

July 28, 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

Deloitte & Touche LLP (“D&T” or “we”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors* (the “Proposed Amendments”) and the *Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm* (the “Proposed Auditing Standard”) (collectively, “the Proposal” or “the Release”) which addresses potential changes to the PCAOB’s auditing standards for audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report.

OVERALL COMMENTS

We support the Board’s efforts to enhance the standards of the PCAOB that address audits involving accounting firms and individual accountants outside the accounting firm that issues the auditor’s report and to align the applicable requirements with the PCAOB’s risk-based standards.

The Proposal represents a significant step forward in providing a risk-based supervisory model that can be used when performing audits that involve other auditors. We are supportive of the objectives of the Board’s Proposal, and offer certain constructive suggestions in this letter that are geared toward ensuring that the final standards clarify the lead auditor’s responsibilities with respect to other auditors, including providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements of the standards in order to:

- Increase the uniformity, consistency, and effectiveness of the lead auditor’s supervision of other auditors, including through application of PCAOB Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201), to other auditors.
- Facilitate improvements in the quality of the work of other auditors through appropriate direction, coordination, and evaluation of the results of their work.
- Strengthen the lead auditor’s understanding of the knowledge, education, and skills of those engagement team members from an other auditor who participate in supervisory activities.
- Enable the lead auditor to delegate certain supervisory activities to appropriate other auditors outside of the lead auditor’s registered accounting firm.
- Clarify the substance of the interactions between the lead auditor and other auditors.

In order to clearly achieve the objectives above, there are certain practical implementation considerations that will need to be deliberated and resolved. The potential benefits of the Proposal are significant and, while some of these considerations are complex and challenging, we do not believe any of these should stand in the way of completing this important project. We stand ready to engage constructively with the Board and other stakeholders to provide our perspective and experiences in order to facilitate the development of improvements to the PCAOB’s auditing standards that will enhance audit quality. A brief summary of the primary matters for additional consideration that we have identified is as follows (we offer further thoughts on each in Appendix 1):

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation.

We believe that the appropriate oversight of other auditors is achieved through a combination of the lead auditor's direct participation in the audit as well as other factors, such as sufficient involvement in, and supervision of, the work of other auditors. We therefore offer recommendations to achieve this goal through modifications to the definition of lead auditor. We also offer thoughts on developing requirements and guidance that provide necessary levels of scalability arising from the continuing evolution of (1) the way in which financial information and reporting is organized, processed, and recorded by complex, multi-national entities and (2) the manner in which accounting firms (and their networks) are organizing themselves, structuring their engagement teams, and innovating audit execution techniques.

Determining the Other Auditor's Compliance with Independence and Ethics Requirements. Our recommendations support the goal of a risk-based approach that acknowledges the ability to rely on an effective shared system of quality control at the network level.

Dividing Responsibility for the Audit with Another Accounting Firm. We fully support the continued practice of enabling registered accounting firms to make reference to the audit of an other auditor in the auditor's report. Our observations and recommendations serve to preserve and enhance a long-standing and necessary practice.

We offer further observations on other areas of the Proposal in Appendix 2 related to the auditor's performance requirements, as well as editorial comments in Appendix 3.

We commend the PCAOB Staff for devoting a significant portion of the May 18, 2016, Standing Advisory Group meeting ("SAG Meeting") to discussing matters relevant to the Proposal and hearing input from a variety of stakeholders. Furthermore, we recommend that the Board perform outreach with the International Auditing and Assurance Standards Board (IAASB), which has recently issued an Invitation to Comment, *Enhancing Audit Quality in the Public Interest — A Focus on Professional Skepticism, Quality Control and Group Audits* (the ITC), which includes a number of proposed actions to enhance the IAASB's standards related to quality control and group audits. As the Proposal has noted, many public accounting firms have based their methodologies on the IAASB's standards. The information obtained from the ITC (including identification of challenges that auditors face) and the comments from respondents may be useful to the PCAOB as it continues with its standard-setting activities. Similarly, the IAASB may also benefit from the perspectives of the PCAOB and views of commenters to the PCAOB's Proposal. Therefore, we encourage the PCAOB to engage constructively with the IAASB on this project.

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D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential effects of the Proposal. We stand ready to collaborate with the PCAOB on these important matters. If you have any questions or would like to discuss these issues further, please contact Dave Sullivan at 714-436-7788 or Megan Zietsman at 203-761-3142.

Very truly yours,



Deloitte & Touche LLP

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APPENDIX 1

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation

As articulated in the “Overall Comments” section of this letter, we recognize and support the Board’s objectives and believe that sufficient oversight and involvement by the lead auditor in an audit that involves other accounting firms is critical to audit quality. We fully support strengthening requirements in the PCAOB’s standards in this area. As noted in the Release, many accounting firms and networks, including the Deloitte network, have adopted requirements and guidance beyond the current requirements of PCAOB Auditing Standard 1205, Part of the Audit Performed by Other Independent Auditors. We believe embedding leading practices into the standards of the PCAOB is appropriate and will be beneficial to audit quality.

