Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

July 29, 2016

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 Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (the "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* (collectively, the "proposals").

We support the PCAOB's consideration of enhancements and promotion of consistency in the auditor's performance when executing its supervisory responsibilities in an audit involving other auditors. We agree the level of interaction between the lead auditor and other auditors is important to audit quality, and we support actions that lead to increased and improved communications between auditors. We also support the Board's consideration of a risk-based approach, as we agree the lead auditor's supervision of other auditors should be commensurate with the risks of material misstatement at locations audited by other auditors, as well as the competency of the other auditors. We believe many of our observations included in this letter will enhance the proposals in line with the Board's intent to develop a risk-based approach.

Overall observations

We agree enhancements to the auditing standards related to the lead auditor's supervision of other auditors may improve audit quality and believe some of the concepts in the proposals and related release text could achieve that objective. However, in order to maintain or enhance audit quality, it is important there continues to be accountability of the other auditor for its work in support of the lead auditor. We are concerned that, while placing additional supervisory responsibility on the lead auditor, the proposals seem to have less focus on the responsibility of the other auditor than is currently in AS 1205. We believe this accountability is important because even with enhanced supervision responsibility of the lead auditor, it is the other auditors who are in best position to supervise and execute on the day-to-day responsibilities of the portion of the audit on which they are reporting.

AS 1205.03 is clear "the other auditor remains responsible for the performance of his own work and for his own report." While this appears to continue to be an objective of the proposals,[1] similar language is omitted from the actual text of the proposed amendments to the auditing standards. Also, some of the proposed requirements do not seem appropriately risk-based and seem to indicate the other auditor is not responsible for the day-to-day supervision of its work.

[1] *See*, for example, Page 41 of the proposals, which says, "Notably, under the proposal, the other auditor would continue to remain responsible for, among other things, obtaining sufficient appropriate audit evidence to support its written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion."

PricewaterhouseCoopers LLP, 400 Campus Drive, P.O. Box 988, Florham Park, NJ 07932
T: (973) 236 4000, F: (973) 236 5000, www.pwc.com/us

We are concerned rescinding the statement describing the other auditor's responsibility from the standards, when combined with the potential level of detail of planning and supervision needed by the lead auditor as described later in this letter, may result in a lack of accountability by the other auditor. Consequently, there is the potential for the other auditor to reduce its responsibility for performing the necessary day-to-day planning and supervision. Additionally, some of the definitional changes described in the proposals seem to indicate the lead auditor would need to evaluate each individual at the other auditor in certain areas (as opposed to the firm), which may not be practical and appears to be another indication of reducing the accountability of the other auditor. The potential reduction in responsibility and accountability of the other auditor, whether actual or perceived, may adversely impact audit quality.

In addition to our overarching concerns described above, the increased supervisory responsibilities placed on the lead auditor by the proposals may reduce the time the lead auditor can devote to areas of heightened risk, which are typically addressed by the lead auditor. This may also adversely impact audit quality.

In some instances, particularly when part of the audit is conducted by an other auditor outside of the lead auditor's network, it may be difficult to perform some of the required procedures contemplated by the proposals because of the inherent restrictions with relation to other auditors' partners, employees and processes. Ultimately, this may lead to more instances of dividing responsibility, which does not appear to be a goal of the Board.

We believe the other auditors are in best position to be responsible for the day-to-day planning and supervision because they are on site. Maintaining the responsibility statement in the auditing standards, as opposed to solely in release text, would emphasize the importance of the other auditor's own supervisory responsibilities. This, together with consideration of some of our other recommendations below to focus more on a risk-based approach, has the potential to increase audit quality.

In the remainder of this letter, we build on these concerns with more specifics, discuss additional concerns, and suggest potential solutions we hope will help the Board in finalizing the standards and achieving what we believe are the Board's intended outcomes.

