Grant Thornton

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Public Company Accounting Oversight Board
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Via Email to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042: 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 Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (Proposal). Overall, we are supportive of the project and agree with the determination that current professional standards regarding the use of other auditors should be subject to outreach and enhancements.

As noted in the Proposal, changes in the business environment, firm structures, financial reporting standards, and regulatory reporting requirements have all contributed to the need to revisit current standards. In addition, many firms, including ours, have revised their methodologies in response to the adoption of group audit standards promulgated by the International Audit and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB). The comparisons highlighted in the Proposal between the potential PCAOB standards and the existing IAASB and ASB standards are helpful in evaluating areas of potential differences.

We view the incremental interaction between the lead auditor and other auditors outlined in the Proposal as a valuable benefit, but it is important to emphasize that the nature, timing, and extent of any required interaction needs to be risk-based and scalable in consideration of the significance of the risks of material misstatement specific to the consolidated financial statements and/or accounts or classes of transactions being audited by the other auditor. We believe the need for the standards to continue to allow flexibility for firms in managing circumstances involving the use of other auditors is critically important. This includes the use of network firms, seconded employees, and shared service centers. We believe that the Proposal seeks to maintain that flexibility while at the same time building in more consistency in certain areas of the standards.

We commend the Board for their approach in the context of the preceding comments. We respectfully submit our comments and recommendations, which are focused on aspects of the Proposal that may benefit from further clarity or on potential unintended consequences related to certain requirements that might be counter to the objectives noted above.

Economic impact

We generally agree with the characterization of current practice described in Section II.B of the Proposal. Many larger and medium-sized firms have adopted a methodology that is based on International Standards on Auditing 600 and AU-C Section 600, *Special Considerations – Audits of Group Financial Statements, Including the Work of Component Auditors* (ISA 600 and AU-C 600, respectively). Those methodologies are intended to comply with both PCAOB Auditing Standard 1205, *Part of the Audit Performed by Other Independent Auditors* (AS 1205), requirements and the ISA/AU-C standards. As noted in the Proposal, this may result in audit procedures that go beyond the current AS 1205 requirements. While some firms may go beyond current PCAOB standards, certain of the procedures are based on facts and circumstances of the engagement and may be dependent on factors such as risk of material misstatement, location of the components, locations being audited by other auditors, presence of U.S. firm seconded resources, etc.

Accordingly, we see potential for the Proposal to have a greater impact on the profession, even on the larger firms with enhanced methodologies, due to the fact that certain proposed requirements may result in a more prescriptive approach, particularly in the context of required communications and documentation that may be needed to evidence compliance with the Proposal. Therefore, we are concerned with the staff's generalization that the Proposal will not have a significant impact on all firms, even those with enhanced methodologies, because:

- The proposed requirements will likely result in a broader impact to larger and/or more networks (irrespective of size of audit firm) due to the specificity of certain of the proposed requirements.
- There could be different implications and a lack of consistency in the application of the proposed amendments and standard based on how networks and firms are structured
- Firms have adopted or exceeded current requirements considering the risk management approach adopted by a particular firm

We would also observe that the linkage between increased work and/or costs and increased audit quality is not clear (for example, not all proposed requirements appear to be scalable based on assessed risks). We have highlighted in the remainder of this letter certain proposed requirements that we believe should be clarified with respect to risks and scalability to help more clearly delineate that any increase in cost is commensurate with an increase in audit quality.

Potential operational challenges and unintended consequences

Independence and qualifications of other auditors

We believe the Proposal generally reflects current practice of the larger firms, and we agree that ongoing communications so that the lead auditor can assess changes in circumstances promotes audit quality. However, we believe certain proposed requirements would benefit from greater clarity as to the Board's intent.