We believe that effective oversight of other auditors is achieved through a combination of the lead auditor’s direct participation in the audit as well as other factors such as sufficient involvement in, and supervision of, the work of other auditors. As currently drafted, we believe the Proposal could be improved by:

- Defining lead auditor more broadly by enabling individuals from more than one registered accounting firm to perform certain supervisory audit activities and procedures in a multi-national audit when those activities and procedures may be better executed by other auditors who belong to a different accounting firm.
- Applying multiple criteria to demonstrate sufficient involvement as lead auditor, rather than having direct participation as the predominant criteria.
- Clearly enabling the lead auditor to follow a scalable, risk-based approach to determine the nature and extent of the necessary supervision of, and involvement with, other auditors.
- Recognizing that global networks may have established a shared system of quality control (i.e., network-level policies, processes, and controls) that, when operating effectively and monitored appropriately, should influence how the lead auditor achieves the requirements of the PCAOB’s standards.

As currently drafted, there may be circumstances, based on the structure of the company being audited and the nature of its cross-border operations and financial reporting, where it will be difficult to identify a registered public accounting firm to serve as the lead auditor.

Lead Auditor — Definition. The definition of lead auditor (PCAOB Auditing Standard 2101, *Audit Planning* (AS 2101)). Paragraph A4(b) appears to preclude other auditors from fulfilling certain planning and supervisory roles and responsibilities designated in the Proposal, as such requirements are for the lead auditor to fulfill. At the same time, AS 1201 allows other auditors, as members of the engagement team (AS 2101.A3(a)), to assist the engagement partner in fulfilling the engagement partner’s supervisory responsibilities identified in AS 1201. We believe this dichotomy may create confusion as to which supervisory activities the other auditor may or may not perform.

In addition, we believe that certain requirements assigned to the lead auditor may better be performed by an other auditor that is more familiar with the language, culture, business environment, and laws and regulations of the business unit or location (and is near the business unit or location).

- For example, we do not believe that in all cases the lead auditor would be in the best position to execute the requirements to gain an understanding of each [individual] other auditor’s “knowledge of the SEC and PCAOB independence requirements and their

experience in applying those requirements” (AS 2101.B4(a); see further comment in Independence section below). These procedures may be better performed either solely by the other auditor, or in combination with the lead auditor, as opposed to solely by the lead auditor.

- For example, in a diversified company, identifying and assessing the risks of material misstatement at individual locations or business units where an other auditor is being used is an activity that is best performed with involvement by both the lead auditor and the other auditor. Similarly, in a situation of a newly acquired subsidiary in an other auditor’s jurisdiction, the other auditor may have much greater knowledge and understanding of the location and the risks of material misstatement that the subsidiary may pose to the consolidated financial statements than the lead auditor.

Another challenge with respect to the proposed definition of lead auditor being limited to a single registered accounting firm is that in certain cases, the engagement partner’s team may be part of a different legal entity than the engagement partner. This may be due to local laws or regulations, such as those that require a separate accounting firm to be established within individual states or provinces within a country. Furthermore, the linkage of lead auditor to a registered accounting firm is not consistent with current practice or the existing ability under AS 1201 to allow individuals from different firms to assist the engagement partner with their AS 1201 supervisory responsibilities. We believe audit quality is best served by ensuring that the appropriate engagement team is in place, without undue emphasis being placed on the legal entities in which these resources reside.

We believe the clearest approach would be to define lead auditor as “the engagement partner, the engagement partner’s team, and designated individuals from other auditors who are performing planning and supervisory activities.” This would eliminate the categorical relationship of the lead auditor to a single registered accounting firm. An expanded definition also would enable the engagement partner to identify, using judgment and based on their knowledge and experience and on the facts and circumstances of the company and its operations, those members of the engagement team who are best suited to directing and supervising the identification, assessment, design, and performance of procedures to respond to risks of material misstatement, in addition to assessing considerations related to ethics and independence. This is of particular importance in a multi-tiered structure (i.e., where an other auditor is supervising the work of a second other auditor; for example, where there is a sub-consolidation of financial information in a region).

Sufficiency of Participation as Predominant Lead Auditor Criterion. The Proposal provides limited criteria for determining the lead auditor; specifically, the only criterion described in the Proposal is 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. We are concerned that this one data point, coupled with the narrow definition of lead auditor discussed above, will create a challenge in identifying who may serve as lead auditor. This challenge could be partially mitigated if the changes to the definition and responsibilities of lead auditor that we have suggested above are reflected in the final amendments to the PCAOB’s standards. Otherwise, we have concerns that focusing only on the quantitative metric of “coverage” of performing audit procedures that address risks may result in the inability for any registered accounting firm to meet the lead auditor definition and requirements to serve as such.

- For example, a company’s operations are spread across business units/locations in 50 global jurisdictions where each location contains two percent of consolidated totals. In that case, in order to execute the audit, dozens of accounting firms will likely have to participate in the audit (e.g., due to local licensing and other laws and regulations that preclude accounting firms performing work in jurisdictions where they are not licensed).

The engagement partner's firm may be selected based on factors such as the domicile of the company, its key decision makers, and the location of its consolidation activities and majority of shareholders. But that same firm may only directly audit small percentages of consolidated account balances. It is unclear whether in such a circumstance, under the Proposal, the engagement partner's firm (which is also the registered accounting firm) would meet the requirements of being the lead auditor.

- For example, a company may process most of its financial reporting transactions in one or more shared service centers located in jurisdictions outside the jurisdiction where the company is domiciled. Other accounting firms may perform the audit work at these shared service centers. Similar to the preceding example, the registered accounting firm in the jurisdiction where the company is domiciled may only directly audit a small portion of the consolidated financial statements. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.
- For example, a company considered a foreign private issuer because of the requirements of the Securities and Exchange Commission (SEC) (including the domicile of the majority of its shareholders) may have the majority of its key decision makers and operations in a different jurisdiction than where the company is domiciled. The registered accounting firm in the jurisdiction of the company's domicile may not, based on licensing laws or regulations, be able to perform procedures in the jurisdiction where the majority of operations exist. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.

