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November 30, 2021

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
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**PCAOB Rulemaking Docket Matter No. 042: *Second 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***

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2021-005, *Second 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* (referred to as the proposed amendments and the proposed standard, respectively, and collectively as the Second Supplemental Request for Comment).

The Board has requested public comment on the Second Supplemental Request for Comment that is intended to improve audit quality and investor protection through enhancements to the current requirements related to the lead auditor's responsibilities concerning 1) the supervision of other auditors and 2) referred-to auditors. Overall, we continue to support the Board's initiative to further strengthen audit quality and investor protection with respect to audits that involve other auditors and referred-to auditors.

**Overview**

KPMG commends the PCAOB for its efforts to acknowledge and respond to the comments it received in relation to 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* (referred to as the Supplemental Request for Comment), through its Second Supplemental Request for Comment. We agree with the Board's goal to provide a more uniform, risk-based approach to supervision in audits that involve other auditors and the Board's approach to achieve this goal through further considerations and amendments to AS 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*.

The Second Supplemental Request for Comment includes certain enhancements that address implementation challenges with respect to the other auditor's compliance with independence and ethics requirements. In our view, these enhancements will significantly improve the lead auditor's ability to respond to the diverse range of facts and circumstances that may arise in audits involving other auditors without sacrificing audit quality. Further, we commend the PCAOB for the re-organization of the proposed amendments from the Appendices to the body of the standards, which improves usability and clarity. Overall, we encourage the Board to continue its momentum on this important project and we look forward to its completion.



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We offer the following comments on the proposed amendments where further clarification and guidance may be warranted.

### **Definition of 'lead auditor'**

We observe that the definition of 'lead auditor' in paragraph .A4 of AS 2101 in the Second Supplemental Request for Comment includes the following (certain portions of the definition are underlined for emphasis):

.A4 Lead auditor –

- a. The registered public accounting firm issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and
- b. The engagement partner and other engagement team members who both:
  - (1) Are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report (or individuals who work under that firm's direction and control and function as the firm's employees); and
  - (2) Assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.

Note: The registered public accounting firm issuing the auditor's report is also referred to in this standard as "the engagement partner's firm."

Note: Individuals such as secondees<sup>5</sup> who work under the direction and control of the registered public accounting firm issuing the auditor's report would function as the firm's employees.

<sup>5</sup> For this purpose, the term "secondee" refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices of the registered public accounting firm issuing the auditor's report, for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer).

As raised in our 2017 comment letter,<sup>1</sup> we appreciate the addition of the Note clarifying the consideration of secondees. Further, we acknowledge that the definition of secondees added as footnote 5 of AS 2101.A4 is consistent with the definition provided by the PCAOB in Form AP staff guidance.<sup>2</sup>

However, we have concerns that the definition of secondees may be too prescriptive, particularly regarding the physical location of the secondees. For example, during the COVID-19 pandemic, certain

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<sup>1</sup> KPMG comment letter on PCAOB Rulemaking Docket Matter No. 042, November 15, 2017.

<sup>2</sup> Staff Guidance – Form AP, Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101, Reports on Audited Financial Statements, February 16, 2017, page 9.



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travel restrictions limited or eliminated the ability of secondees to physically relocate to another country. Further, remote working arrangements, where employees have flexibility in where they physically work, have increased substantially as a result of the pandemic and are expected to continue into the future. As a result, the physical location of a secondee may not always align with the geographical location of the office of the registered public accounting firm issuing the auditors' report. Nonetheless, such secondees work under that firm's direction and control and function as the firm's employees in a remote working environment. Therefore, we question whether the physical location is a necessary attribute when considering whether a secondee would meet the definition of lead auditor.

Additionally, we note that employees of a shared service center – an entity affiliated with one or more firms that provides certain audit-related services to the firm(s)<sup>3</sup> – were discussed as part of the definition of lead auditor in the Supplemental Request for Comment, but are not mentioned in the Second Supplemental Request for Comment. Similar to secondees, the employees of a shared service center may work under the direction and control and function as employees of the registered public accounting firm issuing the auditors' report. Given the continued increase in the use of shared service centers in practice and consistent with our 2017 comment letter, we believe that employees of shared service centers are an important concept to incorporate in the final amendments.

