

July 29, 2016

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. 042,
*Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and
Proposed Audit Standard – Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and the Proposed Audit Standard – *Dividing Responsibility for the Audit with Another Accounting Firm* (Proposed Amendments or Proposed Standard, as applicable).

We support the Board's effort to improve audit quality by enhancing an existing standard that has been part of audit standards since the 1970's. We also agree with the Board's decision to provide a new specific standard for when the auditor divides responsibility for an audit with another accounting firm. We are pleased to provide our observations regarding areas where we believe the Proposed Amendments or the Proposed Standard could be modified to provide clarity for the auditor as well as observations related to risk based concepts.

Our observations are cross referenced to specific paragraph language within the Proposed Amendments or Proposed Standard as well as specific questions, where relevant.

Proposed Amendments

Sufficiency of Lead Auditor Concept

We have general concern over the term "participation" of an auditor in determining if there is sufficient participation to be the lead auditor. Our concern is based on existing risk based standards when combined with the proposed amendments as noted below.

Page A1-14, paragraph B2 (AS 2101) under "Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors", notes "*In an audit that involves other auditors or referred-to auditor, the engagement partner should determine whether the participation of his or her firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements. In making this determination, the engagement partner should take into account the risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm perform audit procedures (which includes considering the portion's materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditor.*"

As noted in paragraph B2, the Proposed Standard would revise the requirement to determine the sufficiency of participation, by requiring the determination to be based on the risks of material misstatements associated with the portions of the financial statement audited by the engagement partner's firm relative to the portion audited by other auditors. The Proposed Standard indicates that imposing this determination, will increase the likelihood that the firm issuing the auditor's report actually performs audit procedures for a meaningful portion of the company's financial statements. The engagement partner firm (lead auditor) is defined at paragraph A4, on page A1-13 based on proposed standards and does not include a firm within the network of the engagement partner firm, nor does this definition of lead auditor appear to include any auditor not employed by the lead auditor firm but who could be directly supervised by the lead auditor. We agree that the participation of the lead auditor should be meaningful. However, we believe under either a direct supervision model or a direct assistance model the lead auditor should include that activity in their determination of meaningful participation. We discuss more on the concepts of direct supervision and direct assistance below.

Currently AS 2110, paragraph 68 notes that there is a presumption of fraud risk involving improper revenue recognition, thus the auditor should presume this fraud risk and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks. Paragraph 70b of this standard also indicates that all fraud risks are significant risks.

The above point regarding sufficiency of participation (paragraph B2) was then illustrated in a couple of examples on pages A4-15 through 18. Example 2 notes that revenue in the other countries represents routine sales and operating activities, which involve no significant accounting judgments. Those activities have not significantly changed over the past several years. Based on this factor, and the fact that Accounting Firm 1 in the example performed procedures at the location that prepared the financial statements, made significant accounting judgments, and handled the complex accounting issues, than Accounting Firm 1's participation was sufficient to be the lead auditor. However, the example also notes that if the other locations had more complex operations with higher risk of material misstatements, Accounting Firm 1 would likely need to directly audit more locations.

Regarding the above example, we have concerns as it relates to revenue in multi-location or multi-national companies. The example appears to identify revenue recognition in the other countries as not a significant risk and therefore the other risk factors noted outweigh revenue risk. This appears to be inconsistent with the concept in AS 2110 that indicates revenue recognition is a significant risk. Therefore, we recommend the PCAOB consider whether AS 2110 should be amended to reflect this conceptual change noted in the example. We also understand the determination of sufficient participation requires judgment and cannot be defined by a formula, however, including an example where sufficient participation is determined when the only risk of material misstatement was revenue recognition would be helpful. Overall, we believe the examples presented help the auditor to form an opinion based on the proposed amendments. However, based on our observations above, we would encourage the PCAOB to clarify and or provide additional examples to help auditors understand what the PCAOB considers sufficient participation. This observation relates to Question 21.

Based on reading the examples in the Proposed Standard, it appears that the review by the lead auditor of testing performed by another auditor is not considered "participation". We believe use of other auditors, when responsibility is not divided and the lead auditor reviews the detailed work papers, should qualify as "participation" by the lead auditor. For example: the lead auditor plans the work, understands the risks and has elected to utilize another auditor to execute the plan. The lead auditor is taking responsibility for that work performed, has reviewed the detailed work and as a result is responsible for the audit quality of that work performed. We believe that level of understanding and involvement by the lead auditor should be sufficient for them to include that portion of the audit as part of what the lead auditor performed in concluding on level of participation.

As drafted in the Proposed Amendments, there does not appear to be a concept of direct assistance. In addition, the Proposed Standard simply addresses other auditors in which responsibility will be divided. However, under the Proposed Amendments, we believe a concept of direct assistance could be added. This concept would cover situations in which the lead auditor engages another auditor to perform certain procedures, but the lead auditor directly supervises, reviews and evaluates the detailed work performed as if the other auditor was an extension of the lead auditor. We believe this is a different level of supervision than what is noted in the proposed amendments to AS 1201, paragraph B2c (page A1-23). We also believe this should allow the lead auditor to include this participation in their overall assessment of the sufficiency of their involvement to be lead auditor.

