

P B T K

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To: Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W., Washington, D.C. 20006-2803
Transmitted by e-mail to: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042, Release No. 2017-005, Supplemental Request for Comment: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*

We appreciate the opportunity to respond to the Board's Supplemental Request for Comment: entitled *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm* that is contained in Release No. 2017-005 dated September 26, 2017 (the 2017 Release), of the Public Company Accounting Oversight Board (the PCAOB or the Board).

Because we have not previously commented in response to the related predecessor Release No. 2016-002, dated April 12, 2016 (the 2016 Release), we are availing ourselves of the opportunity offered by the Board to comment now on certain aspects of the original proposal. However, since the limited comment period designated in the 2017 Release is so short, this letter is necessarily briefer and less specific than it might otherwise have been.

Our comments are presented below in three parts. Part 1 of the attachment contains our general overriding concerns and reservations, and our direct responses to the ten questions¹ set forth in the 2017 Release by the Board are presented in Part 2. Part 3 contains certain editorial recommendations.

We hope the Board finds our comments useful as it continues its deliberations on this proposal. Please contact the undersigned at hlevy@pbtk.com or 702/384-1120 if there are any questions about these comments.

Very truly yours,

Piercy Bowler Taylor & Kern, Certified Public Accountants



Howard B. Levy, Principal and Director, Technical Services

Attachment

¹ We have provided responses only to those questions where we believed we could provide significant input to the Board.

Part 1 — Overriding Concerns and Reservations

We support the Board’s overall objectives as set forth in the 2016 Release including to:

- increase the involvement of the lead auditor in the work of other auditors;
- enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors and facilitate improvements in the quality of the work of other auditors; and
- strengthen existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors when assuming responsibility for their work.

Despite declarations throughout the 2017 Release² that proposed amendments to AS 1201 are “principles-based” and encourage a “scalable risk-based approach to the supervision of other auditors' work” considering materiality and complexity, we find that the pervasive proliferation of “unconditional” and “presumptively mandatory” responsibilities and stated “responsibilities to consider” (terms as defined per PCAOB Rule 3101) run counter to these declarations. Such declarations make the overall tone of the proposed amendments overly prescriptive in many respects, thus strongly discouraging the exercise of subjective auditor judgments based on such considerations as to the nature and extent of supervisory procedures to be applied. The effect of such prescriptive language will add time to audit engagements to perform unwarranted procedures or to document why they are unwarranted, neither of which will enhance audit quality, and the latter will place the auditor at risk of having his or her judgments second-guessed by PCAOB inspectors or adversary parties in litigation.

Part 2 — Responses to Specific Questions Presented in the 2017 Release

Although we have expressed our most significant views in the foregoing comments (Part 1), our direct responses to the 10 questions presented in the 2017 Release (reproduced in italics below) follow. We have few issues with and generally have not commented as to matters of clarity except to a limited extent primarily in our editorial recommendations in Part 3 of this attachment.

Q1. Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?

A1. Subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, and except as set forth in the following paragraph and in Q2 and A2, below, we believe the proposed revised requirement for determining the sufficiency of participation to serve as lead auditor would be appropriate if expressed more as guidance than as rigid requirements .

Q2. Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

A2. We believe the Board should not adopt a rigid, bright-line prescriptive sufficiency criterion for dividing responsibility such as it says (on page 10 of the 2017 Release). Accordingly, we believe the last sentence of AS 2101.B2 should be deleted.

Instead, we believe:

- the substance of the discussion that also appears on page 10 (with footnote 10) of the SEC staff expectation and related presumption of a minimum participation by the lead auditor with respect to 50% of assets and revenues (as set forth the Financial Reporting Manual of the SEC’s Division of

² The short 45-day allowable comment period has prevented us from citing specific examples.

Corporation Finance) should be incorporated into the final standard at AS 1206.06³ and referenced from AS 2101.B2: and

- the improbability of overcoming the SEC staff presumption should be more forcefully emphasized and accompanied by a recommendation for the lead auditor to consult the staff of the Division (or the Office of the Chief Accountant) before accepting an arrangement that does not meet that expectation.

Q3. Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

A3. We believe the proposed requirement in AS 2101.B4a is impractical and therefore excessive. We observe that it makes no reference to any guidance as to how a lead auditor might overcome a perceived weakness in the other auditor's process for determining compliance with the SEC independence requirements and/or PCAOB independence and ethics requirements when there is no apparent evidence of any possible independence impairment or other ethical violation. (See also para. 1 of Part 3, below.)

Q4. Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

A4. We are concerned that the time-consuming process of obtaining information from the other audit firm about its auditors' knowledge, skill, and ability, including the audit firm's policies and procedures for training and assigning personnel, in most cases would likely produce only general, self-serving, highly summarized boilerplate information of little or no value with respect to any audit quality objective. We believe the most effective way to assess competency absent direct prior experience is to rely on personal referrals from trusted sources and regulatory evaluative reports.