The Proposal now includes other auditors in the definition of the engagement team; therefore, the lead auditor is required to assess the knowledge, skill, and ability of *each* engagement team member (among other things) in determining the nature, timing, and extent of the lead auditor's review. It is unclear how the lead auditor may vary their review of the other auditor's work based on the results of that assessment. Most notably, we believe the lead auditor should have the ability to consider and, where appropriate, rely on a network firm's system of quality control in determining the nature and extent of the assessment. Because the Proposal does not acknowledge or distinguish between network firms and unaffiliated firms, we anticipate incremental effort and costs when the lead auditor uses a network firm as the other auditor. The incremental effort would not result in a commensurate increase in audit quality in those circumstances. We strongly encourage the Board to provide better scalability relative to network firms versus unaffiliated firms, since we believe network firms currently rely on the system of quality control when assessing compliance with independence and ethics requirements as well as on continuing education and adherence to firm policies. We also suggest it would be beneficial to note that for continuing audits, past experience with the other auditor personnel would be a factor in evaluating the amount of supervision appropriate in the circumstances.

We note that it is unclear how the lead auditor would be expected to respond to contradictory evidence (for example, negative quality indicators such as an other auditor being sanctioned by the SEC for an independence violation). The lead auditor may have difficulty concluding how the contradictory evidence might impact the assessment of their ability to use the work of the other auditor specific to an individual engagement. Further exploration of this area would be beneficial.

Sufficiency

We appreciate the examples provided in the Proposal regarding determination of sufficient participation. However, the underlying notion of "participation" is subject to interpretation and could result in inconsistent execution. It's possible that firm size and structure may drive the lead auditor determination; a firm comprised of more individuals may have an easier time demonstrating "sufficient participation," which could put smaller firms at a competitive disadvantage. We acknowledge that the proposed requirements are intended to be risk-based, but the related discussion on page A4-15 of the Proposal implies a focus on a coverage approach driven by quantitative benchmarks.

There also does not appear to be consideration given to situations where the lead auditor is heavily involved in the work of the other auditor. In current practice, there may be instances where the lead auditor is so involved that the other auditor becomes a mere extension of the lead auditor's engagement team. In such a case, the lead auditor might be considered to have "sufficient participation" even though an other auditor is technically involved.

Reporting by other auditors

We are concerned by the lack of clarity provided in the Proposal regarding the reporting that would take place in accordance with proposed AS 1201.B2d, which states the lead auditor "obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion." Current reporting practice varies considerably and depends on a variety of factors, such as to whom the other auditor is reporting (for example, network firm or unaffiliated firm) and the extent of involvement of the other auditor.

Oftentimes, a more formal report is provided to the lead auditor by the other auditor when it is an unaffiliated firm. Network firms, on the other hand, generally provide documents more closely resembling an engagement completion document along with the necessary workpapers. We also note that conventions for reporting to unaffiliated firms, developed and adopted by certain of the firms with the larger global firm networks, indicate that the other auditor's report would be qualified if the lead auditor directs the other auditor not to perform certain procedures required by the auditing standards or if the scope of the audit is limited (for example, goodwill at the subsidiary is tested for impairment by the parent; thus, the lead auditor would handle auditing this balance and related impairment assessment).

The involvement of an other auditor can range from performing an offsite inventory observation to a comprehensive audit of the component's financial statements. It is unclear what the PCAOB's expectations are relative to reporting in situations that fall within that spectrum, or if the intention is to leave the form of reporting to the judgment of the lead auditor depending on the circumstances. For example, when audit procedures are limited to certain accounts or classes of transactions, a report resembling an agreed-upon procedures report may be deemed appropriate. We believe interfirm reporting currently experiences operational challenges; thus, this is an opportunity for the PCAOB to provide clear and scalable guidance with regard to acceptable forms of reporting. We ask the Board to consider clarifying the expectations with respect to reporting requirements and, if more consistency of reporting is a desired outcome, providing report examples. Such examples could be based on (i) the extent of work performed by the other auditor (for example, a report on specified procedures and findings or an opinion that implies some level of assurance), and (ii) the nature of the relationship between the lead auditor and other auditor.

Lead auditor communications, supervision, and review

We are supportive of the proposed requirement to communicate scope, tolerable misstatement, and trivial amounts in writing. However, the proposed requirement at AS 1201.B2b regarding the lead auditor's review of the other auditor's planned audit approach does not appear to be risk-based. We believe the lead auditor should be able to focus on significant risks and key workpapers that address risks of material misstatement. We also believe communicating *any* change to audit procedures in writing is overly burdensome and does not align with a principles-based approach. We agree that having written documentation of the communications will be beneficial to audit quality, but we encourage the Board to consider revising these requirements to make them more risk-based and scalable.