Supervision of other auditors

Broadly, and explained throughout this letter, the proposals appear to be unclear as to the level of detail required by the lead auditor to supervise other auditors. The proposals require the lead auditor to perform certain supervisory procedures in all cases and do not appear to allow the lead auditor to appropriately leverage the other auditor when, based on the assessed risk, the lead auditor deems such leverage is appropriate. This may result in less time for the lead auditor to focus on areas of heightened risk, which are typically addressed by the lead auditor. As a result, this may have a negative impact related to audit quality and the costs may exceed the benefits. The Board appears to acknowledge this risk in the release text when it says "because lead audit personnel would be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements...and could potentially lead to inefficient allocation of audit resources."[2]

[2] *See* page 41

We acknowledge AS 1201.B1 discusses the extent of the lead auditor's supervision of the other auditors' work is determined in accordance with AS 1201.06. We believe AS 1201.06 could be enhanced to include a lead auditor's considerations of concepts in AI 10.19 and .20, including the lead auditor's knowledge of the other auditors' quality control policies and procedures and previous experience with the other auditor. We believe these concepts will be most relevant when using other auditors within the same network of firms.

We also acknowledge AS 1201.04 allows the engagement partner to seek assistance from appropriate engagement team members in fulfilling their responsibility related to the supervision of the audit and, in the context of much of AS 1201, "appropriate engagement team members" appears to include partners and managers of the other auditors. However, proposed Appendix B of both AS 2101 and AS 1201 list specific procedures required to be performed by the lead auditor and not the other auditor; therefore, the proposed Appendices do not allow the lead auditor to leverage partners and managers at the other auditors. We explain the specifics in the following sub-sections.

<u>Nature, timing and extent of the other auditor's procedures</u>

AS 1201.B2b would require the lead auditor to obtain and review a description of the nature, timing and extent of audit procedures to be performed by the other auditor. It is not clear how detailed this description is meant to be and does not appear to consider a risk-based approach as the requirement seems to include all procedures performed by the other auditor. For example, when a full scope audit is requested by the lead auditor, it is not clear how much detail would be required to be reviewed by the lead auditor in order to determine whether any changes to the other auditor's procedures are necessary. In such a situation, the proposal appears to imply the lead auditor may need to obtain the entire audit program or, at a minimum, all of planning (if there is sufficient enough detail therein) to review whether the other auditor's planned nature, timing, and extent of its procedures is appropriate.

We believe any requirement for the lead auditor to review the description of the nature, timing, and extent of procedures should be based on the risk of material misstatement. In other words, for areas of heightened risk, the lead auditor should perform the procedures described by AS 1201.B2b. For areas of lower risk, the lead auditor should be able to use the other auditor's review of the description of the nature, timing, and extent of procedures, if deemed appropriate by the lead auditor. We believe this would be consistent with AS 1201.04 allowance of assistants as, in areas of lower risk, the lead auditor could use the partner and manager of the other auditor as his/her assistants in supervising the work of the other auditor. We also believe this would be consistent with the Board's intent as the release text states, "...under the proposal, the lead auditor would focus its efforts on audit areas with the greatest risk of material misstatement to the financial statements. This should result in an appropriate focus on the riskiest audit areas, whether those areas are audited by the lead auditor directly or by another auditor under the lead auditor's supervision."[3] As it relates to the description of the nature, timing, and extent for heightened risk areas, we also believe the Board should consider whether the level of detail of this description does not have to be as robust when there is a common methodology, similar processes, a common system of quality controls and specific training and monitoring among network firms.

<u>Obtaining a written report</u>

We support maintaining the required documents to obtain, review and retain from other auditors consistent with AS 1215.19. AS 1201.B2d, though, would require the lead auditor to also obtain a written report describing the other auditor's procedures, findings, conclusions and, if applicable, opinion. Similar

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[3] *See* page 41

to our concerns on the nature, timing and extent of planning, it is not clear how detailed this description is meant to be. For example, it is not clear if the written report, separate from the opinion, would require a description of each and every procedure performed by the other auditor which, in essence, could be interpreted to require the lead auditor to review, directly or indirectly, every audit procedure that is documented in the audit file of each other auditor. While the release text is clear the lead auditor is not required to review all workpapers of the other auditor,[4] it is possible a "written report" with such detail would essentially equate to all audit procedures documented in the workpapers.

