final amendment" or "final requirement"). Whether or not intended by the Board, the adopting release's drafting of the final requirement is problematic and appears to create technical inconsistencies, including with the risk-based approach in the PCAOB's standards. It can reasonably be interpreted to require the auditor, in all circumstances and without regard to the auditor's assessment of risk, to perform specific procedures to determine whether or not any intentional or unintentional modifications have been made to information a company receives from external sources and provides to the auditor in electronic form.

In our view, this requirement undermines the risk-based approach in PCAOB standards,[2] would likely result in significant unnecessary costs, and in some cases may not be able to be implemented. The impact to management and auditors to meet the requirement for each type/piece of information to be used as audit evidence will likely be significant, even though in many cases the potential risks of modification will be remote – therefore unnecessarily increasing costs without a commensurate benefit to audit quality or ultimately to investors. As a result, we are unable to support approval of the standard without further amendment or contemporaneous interpretive guidance that addresses our concerns.

Changes to clarify the final amendment in AS 1105 have not benefitted from additional input on whether the requirement can be practically implemented, and the potential for unnecessary costs and unintended consequences are not addressed in the final economic analysis.

The final requirement in paragraph .10A of AS 1105 broadly refers to any information provided to the auditor "in electronic form that the company received from one or more external sources" and it requires the auditor to obtain an understanding of the "company's process by which such information was received,

[1] See our comment letter on PCAOB Release 2023-004, *Proposed Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form* (the proposal).
[2] See AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2401, *Consideration of Fraud in a Financial Statement Audit*.

PricewaterhouseCoopers LLP, 400 Campus Drive, Florham Park, NJ 07932
T: (973) 236 4000, F: (973) 236 5000, www.pwc.com

maintained, and, where applicable, processed, which includes understanding the nature of any modifications made to the information before it was provided to the auditor." Further, it requires the auditor to either test "controls over receiving, maintaining, and processing the information (including, where applicable, information technology general controls [ITGCs] and automated application controls" or test "the information to determine whether it has been modified by the company, and evaluating the effect of those modifications."

The proposed requirement in paragraph .10A of AS 1105 related to evaluating the reliability of external information provided to the auditor "that the company received from one or more external sources and **maintained in its information systems** in electronic form" (emphasis added), which we interpreted as information systems relevant to financial reporting.[3] In addition, the proposal would have required the auditor to obtain an understanding of "the company's procedures by which such information is received, recorded, maintained, and processed in the company's information systems" and either test controls over those procedures or test the procedures themselves.

In our comment letter on the proposal, we expressed our view that the requirement to obtain an understanding of the company's procedures is not practicable or necessary in all circumstances, as the nature and extent of controls a company may have over what we believe is a wide variety of external information may vary significantly depending on the type and form of the information. In some cases, such controls may reasonably be determined by management not to be part of a company's information system relevant to its internal controls over financial reporting (ICFR).

The adopting release notes that the Board "clarified the final amendment by removing the reference to 'maintained in the company's information systems,' which confused some commenters. The use of this term in the proposal was intended to refer broadly to information in electronic form within a company that the company could provide to the auditor."[4] In addition, the adopting release indicates that further refinements included adding "where applicable" to address examples "where companies receive information from external sources that may be maintained only – and not processed – by the company."[5] Footnote 3B to paragraph .10A was clarified to note information in electronic form intended to be addressed by that paragraph includes, for example, cash receipts, shipping documents, and purchase orders – although the adopting release also refers to bank statements and interest rate information. The adopting release notes (1) the Board's views that use of the "company's process" is more consistent with AS 2110.30 and .31, which describe the company's business processes that the auditor is required to understand, and (2) clarifies that the intent of the requirement is to understand the flow of the information from the time the company received it from the external source until the company provided it to the auditor. [6]

In practice today, substantially all the information that a company provides to the auditor is in electronic form. We therefore interpret the broad terms used in the final amendment as requiring either testing of all information received from external sources directly or testing controls over that information in all

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3 In its economic analysis on pages 38-39 of PCAOB Release 2023-004, the Board presented a view that the costs associated with the proposal would be expected to be "relatively modest" and noted that these proposed amendments "could require additional time and effort by engagement teams that would use such information in performing audit procedures. This additional time, and therefore the resulting variable costs, may be less on integrated audits or financial-statement audits that take a controls reliance approach because, in these cases, ITGCs and automated application controls over information in electronic form may already be tested." Based on this rationale, we and other respondents interpreted the term "information systems" to be appropriately limited and consistent with paragraph .28 of AS 2110, which focuses on understanding the information system relevant to financial reporting, although we requested clarification.