We believe that there are multiple criteria that should be considered in determining which registered accounting firm can and should act as the lead auditor, beyond just the consideration of the risks of material misstatement associated with the portion of the company's financial statements audited by the engagement partner's firm relative to the portion audited by other auditors. These criteria should include not only factors related to the company (e.g., the legal domicile of the company, the location of the company books and records, the location of the company's executives and key decision makers) but also factors related to the auditor and audit (e.g., professional licensing requirements; the lead auditor's involvement with the other auditors; knowledge of, and experience with, the other auditor; the nature of the business unit or location audited by the other auditor; the business environment and culture in which the other auditor operates).

We believe these additional criteria would be helpful in identifying the lead auditor and in developing a risk-based framework for supervision of other auditors by the lead auditor and engagement team. If a shared system of quality control at the network level exists and is operating effectively, we believe reliance by the lead auditor on such commonalities should influence the nature, timing, and extent of direction and supervision of other auditors from the same network. A shared system of quality control, when operating effectively, provides shared methodologies and a common "language" and understanding that is distinct from other auditors outside of the network. We believe the standard should recognize this distinction as part of its risk-based, scalable approach to direction and supervision.

We believe the requirements in AS 2101.B2 should also be expanded to include the following considerations:

- **The involvement of the lead auditor.** We believe that in-depth involvement of the lead auditor in the audit (including the work performed by other auditors) is the most significant factor in determining that a quality audit will occur. The necessary level of lead auditor involvement in work performed by other auditors should be based on the factors in AS

2101.12, as well as on the lead auditor's assessment of the competence and expertise of the other auditors. For example, if an other auditor is performing audit procedures at a location with a relatively small percentage of the consolidated totals, but the location operates in an unstable economic environment and its financial information gives rise to significant or higher risks of material misstatement, we believe that it would be imperative that the lead auditor be meaningfully involved in the work performed by this other auditor.

- **The factors in AS 2101.12.** AS 2101.12 identifies factors that are relevant to the identification and assessment of risks of material misstatement associated with a location or business unit. In addition to these factors being important to identifying risks of material misstatement, they also provide relevant considerations for determining the necessary level of involvement by the lead auditor in the other auditor's work. For example, consider the scenario where the financial information at a business unit does not have any significant risks, the systems are highly centralized and automated, there is no history of errors, and the other auditors are competent and experienced. Even if the materiality of the business unit is significant in comparison to the consolidated entity, the lead auditor may determine that the necessary level of direct involvement in the work performed by the other auditor may be less extensive than locations with higher risks of material misstatement.
- **The competence and experience of the other auditor.** Understanding the knowledge, education, and skills of the other auditor is a critical factor in determining how involved the lead auditor needs to be in the work of the other auditor. Information such as past inspections results, the experience and knowledge of the other auditor (including whether the other auditor is part of the lead auditor's network), and the lead auditor's interactions with the other auditor all contribute to the lead auditor's determination as to whether the other auditor is capable of performing the requested work. Determination of the competence and experience of the other auditor will influence the lead auditor's involvement with the auditor:
 - For example, if the lead auditor determines that even though an other auditor has received appropriate training and appears sufficiently skilled, they have little experience performing audit procedures in the areas where the lead auditor is asking them to perform procedures, the lead auditor may determine it appropriate to be more heavily involved in the direction and supervision of the other auditor's work.
 - For example, if the lead auditor has extensive experience working with the other auditor, has first-hand knowledge of their skills, and has determined that the other auditor is capable of assisting the lead auditor with supervisory activities, the lead auditor may determine that the necessary level of involvement in the other auditor's work does not need to be as extensive as in the previous example.
- **The nature, timing, and extent of communication with the other auditor.**
 - We believe that ongoing two-way communication between those auditors who are responsible for supervisory activities (whether engagement partner, other members of the lead auditor's team, or other auditors) and other engagement team members underpins the performance of a quality audit and is therefore essential. Accordingly, we are supportive of enhancements to the PCAOB's standards that will drive appropriate and effective two-way communication. We also believe that it is the engagement partner's responsibility to determine that the appropriate individuals are involved in the supervisory activities of an audit. The appropriate nature, timing, and extent of communication between auditors should be risk-based and scalable, and therefore should be a function of many factors, including:
 - The experience the lead auditor has with working with the other auditor and the resulting understanding of their knowledge, education, and skills.

- The results of PCAOB inspections, internal practice reviews (if within the same network), other inspection results, and their relevance to the other auditor’s work.
- The complexity and nature of judgments related to the procedures that the lead auditor has requested the other auditor to perform, including whether the other auditor is responsible for performing procedures related to significant risks.
- If in place and effective, a shared system of quality control for network firms.
- The business and cultural environment in which the other auditor operates.
- The factors described in current AS 1201.6.

We therefore recommend that AS 2101.B2 be modified to give appropriate recognition to qualitative factors that are critical in determining the sufficiency of the lead auditor’s participation in the audit.

Audit Documentation. Accounting firms continue to evolve and innovate in terms of organizational structure, engagement team composition, and audit execution techniques. This means that:

- Engagement team members may not all be from the same office (even when they are from the same firm).
- Some engagement team members may work remotely some, most, or all of the time.
- Audit tools and techniques are becoming more data-driven.
- Audit documentation and retention methods are increasingly paperless and virtual, in keeping with similar changes in company record retention.

Challenges with respect to access to audit documentation prepared by other auditors and audit documentation retention continue to exist, and are for the most part driven by jurisdictional laws and regulations, including privacy and confidentiality. As more jurisdictions implement mandatory firm rotation, the use of firms unaffiliated with the engagement partner’s firm will likely increase, which will increase the challenges related to access to audit documentation. It is important that the PCAOB’s auditing standards are able to be operationalized in an environment in which work structures and the nature of audit evidence will continue to change.

PCAOB Auditing Standard 1215, *Audit Documentation* (AS 1215), requires that “[t]he office of the firm issuing the auditor’s report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs .04–.13 of [AS 1215] is prepared and retained. Audit documentation supporting the work performed by other offices of the firm and other auditors must be retained by or be accessible to the office issuing the auditor’s report” (AS 1215.18). The following identifies certain concerns that we have regarding changes to the PCAOB’s standards related to audit documentation, and our suggested recommendations:

- We believe AS 1215.19A is overly focused on the “office issuing the report.” We agree that it is reasonable to expect that a list of the work papers reviewed by the lead auditor or other auditors assisting the lead auditor be maintained; however, requiring this list to be maintained by the office issuing the auditor’s report does not seem necessary as long as the list is accessible to the firm issuing the auditor’s report. Furthermore, requiring this information to be prepared and maintained by the office issuing the auditor’s report would likely be very burdensome and time consuming for many large audit engagements, especially during a period of time (i.e., near the auditor’s report date) when the lead auditor’s team would be most busy. Modifying the requirement in AS 1215.19A such that

information is accessible to the firm issuing the auditor's report would also address our concerns related to the requirements in AS 1215.19, which requires that the office issuing the auditor's report obtain, review, and retain certain documents, which include those described in AS 1201.B2(c) and (d).

- The requirements in AS 1215.19 and 19A do not take into account an engagement team that has a multi-tiered structure; the judgments made by the engagement partner or lead auditor on establishing the most appropriate supervisory team; the engagement team's decisions on what constitutes appropriate audit evidence; and the structure of the company that is being audited. We believe it is appropriate for the lead auditor to consider how the company's financial information is consolidated in order to determine how to obtain sufficient appropriate audit evidence and how the audit documentation is best maintained (including obtaining the documentation discussed in AS 1215.19 and 19A); we believe the Proposal may be further enhanced to reflect these judgments. To illustrate this concept, we offer the following example:
 - A company has subsidiaries in the United States, the UK, and other countries. The corporate parent is based in the United States.
 - Accounting Firm #1 is the lead auditor, and audits the U.S. subsidiary and the corporate parent. Accounting Firm #2 is an other auditor, and audits the UK subsidiary.
 - The engagement partner has determined that the work of Accounting Firm #2 on the UK subsidiary will be used as audit evidence. The items noted in AS 1215.19 and 19A will be obtained from Accounting Firm #2.
 - The UK subsidiary has smaller subsidiaries in countries outside of the UK that consolidate into the UK subsidiary. Because of licensing and other laws and regulations, Accounting Firm #3 will be used to perform audit procedures on subsidiaries in countries other than the UK. The lead auditor is appropriately involved in the decisions that Accounting Firm #2 makes, and has determined that Accounting Firm #2 is appropriately supervising any other auditors that are being used.
 - Accounting Firm #2 will obtain the items noted in AS 1215.19 and 19A from Accounting Firm #3, as they are best placed to review and understand the work that has been performed. However, given that Accounting Firm #2 is reporting to the lead auditor on behalf of Accounting Firm #2 and Accounting Firm #3, Accounting Firm #2 will provide the items noted in AS 1215.19 and 19A for the entities audited by Accounting Firm #2 and Accounting Firm #3. Therefore, it would not be necessary for the lead auditor to obtain and keep in the audit documentation of Accounting Firm #1 the items noted in AS 1215.19 and 19A in relation to Accounting Firm #3.
- We do not believe that audit work is performed by "an office"; however, AS 1219.19(e) requires that the office issuing the auditor's report reconcile financial statement amounts to the information underlying the consolidated financial statements. The lead auditor is responsible for determining that the financial statement amounts audited reconcile to the information underlying the consolidated financial statements; therefore, AS 1219.19(e) should be modified to reflect who has this overall responsibility.

Determining the Other Auditor's Compliance with Independence and Ethics Requirements

AS 2101.B4 requires that, in addition to confirming the other auditors' compliance with SEC and PCAOB independence and ethics requirements, the lead auditor is required to understand each other auditor's knowledge of the requirements and their experience in applying the requirements. We agree with the requirement to obtain a written representation from each other auditor that the other auditor is in compliance with SEC and PCAOB independence and ethics requirements. However, it

is unclear whether the requirement is applicable to each individual of the other auditor, to the other auditor engagement team collectively, to the firm, or to the network. We believe there will be significant challenges if the requirement means that the lead auditor needs to evaluate the knowledge and experience of every individual of the other auditor.

For example, one interpretation of this requirement could be that the lead auditor needs to evaluate all of the ethics and independence learning material provided by the other auditor's firm or network. This may be particularly challenging when the other auditor is from a different network than the lead auditor due to the proprietary nature of the learning material developed or delivered by the other auditor to its personnel. The requirements of the PCAOB's Proposal may also be interpreted to mean that the other auditor must provide detailed information about other engagements performed by the other auditor, which may be subject to privacy and confidentiality laws and regulations. In addition, it is unclear whether every member of the other auditor engagement team is expected to provide detailed information on ethics and independence or whether there can be consideration of network-level controls and processes related to monitoring compliance with ethical and independence requirements. Meeting this detailed requirement for each individual across a large, complex, multi-national audit will be challenging, particularly if the lead auditor is unable to leverage a shared system of quality control within the lead auditor's network (if one is present and operating effectively).

We believe a risk-based approach to determining whether to obtain any additional understanding beyond the representation, and if so the nature and extent of that understanding, would be more appropriate. This approach would allow for auditor judgment to be applied and for the auditor's effort to be focused on the circumstances where additional information is important to judgments about the competence of the other auditor, or where contradictory evidence with respect to the other auditors' independence may present itself (as AS 2101.B4 already provides for). Furthermore, we believe the lead auditor should be able to rely on a shared system of quality control at the network level, when found to be operating effectively, to address independence and ethics requirements.

Therefore, we recommend clarifying in AS 2101.B4 to whom the requirement to obtain a written representation from is needed. However, we also believe that based on the engagement partner's professional judgment, including their knowledge of, and experience with, the other auditor, and the facts and circumstances, the lead auditor should be able to determine the additional performance requirements that are appropriate.

Dividing Responsibility for the Audit with Another Accounting Firm

We strongly support retention of the engagement partner's ability to make reference (i.e., divide responsibility) in the auditor's report to another auditor as governed currently by AS 1205. The ability for the lead auditor to divide responsibility for the audit with another accounting firm is a recognized and allowable approach in the United States. There are no compelling practice issues that we are aware of that would suggest a need to change an approach that has long been permitted. We do not believe that additional requirements, including supervisory requirements, are necessary to describe the responsibilities of the engagement partner's firm in situations in which the lead auditor divides responsibility for the audit. We believe that certain aspects of PCAOB Auditing Standard 1206, *Dividing Responsibility for the Audit with Another Accounting Firm* (AS 1206), are in conflict with the Board's goals with respect to divided responsibility, and we further describe our observations and recommendations to the Proposed Auditing Standard below.

The Principles Underlying Division of Responsibility. Currently, the decision to divide responsibility does not happen often and most often occurs when a significant transaction occurs toward the end of the fiscal year and the lead auditor determines that they will not have appropriate time to assume

responsibility for the work performed by the other auditor, or where there is an equity method investment and there is an inability to obtain unfettered access to all people and information in order to assume responsibility for the work of the referred-to auditor. In such circumstances the auditor's report provides transparency to the users of the audited financial statements about the responsibility taken by the lead auditor, as often evidenced with language similar to: "Our opinion insofar as it relates to Subsidiary B is based solely on the opinion of the other auditor."

The Proposal, however, contains additional requirements that go beyond current practice and that may result in more opaqueness around the responsibility and activities the lead auditor is required to undertake with respect to the referred-to auditor, as well as the purpose of such activities. For example, the Proposal (AS 2101.14) requires that the lead auditor have discussions with the referred-to auditor to identify and assess risks of material misstatement associated with the location. As another example, AS 2401.53 requires that the lead auditor discuss with the referred-to auditor the extent of work that needs to be performed to address certain fraud risks.

This greater level of involvement by the lead auditor in the work of the referred-to auditor diminishes the "clear line" with respect to responsibility and what the lead auditor does or does not know about the financial information at that location. For example, based on the discussion mentioned in the previous paragraph, would the lead auditor be compelled to evaluate how the referred-to auditor responded to an identified risk of material misstatement? At what point would the lead auditor be perceived to have gone beyond basing the opinion as it relates to a particular subsidiary or equity method investee "solely" on the referred-to auditor's opinion? The predominant factors influencing the decision to divide responsibility today are primarily timing (e.g., late-year acquisitions) and access (e.g., equity method investments that are not controlled by the company being audited). The increase in the required extent of involvement in the work of the referred-to auditor, and a greater understanding of the referred-to auditor's response to risks, may result in division of responsibility for different factors than exist today. We are not sure whether the Board intended such an outcome. This may be why the Proposal does not carry forward existing guidance (AS 1205.06) which provides considerations in determining whether to make reference to another auditor. However, we find this guidance is used in practice today and we believe it is helpful and should be retained.

Dividing Responsibility when Different Financial Reporting Frameworks Have Been Used. We note the Proposed Auditing Standard eliminates the current option of dividing responsibility when a different financial reporting framework has been used. This option is used in practice today and is recognized by the SEC. The SEC's Financial Reporting Manual (FRM) states "... financial statements of subsidiaries or investees of a foreign private issuer are sometimes prepared in differing GAAP's than that of the registrant. The audit report should be clear as to which auditor is taking responsibility for auditing the conversion of the GAAP of the subsidiary or investee to the GAAP of the issuer, as well as auditing the U.S. GAAP reconciliation" (FRM 6820.7). As far as we are aware, there have been no recognized practice issues or challenges arising from dividing responsibility when a different financial reporting framework has been used.

Given the broad use of International Financial Reporting Standards (IFRS) globally, in a multi-national group audit where subsidiaries have statutory audit requirements, often the financial information of the company is kept in IFRS for statutory audit purposes and then converted to U.S. GAAP for consolidated reporting purposes. With an expected turnover in subsidiary auditors arising from mandatory firm rotation in certain jurisdictions, we believe that an increase in dividing responsibility with a subsidiary auditor may occur. We believe in such a circumstance, where local GAAP is not U.S. GAAP, continuing the current practice of being able to divide responsibility when a different financial reporting framework is used is important.

APPENDIX 2

The comments noted in this section are intended to clarify the auditor performance requirements to avoid misinterpretation.

Obtaining the Other Auditor's Written Report. The Proposal could clarify what will be sufficient for the lead auditor to obtain to satisfy the requirement in AS 1201.B2(d). For example:

- Is it sufficient for the lead auditor to receive only the items noted in AS 1215.19 from the other auditor, provided the receipt of such items results in the lead auditor being appropriately informed about the work performed and the related results?
- Is it sufficient for the lead auditor to obtain only the working papers from the other auditor and not a summary report, provided the receipt of such working papers results in the lead auditor being appropriately informed about the work performed and the related results? For example, if the other auditor performs only an observation of an inventory count, would it be sufficient for the other auditor to provide all working papers to the lead auditor (assuming that the working papers include information such that the lead auditor is appropriately informed about the work performed and the related results)?

Specifically related to Question 53 in Appendix 4, while superseding AI 10 generally seems appropriate, paragraphs .11-.17 are helpful in providing consistency related to lead auditor and other auditor communications; this guidance can be especially helpful when the other auditor is not from the same network as the lead auditor. We recommend retaining or developing new example communications that may be used, together with an explanation of when different types of communications might be more appropriate. For example, we believe it would be helpful for additional clarity to be provided about the circumstances that may necessitate or require an opinion-style report from the other auditor to the lead auditor.

Discussions with Other Auditors. AS 2101.14 requires the lead auditor to discuss with and obtain information from the other auditors or referred-to auditors, as necessary, to identify and assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit. However, the lead auditor may initially identify and assess risks *prior* to determining the locations where procedures will be performed to respond to those risks (and therefore prior to identifying an other auditor). It is important that the standard recognize the iterative nature of the planning process to enable risk assessment activities and other auditor outreach to occur appropriate to the facts and circumstances and less in a seemingly required sequential manner.

Specialized Skill or Knowledge. Clarity is needed as to the purpose for the proposed wording in AS 2101.16, which states “[t]he auditor should determine whether specialized skill or knowledge, including relevant knowledge of foreign jurisdictions, is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.” There are many examples of where specialized skills may be needed and the current wording allows for appropriate consideration. Additional clarity as to why there is an added focus on knowledge of foreign jurisdictions is needed, especially in light of this requirement being applicable to “the auditor” (e.g., the auditor in a foreign jurisdiction is now required to consider whether knowledge of the foreign jurisdiction in which they practice is necessary). While Page A4-25 of the Release implies that the reasoning for this change is to assist with gaining an understanding of the qualifications of the other auditor’s supervisory personnel (and who assist the lead auditor with planning or supervision), the explanatory phrase added to AS 2101.16 does not appear to achieve this goal.

Changes in Audit Procedures. AS 1201.B2 (b) states that the lead auditor should “determine whether any changes to the procedures are necessary, discuss such changes with the other auditor, and communicate them in writing to the other auditor.” Requiring that changes in the nature, timing, and extent of audit procedures be in writing in all cases seems overly onerous and inconsistent with current practice of how the engagement partner (or engagement team members who assist with fulfilling the engagement partner’s responsibility pursuant to AS 1201) would manage communications about necessary changes in work performed by engagement team members. Determining whether changes to audit procedures are necessary and making the necessary communications often involves a collaborative effort between engagement team members and results in direct changes to related working papers (versus a separate document identifying the change, in addition to the change in the related working paper). As the lead auditor has the ability to review working papers of the other auditor, the lead auditor has the ability to determine that changes to audit procedures were appropriately incorporated; therefore, having an additional layer of documentation seems unnecessary.

Recommended Changes to Provide Clarity When Dividing Responsibility. In light of our analysis of the Proposed Auditing Standard, we have identified several areas where improvements may be warranted to provide further clarity for auditors:

- AS 1206.2 states that “[t]he objectives of the lead auditor are to: (1) communicate with the referred-to auditor and determine that audit procedures are properly performed with respect to the consolidation or combination of accounts in the company’s financial statements and...” This phrasing implies that the object of the lead auditor is to communicate with the referred-to auditor as it relates to the audit procedures to be performed with respect to the consolidation, which we do not believe is the intent. We recommend that the PCAOB consider modifying the objective to make it clear that the objective of the lead auditor is to perform procedures that are necessary in order to make reference to the report of the referred-to auditor in the lead auditor’s report, and make the necessary disclosures in the lead auditor’s report.
- AS 1206.08(b) states that the lead auditor’s report should “[i]dentify the referred-to auditor by name and refer to the auditor’s report of the referred-to auditor when describing the scope of the audit and when expressing an opinion.” Given that the referred-to auditor’s report is included in the filing, it does not seem necessary to identify them specifically by name in the auditor’s report. We recommend the PCAOB re-consider the necessity of this requirement.
- AS 1206.08(c) states that the lead auditor’s report should “[d]isclose the magnitude of the portion of the company’s financial statements, and if applicable, internal control over financial reporting, audited by the referred-to auditor.” Furthermore, the second note to AS 1206.1 states that “[t]his standard applies when the lead auditor divides responsibility for the audit with one or more referred-to auditors. When there is more than one referred-to auditor, the lead auditor must apply the requirements of paragraphs .03 through .09 of this standard [AS 1206] in relation to each of the referred-to auditors individually.” In current practice, if there is more than one referred-to auditor, the auditor’s report generally combines the disclosure about the magnitude of the portion of the company’s financial statements and, if applicable, internal control over financial reporting, for all referred-to auditors, which has been a longstanding and accepted practice with auditor’s reports filed with the SEC. We recommend that the Board clarify whether the intention is to require that this information be disclosed for each referred-to auditor and consider, in making this clarification, how this would conflict with current practice and what is currently acceptable to the SEC. In addition, we request that the PCAOB include an illustrative report example when multiple referred-to auditors exist in the final standard.

- AS 1206 does not appear to have sufficient guidance on dividing responsibility for an audit of internal control over financial reporting, as the Proposed Auditing Standard appears to be heavily focused on the financial statement audit. Some examples that lack reference to audits of internal control over financial reporting include:
 - AS 1206.1: Note: This standard applies when the lead auditor divides responsibility for the audit with one or more other auditors.
 - AS 1206.4: The lead auditor should communicate to the referred-to auditor, in writing, the lead auditor’s plan to divide responsibility for the audit with the referred-to auditor pursuant to this standard and other applicable PCAOB standards.

It would be more appropriate for the reference to “the audit” in the above examples to refer to both the financial statement audit and the audit of internal control over financial reporting given that the auditor can divide responsibility for the financial statement audit or the audit of internal control over financial reporting. Alternatively, when phrases such as “the audit” are used, they could be footnoted and clarified that such phrases refer both to the audit of the financial statements and the audit of internal control over financial reporting, if applicable.

- AS 1206.01 states “[t]his standard establishes requirements for the lead auditor regarding dividing responsibility for the audit of the company’s financial statements and, if applicable, internal control over financial reporting with a referred-to auditor.” However, we have observed that throughout the Proposal there are auditor performance requirements when a referred-to auditor exists (e.g., Appendix B to AS 1201). Accordingly, we recommend that the Board clarify in the Proposed Auditing Standard that requirements exist in other PCAOB standards related to when the lead auditor divides responsibility and that an appendix or footnote reference be added that identifies such other requirements.
- It is unclear as to why in situations where the lead auditor is unable to divide responsibility with another accounting firm, the lead auditor’s performance requirements are limited only to the three options presented in AS 1206.7. We believe that another alternative is to allow for the lead auditor to identify a different other auditor and appropriately apply the requirements of the Proposal when using an other auditor. Therefore, we recommend that this additional alternative be included in AS 1206.7.
- We recommend that in AS 1206, Appendix B, an example is provided for the situation in which the lead auditor is making reference to a referred-to auditor for the financial statement audit only, and the lead auditor’s report on the financial statements is separate from the lead auditor’s report on internal control over financial reporting (given that this is the most common scenario that is encountered).

APPENDIX 3

<p>AS 1201.B(2)(b)</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>Note: Based on the necessary extent of supervision of the second other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor who is assisting the lead auditor in supervising the second other auditor) to determine the nature, timing, and extent of procedures to be performed.</p>
<p>AS 1206.03</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p>

	The lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, <u>as necessary</u> , to test and evaluate...”
<i>AS 1206.7</i>	<p>It is unclear that the circumstances described in AS 1206.7 exist in situations where the lead auditor originally expected to divide responsibility with the referred-to auditor, and has subsequently determined that this is not possible. Therefore, we recommend making the following changes:</p> <p>In situations in which the lead auditor <u>originally planned to divide responsibility for the audit with another accounting firm, but has subsequently determined that this is not possible is unable to divide responsibility with another accounting firm</u> (e.g., due to concerns about the competence or independence of the referred-to auditor), the lead auditor should:...</p>
<i>AS 1206.08(c)</i>	<p>We recommend the following change to AS 1206.08(c), given that the second sentence states “[t]his may be done,” and therefore using “or” instead of “and” provides flexibility as to the criteria used (as total assets and total revenues are not always the criteria used):</p> <p>Disclose the magnitude of the portion of the company’s financial statements, and if applicable, internal control over financial reporting, audited by the referred-to auditor. This may be done by stating the dollar amounts or percentages of total assets, total revenues, <u>or and</u> other appropriate criteria necessary to identify the portion of the company’s financial statements audited by the referred-to auditor.</p>
<i>AS 1206, Footnote 1</i>	<p>We recommend making the following changes to clarify the meaning:</p> <p>The term “company’s financial statements,” as used in this standard, describes the financial statements of a company that include—through consolidation or combination—the financial statements of the company’s business units, <u>as well as the financial information related to equity method investments</u>.</p>
<i>AS 1206.B1</i>	<p>We recommend the following changes to AS 1206.B1, the first paragraph of the Introductory Paragraph, to improve readability and to clarify that the statement of comprehensive income is not part of stockholders’ equity:</p> <p>We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the related consolidated statements of operations, <u>comprehensive income, and</u> stockholders’ equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 20X3.</p>
<i>AS 1206.B1</i>	<p>We recommend the following changes to AS 1206.B1, the Opinion Paragraph, to address grammar inconsistencies (first sentence) and to recognize that the opinion on the effectiveness of internal control over financial reporting is only for one year (second sentence):</p> <p>In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the results of <u>its their</u> operations and <u>its their</u> cash flows for each of the years in the three-year period ended December 31, 20X3, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, based on our audits and the report of Firm ABC, X Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X3, based on [Identify control criteria, for example, “criteria established in Internal Control—Integrated Framework:</p>

	2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)”).
<i>AS 1206.B1</i>	<p>We recommend the following changes to AS 1206.B1, the second Introductory Paragraph, to better reflect that the auditor’s opinion is on the effectiveness of internal control over financial reporting:</p> <p>We did not audit the financial statements and internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets constituting XX percent and YY percent of consolidated assets as of December 31, 20X3 and 20X2, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively. Those financial statements and B Company’s internal control over financial reporting were audited by Firm ABC whose report[s] has[have] been furnished to us, and our opinions, insofar as they relate to the amounts included for B Company and the effectiveness of its internal control over financial reporting, are based solely on the report[s] of Firm ABC.</p>
<i>AS 1215.19A</i>	<p>We recommend the following change to clarify that retention of work papers is by the office (as is consistent with AS 1215), not the lead auditor:</p> <p>Audit documentation of the firm office issuing the auditor's report must contain a list of additional work papers of other auditors (beyond those described in paragraph .19 [of AS 1215]) that were reviewed by the lead auditor but not retained by the firm issuing the auditor’s report lead auditor, if any.</p>
<i>AS 1215.18, AS 1215.19, and AS 115.19(e)</i>	<p>It unclear as to what the reference to “other offices of the firm” means (i.e., offices of what firm?) in certain paragraphs in AS 1215. We recommend making the following changes to improve readability and clarify the meaning (see additional comments on AS 1215 in Appendix 2):</p> <p>AS 1215.18: The office of the firm issuing the auditor’s report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs .04-.13 of this standard is prepared and retained. Audit documentation supporting the work performed by other offices of the firm issuing the auditor’s report and other auditors must be retained....</p> <p>AS 1215.19: In addition, 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 issuing the auditor’s report and other auditors:...</p> <p>AS 1215.19(e): Sufficient information to enable the office issuing the auditor’s report to agree or to reconcile the financial statement amounts audited by other offices of the firm issuing the auditor’s report and other auditors to the information underlying the consolidated financial statements.</p>
<i>AS 2101.A3(a)(2)</i>	<p>AS 2101.A3 (a)(2) states that the engagement team includes “specialists whose work is used on the audit and who are employed by the lead auditor or another accounting firm participating in the audit.” It is unclear as to how specialists whose work is used on the audit should be considered when they are neither employed nor engaged by the lead auditor or another accounting firm participating in the audit. For example, a specialist (e.g., an IT Specialist) may be a Partner in the same firm as the lead auditor; in such a case, they would not be considered to be “employed by the lead auditor,” nor would they be an “engaged specialist.” We recommend the following change:</p>

	<p>a. Engagement team includes – ...</p> <p>(2) Specialists whose work is used on the audit and who are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor’s report employed by the lead auditor, or of another accounting firm participating in the audit</p>
<i>AS 2101.A4</i>	<p>We recommend making the following changes in order to acknowledge that there may be instances where an auditor’s report may not ultimately be issued:</p> <p>Lead auditor –</p> <p>(a) The registered public accounting firm engaged to issue issuing the auditor’s report on the company’s financial statements and, if applicable, internal control over financial reporting; and</p> <p>(b) The engagement partner and other engagement team members who: (1) are partners, principals, shareholders, or employees of the registered public accounting firm engaged to issue issuing the auditor’s report 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.</p>
<i>AS 2101.A5</i>	<p>We recommend making the following changes in order to conform to language used in the definition of engagement team:</p> <p>Other Auditor –</p> <p>(a) A member of the engagement team who is not a partner, principal, shareholder, or employee of the registered public accounting firm engaged to issue the auditor’s report lead auditor; and</p> <p>(b) A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.</p>
<i>AS 2101.A6</i>	<p>We recommend making the following changes to the definition of referred-to auditor, which is consistent with the terminology used in the Note to AS 2101.A4 and current practice:</p> <p>Referred-to Auditor – A public accounting firm, other than the engagement partner’s registered accounting firm lead auditor, that performs an audit of the financial statements and, if applicable, internal control over financial reporting of one or more of the company’s business units and issues an auditor’s report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead auditor’s report on the company’s financial statements and, if applicable, internal control over financial reporting.</p>
<i>AS 2101.B2</i>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>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 of the portion of the company’s financial statements for which the engagement partner’s firm performs audit procedures), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors.</p>
<i>AS 2101.B4</i>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p>

	<p>In an audit that involves other auditors, the lead auditor should determine each other auditor’s compliance with the SEC and PCAOB independence and ethics requirements <u>in the context of the engagement</u> by...</p>
<p><i>Use of term “public accounting firm”</i></p>	<p>Generally, the Proposal uses the term “accounting firm” or “registered public accounting firm.” However, in certain instances the term “public accounting firm” is used. If there is not an intended difference in the use of these terms, we recommend that the Proposal refer consistently to “accounting firm” or “registered public accounting firm.” We recommend making this change to the following paragraphs (and also recommend that the Board consider whether additional instances of the term “public accounting firm” need to be changed):</p> <ul style="list-style-type: none"> • AS 2101.A5(b) and A6 • AS 1201.A5 • AS 1215 Footnote 4 • AS 1206.A3 • AS 2201.C1.