We believe the written report obtained by the lead auditor should be limited to describing the other auditor's procedures, findings and conclusions for areas of heightened risk. Even for areas of heightened risk, we believe there should not be a requirement to obtain each individual workpaper and each standard step (unless determined by the lead auditor to be appropriate, as discussed below) but, rather, the descriptions obtained by the lead auditor should include a summary of the procedures performed in these areas. For example, nature and precision of substantive analytics, nature of the test of detail performed, and level of audit evidence obtained. The other auditor's opinion and other required communications would be sufficient to satisfy the requirement for the lead auditor to review the remainder of the work of the other auditor or, if an opinion is not obtained, the written report contemplated by AS 1201.B2d could be limited to findings and conclusions for areas of lower risk if deemed appropriate by the lead auditor based on the risk of material misstatement. Similar to the nature, timing, and extent of procedures in the planning phase discussed above, we believe the Board should also consider the level of detail to be provided if the firm is part of the same network of firms and that network has a common methodology, similar processes, a common system of quality controls and specific training and monitoring related to PCAOB engagements.

<u>Workpaper review</u>

Separately, the lead auditor may select certain workpapers to review. This may be in the heightened risk areas discussed above or in other areas deemed appropriate by the lead auditor. Based upon AS 1201.B2c which states the lead auditor should "[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed," we expect additional workpapers of the other auditor may be subject to review by the lead auditor compared to today. In determining which specific documentation (i.e., workpapers) should be reviewed, we support the lead auditor's use of a risk-based approach, including the lead auditor's consideration of their familiarity with the other auditors and if the firm is part of the same network of firms.

The release text describes the lead auditor could determine it necessary to review areas of heightened risk of material misstatement <u>or</u> work performed by less experienced other auditors.[5] While we agree an area of heightened risk can be part of the lead auditor's considerations, this statement could be read that, regardless of who has reviewed the work at the other auditor, the lead auditor should consider reviewing work performed by less experienced other auditors in areas of lower risk. As stated earlier, we believe the lead auditor should be able to leverage the review and supervision performed by the engagement partners and managers of the other auditor; therefore, consideration of who reviewed the work at the other auditor should be the lead auditor's focus, and not who performed the work. This would be consistent with AS 1201.04 allowance of assistants.

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[4] *See* page A4-37

[5] *See* page A4-34

We also note the proposed requirement in AS 1215.19A for the lead auditor to document a list of additional other auditor workpapers reviewed by the lead auditor but not retained by the lead auditor. We agree with the Board's decision to not require the lead auditor to make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. However, there may be practical challenges for which guidance would be helpful on how to implement in documenting review of workpapers of the other auditor.

For instance, it is important the Board acknowledge other auditors outside of the United States may document their workpapers in a local language because that is what they're most comfortable with (or is required by their local law) and therefore helps promote audit quality. In order to facilitate the lead auditor's review of these workpapers, the other auditor may need to document in a language other than their primary language, or the lead auditor would need to rely on translators, either of which may adversely impact audit quality and introduce unnecessary costs. Similarly, the Board acknowledges privacy laws of certain jurisdictions may create obstacles for the transfer of the other auditor's documentation from the country in which the other auditor is located to the lead auditor's country.[6] These challenges should not be underestimated.

For these situations, we recommend the Board provide the ability for the lead auditor to perform alternative procedures compared to a review of the workpapers. For example, alternative procedures could include allowing the lead auditor to satisfy its responsibilities through discussion with the other auditor or through use of technology in viewing workpapers in which the other auditor discusses the workpaper or certain aspects of the workpaper with the lead auditor. The lead auditor would then document the alternative procedures performed and the results of the procedures. We believe this will help minimize the risk of incorrect translation and avoid unnecessary obstacles or costs created by local privacy laws. If it is expected the lead auditor will review the workpapers in another language or cannot overcome the obstacles for the transfer of the workpapers, then translators may be needed and the lead auditor may need to travel to the locations of the other auditors. Depending on the number of locations and areas for which the workpapers are selected to be reviewed, this could result in a significant time commitment leaving the lead auditor with less time to focus on the heightened risks in the areas they are directly responsible for. We believe this could have a negative impact on audit quality instead of enhancing audit quality. If the Board believes alternative procedures are not warranted, the Board may also want to consider additional outreach related to the severity of these challenges.