4 PCAOB Release 2024-007, page 29.

5 PCAOB Release 2024-007, page 29.

6 PCAOB Release 2024-007, page 29.

circumstances—regardless of the auditor's risk assessment and regardless of whether the information is maintained in a company's information systems relevant to financial reporting. When read together with the adopting release, the final requirement in paragraph .10A of AS 1105 sets out an expectation that auditors will often need to test controls over information from external sources.

The potential impact of this significant broadening of the scope of the auditor's procedures is not contemplated in the economic analysis in the proposing or adopting releases – which characterize the expected costs as "relatively modest."[7] In our view, the impact to management and auditors to meet the requirement for each type/piece of information to be used as audit evidence will likely be significant, even though in many cases the potential risks of modification will be remote – therefore unnecessarily increasing costs without a commensurate benefit to audit quality or ultimately to investors. Further, we are concerned that the final requirement in paragraph .10A of AS 1105 undermines the more principles-based requirement in paragraph .09 of AS 1105 and the risk-based approach underpinning the PCAOB's standards, including AS 2110 and AS 2401.

To avoid unnecessary effort and cost, it is important to maintain the risk-based approach underpinning the PCAOB's standards, such that the auditor assesses the risk of potential modification and performs procedures accordingly. To do so, changes to the standard, or contemporaneous interpretive guidance, are necessary.

The following language in the adopting release[8] is helpful to explain the Board's intent on scalability:

> [W]e are not prescribing the nature, timing, or extent of the auditor's procedures to evaluate the reliability of the external information. An auditor would design the procedures considering the wide variety of types of external information received by companies and differences in the processes for receiving, maintaining and, where applicable, processing such information. Further, the nature, timing, and extent of the auditor's procedures would depend on the purpose for which the auditor uses the information whose reliability is being evaluated. In general, performing audit procedures to address the risks of material misstatement involves obtaining more persuasive evidence than in performing risk assessment procedures. Accordingly, evaluating the reliability of information used in substantive procedures and tests of controls would require more auditor effort than evaluating the reliability of information used in risk assessment procedures.

However, changes to the standard, or contemporaneous interpretative guidance, are likely necessary to explain how risk assessment applies. This could be accomplished through the addition of required interaction between paragraphs .09 and .10A of AS 1105, AS 2110, and AS 2401 to avoid unintended consequences of the broad scope of the final amendment. The final amendment does not appear to allow for the possibility that, based on all those individual requirements, an auditor otherwise could appropriately conclude that it is not necessary to perform the specific procedures contemplated by paragraph .10A to evaluate the reliability of each individual piece of information a company receives from external sources and provides to the auditor in electronic form (including when such information is only used to inform risk assessment). As described in our comment letter on the proposal, when such information is used to perform technology-assisted analysis,[9] we take a more holistic approach to

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7 See footnote 3. This language describing expected costs was retained in the adopting release – see PCAOB Release 2024-007, page 49.

8 PCAOB Release 2024-007, page 32.

9 PCAOB Release 2023-004, pages 24–25, highlights that "[t]he staff's research indicates that in performing technology-assisted analysis, auditors use large volumes of information provided by the company that the company received from external sources in electronic form" and the Board's intent is to "emphasize the importance of controls over information technology for the reliability of audit evidence." Changes made to paragraph .08 of AS 1105 further incorporate this view.

considering the inputs into that analysis, such that other procedures may achieve the same objective with respect to evaluating reliability.

We are also concerned that broad application of this requirement raises certain practical challenges. For example, to evaluate reliability of information from external sources, the adopting release notes that the auditor may obtain customer purchase order information from the company's information systems and compare this information to the original purchase order submitted by the customer to determine whether any modifications were made by the company.[10] We have observed in practice that companies may or may not retain information such as original purchase orders, or these documents may not exist in hardcopy form or be retained centrally (for example, a purchase order could be sent to the company in the form of a PDF attachment in an email or could be submitted through an electronic portal), or the hardcopies themselves may routinely be digitized and discarded upon receipt. A purchase order received via EDI would typically be subject to internal controls that may include ITGCs or automated application controls, whereas information such as PDFs of purchase orders, bank statements, and contracts shared with the auditor are unlikely to be subject to such controls. More broadly, we observe in practice that, even when physical copies of other types of information to be used as audit evidence initially exist (e.g., bills of lading received at a plant location), companies often digitize this information for their own books and records and that electronic information is provided to the auditor.

We believe further engagement with preparers and auditors will be necessary for the SEC and PCAOB to better understand these concerns, to set out a final standard that is appropriately risk-based and focused on audit quality, which ultimately benefits investors. We can only support SEC approval of the standard if there is additional guidance to support the standard that provides appropriate interpretation of paragraph .10A of AS 1105, or if the PCAOB were to directly amend the standard to address these concerns.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions. Please contact Brian Croteau at brian.t.croteau@pwc.com or Tim Carey d.timothy.carey@pwc.com regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

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[10] PCAOB Release 2024-007, page 30.