Reporting by Other Auditors

In supervising the work of other auditors, the lead auditor should obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion (AS 1201, page A1-23, par B2d). As noted by the PCAOB, in many situations reporting similar to this description takes place today in practice. We agree with that statement, however, this reporting is unstructured and thus takes on many different forms and content today. Considering the PCAOB is proposing this reporting as a requirement, we believe that the profession would benefit from suggested examples as part of these Proposed Amendments. In addition, the requirement simply states "procedures, findings, conclusions, and, if applicable, opinion". This could be interpreted to indicate a list of all procedures and all findings which does not seem appropriate. From a conceptual perspective, we believe the profession could benefit from additional clarification of what the PCAOB believes is appropriate, such as procedures and findings related to significant risk areas.

Question 33 asks several questions related to the reporting by other auditors. As noted above, we believe several suggested examples could help firms in meeting this requirement and ensure appropriate items are addressed, as expected by PCAOB. Additionally, this requirement likely results in a change in practice for all firms, since current content of reports may not meet PCAOB requirements or expectations.

Finally, we believe the PCAOB should exclude other auditors performing work under a direct supervision model or a direct assistance model from AS 1201, paragraphs B2(b, c, d and e). As noted above, we believe under either a direct supervision model or direct assistance model, there should not be a requirement for reporting since the other auditors would be considered part of the lead auditor firm and the other auditor work is typically incorporated directly within the lead auditor work papers. If the standard was adopted as currently drafted, it is likely that additional time and effort will be spent by all firms under the proposed amendments in order to ensure reporting covers the various content points in paragraph B2d, which will add additional cost to the audit without a perception of benefit.

Other Auditors – Letters of Representation

As proposed in AS 1215, paragraph 19 (page A1-26 and 27) – "*the office issuing the auditor's report must obtain, and review and retain, prior to the report release date, the following documentation related to the work performed by other offices of the firm and other auditors*". The documentation noted includes letters of representations from management as item "g". Currently, AS 2805 addresses management representations, but this guidance is based on representations from management as part of an audit of financial statements. In many situations the use of other auditors may not be for an audit of a complete set of financial statements. Other auditors may be used for specific testing of certain elements of the financial statements and the timing may or may not coincide with the completion date of the overall financial statements and the opinion date. As a result of these items we believe the PCAOB could provide clarity associated with the following matters:

- a. Should the letter of representation be required in all cases, or only if there is an audit of financial statements performed by other auditors?
- b. Should you obtain a letter of representation if other auditors only perform limited procedures, such as a revenue test?
- c. What should be the date on the letter of representation – for example, the report release date at the subsidiary level or the report release date at the parent company level?
- d. What are the requirements to update a letter of representation obtained prior to the parent company report release date?

We suggest that item “g” be moved to a recommended matter based on the risk associated with the procedures performed by another auditor as well as the level of knowledge that corporate management signing the overall letter of representation has of the various other operations. We believe by making this a recommended step, the PCAOB could be less prescriptive in their guidance and allow the auditors to use their judgment on the letter of representation wording as well as dating to address the associated risk.

Investment Accounted for Under the Equity Method

As proposed under AS 2503, par 28 (page A3-20) the auditor should obtain sufficient evidence in support of the investee's financial results for valuations that are based on an investee's financial results, including the equity method of accounting. *“In determining whether or not the report of the investee's auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation and standing of the investee's auditor, visiting the investee's auditor and discussing the audit procedures followed and the results thereof, and reviewing the auditor program and/or working papers of the investee's auditor.”* Considering the nature of an investment, the sufficiency of the audit evidence may be based on an audit performed under PCAOB, AICPA, International or a specific other country audit standards since the owners of these investments do not control the related entity, therefore the owner cannot require an audit in accordance with PCAOB audit standards to be performed. As noted in AS 1105, sufficiency of evidence is based on quantity of evidence which is affected by risk of material misstatement and quality of audit evidence. We believe providing clarity to paragraph 28, including when the PCAOB believes an opinion using PCAOB audit standards would be preferred or suggested would be beneficial.

Using a Service Auditor's Report

The Proposed Amendments (AS 2601, par 19) appear to have changed the requirements of the following three procedures from *“should give consideration to the guidance”* to *“In considering whether the service auditor's report is sufficient to meet his or her objectives, the user auditor should consider performing one or more of the following”* procedures (listed as bullet points). The three procedures noted as bullet points are: 1) visiting the service auditor and discussing the audit procedures followed and results thereof, 2) reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work, and 3) reviewing additional audit documentation of the service auditor. While these items are noted as “consider” the paragraph under these bullet points indicates additional procedures to perform if the user auditor believes the service auditor's report is not sufficient. This language may lead an auditor to presume that at least one of the three steps noted is more than “consider” in order to document the sufficiency of the report. Also, if the auditor believes the service auditor's report may not be sufficient, it is suggest that the auditor may supplement their understanding “by discussing with the service auditor the scope and results of the service auditor's work”. This procedure appears to be very similar (potentially redundant) to procedure number 1 above (first bullet point in the proposed standard) however not as extensive, which does not appear appropriate based on the circumstance. As a result, we believe the three bullet points to consider are better positioned as a response for the user auditor to take when the service auditor's report may not be sufficient.

Crowe Horwath LLP supports the PCAOB's efforts to improve public company auditing standards and the due process to ensure proposed standards result in such improvement, mindful of cost benefit considerations and avoidance of unintended consequences. We would be pleased to respond to any questions regarding our observations noted within this letter. This is a complex subject and if there are any other questions regarding this subject, please contact Michael G. Yates at (574) 236-7644.

Sincerely,

Crowe Horwath LLP

Crowe Horwath LLP