Overall, we believe the existing definition in paragraph .A4b(1) of AS 2101, specifically "individuals who work under that firm's direction and control and function as the firm's employees", would be sufficient to allow auditors to make a principle-based assessment that best reflects the substance of the arrangements. We believe a principle-based approach to the proposed amendments will capture the evolving nature of how and where work is performed by auditors in the future. Therefore, we recommend the Board consider including secondees and employees of shared service centers as examples when applying paragraph .A4b(1) of AS 2101, without defining such terms too prescriptively.

#### **Definition of 'other auditor'**

Many global companies have complex organizational structures with multiple business units including subsidiaries, divisions, branches, components, or investments, both domestically and internationally. When the lead auditor applies AS 2101.11 to determine the extent to which audit procedures should be performed at selected locations or business units, multiple offices within the same audit firm in a certain jurisdiction may perform audit procedures over selected locations or business units. In these circumstances, individual offices of the same registered public accounting firm are often treated as an 'other auditor' under current practice. For example, the lead auditor located in the New York office would inform the 'other auditors' in the Chicago and Atlanta offices of the scope of work to be performed and the tolerable misstatement over specific components (akin to proposed revisions to AS 1201.08). Similarly, the other auditors in the Chicago and Atlanta offices would provide interoffice reporting to the lead auditor in the New York office based on firm policies and procedures (akin to proposed revisions to AS 1201.12).

However, based on the definition of 'lead auditor' within the Second Supplemental Request for Comment, it is our understanding that all offices within the same registered public accounting firm would

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<sup>3</sup> Supplemental Request for Comment, footnote 74, page 34.



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be considered to be part of the lead auditor. In the example above, because the New York, Chicago, and Atlanta offices are all offices of the same registered public accounting firm, they would all meet the definition of 'lead auditor', which we believe will be a change in current practice.

Further, we observe that the definition of 'other auditor' as proposed in paragraph .A5 of AS 2101 would create a difference when compared to the proposed ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* (referred to as Proposed ISA 600 (Revised)), that is expected to be finalized in December 2021. Specifically, we observe the following definition of 'Component auditor' in paragraphs 9(c) and A13 of Proposed ISA 600 (Revised) (underline added for emphasis)<sup>4</sup>:

9(c). Component auditor – An auditor who, at the request of the group auditor, performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. (Ref: Para. A13–A14)

A13. References in this ISA to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

Under Proposed ISA 600 (Revised), a component auditor may be from another office within the group auditor's firm. However, another office within the lead auditor's firm would not meet the definition of an 'other auditor' as proposed in the Second Supplemental Request for Comment. We acknowledge the Board discussed the difference in definitions with non-PCAOB rules in the Supplemental Request for Comment, but we did not observe further commentary on this issue from the Board in the Second Supplemental Request for Comment. Such a difference and change from current practice may create unnecessary confusion that increases the likelihood of misinterpretation and may have a negative impact on audit quality due to misapplication of the final amendments. We recommend the Board further consider this issue and its implications on current practice and provide additional guidance in the final amendments with respect to the expected change in performance when engagement teams from multiple offices within a registered public accounting firm participate in the audit, to assist firms in their implementation efforts.

### **Determination to serve as lead auditor**

As expressed in our 2017 comment letter, we continue to believe the sufficiency of participation in the audit by the lead auditor should be a risk-based assessment with collective consideration of quantitative and qualitative factors. Accordingly, we agree with the proposed third consideration added to paragraph .06A of AS 2101 that allows the lead auditor to consider the extent of the engagement partner's firm's supervision of the other auditors' work in the determination of sufficiency of participation.

However, given the diversity and complexity of company structures and the corresponding organization of audits involving other auditors that exist today and will continue to evolve over time, we believe that the three considerations proposed in paragraph .06A of AS 2101 – namely importance of the locations or

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<sup>4</sup> The International Auditing and Assurance Standards Board Quarterly Board meeting, September 13-17, 2021 Agenda Item 2-D, pages 9 to 10.