Another challenge is the lack of clarity as to what might be defined as a "review." The lead auditor may look at a number of workpapers or portions of a workpaper in gaining an understanding of an issue and determining which workpapers are most important. In doing this, the lead auditor may direct the other auditor to provide specified documentation for review.[7] It is not clear if this initial consideration would be defined as a "review" for which documentation is needed. Additionally, the lead auditor may look at a workpaper to understand the nature, timing and extent of the work to be performed, but not review the results of the actual work. To clarify, we recommend documentation of which workpapers and, where relevant, which portions of workpapers have been reviewed be required once the lead auditor has decided the area of the work or the specific workpaper is necessary to review based on the assessed risk.

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[6] *See* page A4-26

[7] AS 1201.B2c requires in supervising the work of other auditors, the lead auditor should direct the other auditor to provide for review specified documentation with respect to the work requested to be performed

Multi-tier audits

AS 1201.B3 requires the lead auditor to remain responsible for directly communicating to all other auditors (including second other auditors in a multi-tier engagement) the scope of work to be performed, tolerable misstatement,[8] identified risks of material misstatement and amounts below which misstatements are clearly trivial.

In a multi-tier situation, the first-tier other auditor, who may be more familiar with the consolidation at its level, might be in better position to consider the scope of the work to be performed, identification of the risk of material misstatement, and the tolerable misstatement for second-tier other auditors reporting to them. As written, the standard appears to require the lead auditor to make those determinations. Instead, we would support communication of those decisions by the first-tier other auditor to the lead auditor as part of its supervision of the first-tier other auditor.

Planning - individuals

We have noted the proposed definition of "other auditors" includes individuals, and not just the firm for whom they work. As a result of the proposed definition, it would appear the lead auditor would be required to determine, for each team member of the other auditor, the individual's knowledge of SEC and PCAOB independence and ethics requirements, their experience in applying the requirements, and obtain a written representation from each of them in accordance with AS 2101.B4, instead of relying on the understanding of the firm's process and allowing the other auditor to monitor individual compliance. This would also appear to require the lead auditor to develop a process to monitor changes in the engagement team at the other auditor level in order to determine whether they have identified every engagement team member spending time on the audit. Proposed AS 2101.B6a would also require the lead auditor to gain an understanding of the knowledge, skill and ability of the other auditors who assist the lead auditor with planning or supervision.

We agree enhancements could be considered in this area, but having the lead auditor perform these activities at the same level as is done for those working directly for the lead auditor as part of the lead auditor's firm could distract from other important areas of the audit. Today, this is often performed at the firm level, with the other auditor's engagement partner confirming to the lead auditor on behalf of their firm and team, which seems like a more appropriate approach. In order to enhance the current procedures, we would also support the lead auditor's consideration of relevant network information, if applicable, and publicly available information related to an individual's or firm's independence and competency, such as SEC or PCAOB enforcement actions and PCAOB inspection reports.

Planning - firm level

Proposed AS 2101.B4 describes the lead auditor should determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements by gaining an understanding of each other auditor's knowledge and experience in applying the requirements and obtaining a written representation. While we agree such procedures are appropriate, we have concerns the lead auditor's ability to "gain an understanding" may be impacted by whether or not the other auditor is a member of the same network as the lead auditor. We suggest the PCAOB provide guidance on how firms are expected to perform these procedures when the other auditor is not a member of the same network, as well as guidance on how much

[8] Separately, in response to Question 3 on page 24, we do not believe it necessary to provide more specific guidance for determining tolerable misstatement for individual locations or business units under AS 2105

additional understanding is necessary when the other auditor is part of the same network and is expected to comply with network level independence and ethics policies and guidance. When the other auditor is not a member of the same network, we would support the lead auditor's consideration of relevant publicly available information about the other audit firm, such as SEC or PCAOB enforcement actions or, to the extent relevant, PCAOB inspection reports. If the firms are members of the same network, the level of effort can be based upon whether the firms have a similar methodology, training, and monitoring process related to these areas.