Q5. Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

A5. Since it is clear that other auditors are subject to the ethical requirements of the PCAOB, we believed it is unnecessary to include the note inserted in AS 1015.02 about due professional care. However, although it can be discerned that AS 1015 applies to referred-to auditors, we believe the standard would be improved if such applicability were to be more clearly articulated therein.

Except with respect to multi-tiered audits (see our response below to Q7), we found nothing in proposed revised AS 1201 addressing responsibilities of other auditors, and, subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, we find the proposed revisions appropriate.

Q6. Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

A6. See the second paragraph of Part 1 of this attachment for our overriding concerns and reservations about the effect of excessively prescriptive language on scalability.

³ Or referenced there by footnote.

Q7. Are the revised proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

A7. Subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, we find that the proposed requirements relative to multi-tiered audits would be appropriate if expressed more as guidance than as rigid requirements.

Q8. Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

A8. We believe that the revised AS 1206.06d proposed in Appendix 2 of the 2017 Release should be expanded with language that would require that the lead auditor to document the basis for concluding that the auditor who audits the conversion has sufficient knowledge of both reporting frameworks to assume that responsibility effectively.

Q9. Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards propose or adopted by the Board since the 2016 proposal?

A9. We believe the revised AS 1201 should address how the lead auditor might deal with critical or key audit matters reported by other auditors and, if not reported as such, how other auditors audited significant estimates or made use of specialists or internal auditors.

Q10. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

A10. See the second paragraph of Part 1 of this attachment for our overall concerns about the effect of overly prescriptive language on scalability.

Although we have no access to any supporting research, our instinctive judgment is that the ability of smaller firms without offices in or near cities where other auditors are based will likely be impaired because they will find it impractical⁴ to perform the extent of supervisory procedures necessary to comply with the revised standard (AS 1201), if adopted as proposed. As further discussed in the following paragraph, such firms will be forced choose the divided responsibility reporting model option provided for in proposed new AS 1206, if available pursuant to the criteria set forth in AS 1206.06 if acceptable to their client(s), or give up the engagement(s) if not. (See also para. 3 of Part 3, below,)

As suggested the bottom of page 9 of the 2017 Release, a predictable consequence we see as likely to be unintended is a shift from the dominant auditor preference (or a bias) of assuming responsibility in favor of making reference to an another auditor in the audit report. The shift would be caused by the burdensome additional supervisory requirements of the lead auditor of proposed AS 1201 that would add significant time and cost to the audit and the risk of liability or regulatory challenges to any risk-based scope decisions that might be made with regard thereto. However, it is likely that many issuers would object to reporting a division of responsibility and, therefore, seek to displace auditors who find it impracticable or impractical to assume full responsibility.

On the other hand, we see a significant risk of regulatory challenge that a decision to divide responsibility would be insufficiently supported by evidence that it was “determined based on the criteria set forth in the

⁴ See para. 3 in Part 3, below.

proposed standard [AS 1206.06],” and that it was “impracticable⁵ for the lead auditor to supervise the work of another audit firm.” The latter consideration is set forth only in the 2017 Release but not in the text of the proposed standard, AS 1206. There is no guidance provided as to how to establish impracticability, so if it is intended that impracticability be established, it should be added to the criteria set forth in AS 1206.06, and such guidance should also be provided.

Part 3 — Editorial Recommendations

1. We believe the word, “determine” (or “determines”), as used in AS 1206.06c and AS 2101.B4 (and there may be other instances) is too strong for most contexts that entail the exercise of judgment. Accordingly, we believe a form of softer word such as “assess” or “evaluate” should be substituted.
2. We believe the language in proposed AS 1206.07a should be clarified as to whether it is, in fact, intended to require the lead auditor to take responsibility for all audit planning and performance away from the other auditor or merely to supplement such work as may be deemed necessary.
3. We believe the word, “impracticable” should not be used in the final release and standard in relation to criteria for determining eligibility to use the division of responsibility reporting option because it is too restrictive but rather that the word, “impractical,” be substituted for it in AS 1206.06 and wherever else it would appear in that regard. Our view is based on the fact that most authorities hold that these two terms are not synonymous (as many people believe) but rather that “impracticable” is more closely synonymous with “impossible,”⁶ than would be appropriate for this context and that “impractical” refers more appropriately, however, to the relative merits of adopting or not adopting a particular course of action. We believe cost-benefit considerations would likely be relevant to assessing impracticality but not impracticability and that such considerations should be significant to a determination of eligibility for division of responsibility reporting.
4. Since risk assessments are inherently subjective, AS 2101.B2 leading into .B2 a and b should end with words like, “the auditor’s judgments as to.”

⁵ *Ibid.*

⁶ Consider the special-purpose definition of “impracticability” contained in Subtopic 250-10-45-9 of the Accounting Standards Codification of the Financial Accounting Standards Board.