Definitions

We are supportive of the PCAOB driving consistency in practice through defining terms such as "engagement team," "lead auditor," and "other auditor." Nevertheless, we are concerned about how operational the definition of "lead auditor" will be in contemplation of short-term personnel sharing arrangements, longer-term secondments, and contractors, since the definition states that individuals are part of the lead auditor only if they are "employees of the registered accounting firm signing the auditor's report." This could lead to inconsistencies in practice depending on how firms legally structure these types of arrangements. We recommend the Board consider expanding the definition to include engagement team members that work alongside or in the same capacity as employees of the lead auditor. This will provide a more principles-based approach and allow firms to apply it with these types of employment arrangements.

Audit documentation

We are concerned about proposed AS 1215.19A regarding the lead auditor's documentation including a list of additional workpapers of other auditors that were reviewed but not retained by the lead auditor. We believe that while the intent would be to evidence the depth of the review, the tracking of all workpapers that were looked at is overly burdensome. The review process is dynamic, and the proposed requirement implies that the lead auditor would have to inventory every single workpaper they happen to open or refer to during that review process, in addition to documenting a description of the workpaper, who reviewed it, and when that review took place. We believe the requirement that the workpapers be accessible to the lead auditor is sufficient from a documentation perspective and encourage the Board to reconsider the cost/benefit of implementing such a prescriptive requirement.

Other auditors' responsibility for their own work

In reviewing the Proposal compared to the extant AS 1205, we noted certain text that is no longer captured in either the proposed amendments or standard. Specifically, we call attention to AS 1205.03, which states, in part, "Regardless of the principal auditor's decision [whether to make reference to an other auditor in the auditor's report], the other auditor remains responsible for the performance of his own work and for his own report." We are supportive of the Board's endeavor to improve quality and accountability of the lead auditor when supervising and using the work of other auditors. However, this should not diminish the expectation that the other auditor should also be expected to remain responsible for the quality of their work. We believe omitting this notion from the Proposal could imply a "free pass" to other auditors regarding the quality and sufficiency of their work.

Dividing responsibility for the audit

We commend the Board for proposing a separate standard when dividing responsibility for an audit with another accounting firm. While we acknowledge that instances of dividing responsibility are rare in issuer audits, we believe the profession will benefit from having all relevant requirements in one standard. We are also supportive of the proposed definitions; separating "referred-to auditor" and "other auditor" provides greater clarity to both roles and how the auditing standards apply to each.

We note, however, instances where extant language in AS 1205 was not included in proposed AS 1206, and we believe there are potential unintended consequences by not carrying over that language. Currently, a firm generally does not make reference to another firm in its global network. We believe the omission of guidance such as AS 1205.05-06 from a proposed standard would indicate that such considerations are no longer appropriate, resulting in a change in practice. The profession will continue to face scenarios where it may be impractical for the lead auditor to take responsibility for the other auditor's work. Therefore, we ask the PCAOB to consider including these extant paragraphs in the proposed AS 1206.

The Proposal also does not allow for division of responsibility when financial reporting frameworks are different. We believe this may also create a change in practice since AU-C 600 allows for such division if certain requirements are met (AU-C 600.26). This is an important option that should be afforded to auditors under PCAOB standards (consider, for example, an equity investee where the financial statements are prepared using IFRS). We encourage the Board to also consider addressing and allowing for such situations in proposed AS 1206.

Applicability and effective date

We agree with staff observations that the use of other auditors in audits of broker-dealers is not common. However, we believe it will benefit audit quality in all PCAOB audits to apply a more updated, risk-based and principles-based approach to the use of other auditors. Therefore, we believe the Proposal should apply to broker-dealers and emerging growth companies.

With regard to the effective date, we believe auditors will need at least one year to coordinate and execute the proposed amendments and standard, since planning for large, international engagements begins very early in the audit process. Therefore, firms will need time to update audit methodologies and tools on a timeline that enables engagement teams to apply the new requirements from the beginning of the audit.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at (704) 632-6834 or Trent.Gazzaway@us.gt.com.

Sincerely,

Grant Thornton LLP