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business units, the risks of material misstatement, and the extent of supervision – may not be sufficiently comprehensive to capture all facts and circumstances that may arise.

Under a risk-based approach, while the three considerations proposed in paragraph .06A of AS 2101 are relevant and helpful, a lead auditor may need to consider other quantitative and qualitative factors when making the sufficiency of participation assessment. Therefore, we recommend the PCAOB allow the lead auditor to use professional judgment and consider other relevant factors that may be necessary based on the facts and circumstances of the audit in their determination as to whether they can serve as the lead auditor. We suggest the following changes to the lead in of paragraph .06A of AS 2101 (similar to paragraph .12 of AS 3101) for the Board’s consideration:

.06A In an audit that involves other auditors or referred-to auditors, 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 following, in combination, as well as other factors specific to the audit:

#### **Other auditors’ compliance with independence and ethics requirements**

We appreciate the modifications to paragraph .06D of AS 2101 in the Second Supplemental Request for Comment in response to comments received by the PCAOB related to the lead auditor’s procedures in determining the other auditor’s compliance with independence and ethics requirements.

However, given the definition of ‘other auditor’ intentionally includes both the firm and individuals, we continue to believe further clarity is needed regarding the level (i.e., firm, individual, or both) at which the lead auditor is expected to apply the requirement in paragraph .06Da:

.06D In an audit that involves other auditors, the lead auditor should, with respect to each other auditor, perform the following procedures in conjunction with determining compliance with SEC independence requirements and PCAOB independence and ethics requirements pursuant to paragraph .06b of this standard:

- a. Obtain an understanding of the other auditor’s (1) knowledge of SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements;

If the PCAOB’s intent is for the lead auditor to apply the above requirement at the individual engagement team member level, we think this overlaps with the requirement in paragraph .06Ha(2) of AS 2101. Specifically, paragraph .06Ha(2) requires the lead auditor to obtain an understanding of the knowledge, skill, and ability of the other auditor’s engagement team members with respect to the PCAOB standards and rules, and SEC rules and regulations, which include PCAOB independence and ethics requirements and SEC independence requirements.

If the intent is for the lead auditor to apply the requirement in paragraph .06Da at the firm level, we request additional practical guidance as to how audit firms may apply or consider knowledge and experience requirements at the firm level (as audit firms commonly apply or consider knowledge and experience requirements at the individual engagement team member level). Further, we seek to better



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understand the incremental value provided by a firm-level independence and ethics requirement in paragraph .06Da when the individual-level requirement already exists in paragraph.06Ha(2). We believe the evaluation at the individual engagement team level in accordance with the requirement in paragraph .06Ha(2) is most appropriate to enable a lead auditor to evaluate the other auditors' independence and ability to comply with PCAOB independence and ethics requirements and SEC independence requirements. However, should the Board believe an evaluation at both the firm and individual level is necessary, we request that additional guidance be provided to guide lead auditors in how to consider the information about the two different levels, especially when that information may differ. For example, consider a scenario where the other auditors' firm has a 'low' level of knowledge and experience in applying independence and ethics requirements under paragraph .06Da, but the other auditors' engagement team members have a 'high' level of knowledge and experience in applying those requirements under paragraph .06Ha(2). In this scenario, it is unclear whether the 'high' level of knowledge and experience at the individual level under paragraph .06Ha(2) should be given more weight compared to the 'low' level of knowledge and experience at the firm level, or how the lead auditor is expected to evaluate the other auditor under such a scenario.

We acknowledge that based on the discussion on page 19 of the Second Supplemental Request for Comment, the new Note added to paragraph .06D is intended to address practicability challenges in applying the requirement in paragraph .06Da of AS 2101. However, we do not believe the new Note fully achieves its intended purpose.

Furthermore, the placement of the new Note at the end of paragraph .06D and the reference within the Note "For the matters described in paragraph .06D,..." seems to indicate the Note has broader application than just paragraph .06Da. This may cause further confusion as to whether the other requirements in paragraph .06D should be applied at the firm level or individual engagement team member level. For example, as it relates to paragraph .06Db(1), we believe the written affirmation requirement on policies and procedures would apply at the firm level and not to individual engagement team members. But the new Note added to paragraph .06D raises questions as to whether the Board expects the requirement in paragraph .06Db(1) to also apply at the individual engagement team member level.

As illustrated above, without further clarity, there is a risk of misinterpretation that could result in the lead auditor performing unnecessary procedures, which in turn may lead to increased costs and potentially harm audit quality as a result of incorrectly focused efforts.

In addition, paragraph .06Db(2) of AS 2101 requires the lead auditor to obtain from the other auditor a written description of all relationships between the other auditor and the audit client or persons in financial reporting oversight roles at the audit client that may reasonably be thought to bear on independence pursuant to the requirements of paragraph (b)(1) of PCAOB Rule 3526. With respect to other auditors that are affiliated with the lead auditor, such information is already being obtained by the lead auditor, in many cases from a centralized source, so that the lead auditor can fulfill their communication responsibilities pursuant to PCAOB Rule 3526. We request additional guidance as to whether obtaining such information from a centralized source that is accessible by all of the firms that are affiliated with the lead auditor would fulfill the requirement in paragraph .06Db(2), or if the lead



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auditor would also be expected to obtain a written description of the same information directly from an affiliated firm that is an other auditor.

### **Applicability**

We are not aware of any strong arguments that would indicate that audits of emerging growth companies and broker dealers should be excluded from the proposed amendments and proposed standard. We, therefore, agree with the Board that the proposed amendments and proposed standard should apply to audits of these types of entities.

### **Effective date**

Substantial changes to our audit methodology will be required to effectively implement the final amendments and final standard, if they are consistent with what is reflected in the Second Supplemental Request for Comment. It will be necessary to develop and issue policies and procedures and produce and provide training to our audit professionals, including those throughout our network member firms who participate in audits conducted in accordance with PCAOB standards.

Further, planning and coordination of audits involving other auditors typically occurs early in the audit planning phase (e.g., March for December fiscal year-end engagements). Therefore, once updates to methodology, guidance, and training are complete, the lead auditor will require sufficient time to successfully execute by incorporating the new requirements into the audit plan, and for proper coordination and communication to occur between the lead auditor and the other auditors.

Consequently, we recommend that the effective date should be no earlier than two years after the SEC's approval of the final amendments and final standard.

### **Other editorial comments**

Included below are minor editorial comments for the Board's consideration.

In paragraph .06Dc of AS 2101, the lead-in sentence indicates that the requirements that follow apply to the matters described in items a and b. We are unclear as to how the requirements that follow apply to item a.

In paragraph .06F of AS 2101, the words 'investigate' and 'investigation' are used. Those words may convey a stronger meaning than the PCAOB intended. We would recommend that the Board consider revising the words to 'evaluate' and 'evaluation', or similar words, to avoid any potential misinterpretation.

In paragraph .A3a(2) of AS 2101, in order to avoid any potential misinterpretation that the definition includes all specialists employed by the lead auditor, regardless of whether they participate in the audit, we would recommend that 'participating in the audit' be replaced with ', and participate in the audit,'.

We note that throughout the proposed amendments, there is a reference to 'locations or business units', but paragraph .A6 of AS 2101 only references 'business units'. We would recommend that 'locations or' be added to that paragraph.



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Footnote 1A of AS 1201 points to the definition of 'engagement partner' in Appendix A. We note that the other defined terms in that standard, such as 'engagement team', 'lead auditor', 'other auditor', and 'referred-to auditor', are addressed in paragraph .A1b of Appendix A, which refers to Appendix A of AS 2101. Since 'engagement partner' is also defined in Appendix A of AS 2101, we would recommend revising footnote 1A to also point to Appendix A of AS 2101, as is done for the other defined terms. Paragraph .A1a of Appendix A could then be removed, and paragraph .A1b could be revised to also include the term 'engagement partner'.

\* \* \* \* \*

We appreciate the Board's careful consideration of our comments and observations, and support the Board's efforts to increase accountability of the lead auditor and improve audit quality and investor protection. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Matt Doyle ((212) 954-2187 or mrdoyle@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

Very truly yours,

**KPMG LLP**

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