Determination to serve as lead auditor

The proposed requirement in AS 2101.B2 describes a requirement for the engagement partner to determine whether the participation of his or her firm is sufficient to carry out the responsibilities of a lead auditor. 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 performs audit procedures (which includes considering the portion's materiality) in comparison with the portions for which the other auditors and referred-to auditors perform audit procedures.

The proposed requirement could be read to indicate the only consideration in the lead auditor's determination is the proportion of the financial statements audited by the lead auditor compared to other auditors and referred-to auditors (i.e., quantitative in nature only). It is also difficult to determine from the standard if that comparison is done individually (the lead auditor should have a greater proportion than any other auditor) or in the aggregate (the lead auditor should have a greater proportion than all other auditors combined). In fact, if the latter, it is possible to imagine scenarios in which no audit firm can be viewed as the lead auditor. It is our experience that, due to qualitative reasons, the firm in the best position to be the lead auditor may not audit the largest portion of the financial statement line items individually or in the aggregate. The release text seems to acknowledge this notion.[9]

We believe the examples in Appendix 4 are very helpful in clarifying the intent of the Board. In particular, Example 2 on pages A4-16 and 17 is a practical example wherein the lead auditor audits less revenue (only 10%) than some other auditors at other locations but, for the qualitative reasons described in the example, it is determined the firm can still be the lead auditor. While we believe this example is appropriate, we are concerned the thought process described by the example may not be clear through the words in the proposed amendment.

In order to clarify the proposed amendment, we recommend certain of the language from Appendix 4 be brought into the standard, including the statement "the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit."[10] We also recommend clarifying that the "greater portion of the risks" relates to any other individual auditor, and not all other auditors combined. We believe including this language in the standard and continuing to publish the examples will help clarify the Board's intent.

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[9] *See*, for example, page A4-15, which states that the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms

[10] *See* page A4-15

Other topics

Short-term personnel sharing arrangements

With regard to Question 17[11] regarding short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees, and some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor, these employees, while perhaps still employed by a different firm, are in fact integrated into the lead auditor's engagement team and supervised by the lead auditor. As a result, we believe these individuals should be treated as part of the lead auditor.

Amendments to AS 1301

The proposals amend AS 1301 to require the lead auditor to communicate the basis for the engagement partner's determination that the participation of the lead auditor is sufficient to serve as lead auditor in any audit involving other auditors or referred-to auditors. We recommend this not be required in all cases, particularly when such a determination is evident. We recommend instead maintaining the current requirement, to make this communication if *significant* parts of the audit are performed by other auditors. We believe from an oversight perspective this is when the audit committee would want to engage with the lead auditor regarding the lead auditor's determination.

Divided responsibility

In question 51,[12] the Board notes a potential for increased use of divided responsibility, and questions if this should be prohibited or otherwise limited. We do not believe it should be prohibited or limitations should be placed on an auditor's ability to divide responsibility. This model is typically used in other circumstances than those noted in the question (equity method investees or when referred-to auditor covers only a small portion of the consolidated assets or operations), such as a recent acquisitions, and use in these situations may help improve audit quality as the predecessor auditor has a more immediate understanding of the business and risk of the acquired company.

Amendments to AS 2410

The proposed changes to AS 2410.16c could be misread as only requiring the auditor to communicate to referred-to auditors, as the phrase "other auditors" has been eliminated. Although "other auditor" is within the proposed definition of "engagement team," it may be more clear to auditors, and help avoid missteps, if the amendment more specifically added a reference to "other auditors," as follows:

Promptly communicate to appropriate members of the engagement team, including other auditors, and the referred-to auditor relevant information about the related party or relationship or transaction with the related party.

[11] *See* page A4-12

[12] *See* page A4-55

Amendments to AS 2201

The amendments to AS 2201.C11 describe requirements to refer to the report of the referred-to auditor in the lead auditor's opinion on the company's internal control over financial reporting. To be consistent with the requirements of the proposals, we suggest adding that the lead auditor should reference the name of the referred-to auditor as well.

Application to brokers and dealers and emerging growth companies

We believe the proposed amendments should apply to audits of brokers and dealers and emerging growth companies and see no reason to exclude those audits.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Leonard L. Combs (973-236-5265) or Neil A. Weingarten (617-530-6225) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP