November 14, 2017

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

RE: PCAOB Rulemaking Docket Matter No. 042

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Supplemental Request for Comment: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* included in PCAOB Release No. 2017-005 (the "release").

We support the PCAOB's consideration of enhancements and the promotion of consistency in the auditor's performance when executing its supervisory responsibilities in an audit involving other auditors. We agree the nature of interaction between the lead auditor and other auditors is important to audit quality, and we support actions that lead to 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.

Overall observations

A number of the proposals addressed within the Supplemental Request for Comment ("SRC") relate to how important matters are addressed when executing complex multi-location audits and require careful evaluation of how best to accomplish the intended objectives in both an effective and efficient manner. In that regard, we note the PCAOB has not included incremental economic analysis (including, for example, a specific discussion of the problems identified and intended to be solved, the characteristics of firms and audits at which such problems have been identified, alternatives considered, or cost, benefits and unintended consequences of various alternatives) of the revised proposed provisions in the SRC. We also believe the proposed changes may not give appropriate consideration to current approaches to multi-location audits (e.g., in relation to scoping and risk assessment). Moreover, some of 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 become most critical when finalizing the audit.

We have included our preliminary views in this letter, but are concerned that the lack of specificity about the PCAOB's objectives in certain areas impedes our ability to make specific recommendations for finalizing the standard. We believe the issues set out in the SRC would be best resolved by the PCAOB through further outreach and other incremental efforts before the standard is finalized.

A key concern is that the standard is not appropriately scalable and does not take into account certain distinctions that affect how auditors plan and perform their work today to bring quality to multinational audits. The final standard will apply to a range of circumstances in which multi-location audits are conducted and must therefore be capable of being scaled and tailored to varying circumstances. The standard will also apply to a range of firms, including some very large networks of member firms, such as

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ours, that have made significant investments in systems of quality control (which must be leveraged in order to be effective given the nature of many of the multinational audit engagements performed by our firm). It will also apply to smaller firms, where more bespoke inquiries and assessments may be more appropriate given the inability or inefficiency to develop and leverage similar systems of quality control. Finally, the standard is intended to address the use of other auditors both within and outside the lead auditor's network – but in our view does not adequately consider the distinctions between these two circumstances.

If the lead auditor and other auditor are members of the same network, we believe the level of effort in applying many of the requirements can be based upon whether the firms have a common methodology, training and monitoring process. In such circumstances, effective network-level processes and controls are an important input to audit quality and should be considered. On the other hand, when the other auditor is not from the same network, we believe there may be practical challenges in complying with a number of requirements, which will be difficult to overcome. Finally, as requirements for mandatory audit firm rotation become effective in some jurisdictions, there is a greater likelihood that firms from different networks will be involved in multi-location audits. This may lead to an increase in divided responsibility because the lead auditor would be unable to obtain information needed to comply with the proposed standard. We do not believe this result would benefit audit quality.

We have suggestions related to what we see as potential practical challenges or areas where additional clarification would be helpful. We have organized our observations and recommendations into the following topical areas:

I. Independence and ethics
II. Supervision and review
III. Referred-to auditors / Divided responsibility
IV. Other matters

I. Independence and ethics

While we acknowledge AS 2101.06b requires the auditor to determine the audit engagement's compliance with independence and ethics requirements, the requirement to consider the independence of other auditors relies on inquiry, which may include obtaining a written representation. The extant standard is consistent with the reality of the challenges of obtaining or evaluating certain types of information from other auditors, in particular those outside of the lead auditor's network. It also recognizes the inefficiency in asking each lead auditor to make separate assessments of other auditors at a firm level that they are not well-positioned to make. Reliance on a written representation is premised on other auditors' firms having necessary systems of quality control.

Our response to the April 2016 proposal supported requiring the lead auditor to gain an understanding of each other auditor's knowledge and experience in applying the requirements and obtaining a written representation. However, we expressed concerns that 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. These concerns persist, and we do not support the new requirement to "determine an other auditor's compliance with independence and ethics," in particular the revised requirement to "gain an understanding of each other auditor's process for determining compliance with SEC independence requirements and PCAOB independence and ethics requirements." We believe requiring a lead auditor to gain an understanding of each other auditor's process to determine compliance would be costly and neither effective nor efficient given the complexities of these processes. In particular, individual engagement partners would not be well-equipped to make such assessments. It is the other auditor's professional responsibility to monitor individual compliance, as well as to have a sufficient basis for making written representations about the same.

When the other auditor is not part of the lead auditor's network, practical challenges to gaining an understanding of the other auditor's processes include confidentiality restrictions and concerns with sharing proprietary information. The current proposal does not provide any guidance for lead auditors on how to handle situations in which the lead auditor is unable to obtain information beyond a written representation relating to compliance with independence and ethics requirements, including the information contemplated by AS 2101.B4b(1). In this regard, we note the current communications to audit committees in accordance with PCAOB Rule 3526 focus on independence communications related to the registered accounting firm and its affiliates. The primary auditor's Rule 3526 reporting to the audit committee either includes any covered relationships of any secondary auditors not affiliated with the firm or states that it does not do so.[1] We do not believe the PCAOB intended to change practice to require the inclusion of such relationships of secondary auditors in Rule 3526 communications in all cases and do not recommend doing so.

Our recommendations

We acknowledge the PCAOB's overall objectives of improving audit quality; however, neither the 2016 proposal nor the SRC outlines the specific nature of the concerns with how auditors of large global networks of member firms are currently considering independence in multi-location audits. Accordingly, while we do not believe the proposed requirement would be effective or efficient to implement, it is challenging for us to recommend alternatives without better understanding the PCAOB's specific concerns in this area.

As reflected below, our preliminary suggestion is for the PCAOB to reconsider the proposed requirement in the April 2016 proposal.[2] We also 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 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. Our views on a possible direction of the guidance are as follows:

- If the firms are members of the same network, the level of effort should depend on whether the firms have a similar methodology, training and monitoring process. We believe lead auditors should continue to be able to rely on network processes and controls as long as they have evaluated the results of the network's monitoring of the network firm's compliance with independence and ethics requirements. This would supplement the lead auditor's responsibilities to consider any relevant matters regarding independence raised by other auditors in their written representations.

- When the other auditor is not a member of the same network, we would support requiring the lead auditor to make inquiries of the other auditor to gain the required understanding of the other auditor's knowledge and experience with the SEC independence requirements and PCAOB

[1] See PCAOB Release No. 2008-003.

[2] See page A1-15 of the April 2016 release.

independence and ethics requirements. The lead auditor would be required to perform additional procedures if it becomes aware of information during the course of the audit in relation to the other auditor's compliance with independence and ethics requirements.

Instead of requiring the lead auditor to gain an understanding of the other auditor's processes, we recommend the PCAOB consider requiring representation from the other auditor that the other auditor's firm has a process in place to assess compliance with applicable independence and ethics requirements, including consideration of relationships that may reasonably be thought to bear on independence. We support the PCAOB's proposal to require each other auditor to provide a written representation as to whether the other auditor is in compliance with the independence and ethics requirements, and for the lead auditor to be expected to perform additional procedures should there be indications that these written representations may not be reliable.

We preliminarily suggest the following changes to the proposed requirement in AS 2101 in light of the concerns and recommendations outlined above:

.B4 In an audit that involves other auditors, the lead auditor should obtain information about ~~determine~~ each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

a. Gaining an understanding of each other auditor's knowledge of ~~(1) process for determining compliance with~~ the SEC independence requirements and PCAOB independence and ethics requirements and ~~(2)~~ their experience in applying the requirements; and

Note: If the lead auditor and the other auditor are members of the same network, the level of effort to gain the required understanding can be based upon whether the firms have a similar methodology, training, and monitoring process related to these areas. In other circumstances, the lead auditor should make inquires of the other auditor to gain the required understanding.

b. Obtaining a written representation from each other auditor that includes:

(1) A statement that the other auditor has appropriate policies and procedures for assessing compliance with SEC independence requirements and PCAOB independence and ethics requirements, including consideration of matters that may reasonably be thought to bear on independence;

(2~~1~~) A written description of all relationships between the other auditor and the audit client or persons in financial reporting oversight roles at the audit client that may reasonably be thought to bear on independence; and

(3~~2~~) A statement ~~written representation~~ that the other auditor ~~it~~ is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if the other auditor ~~it~~ is not, a description of the nature of any noncompliance.

Note: ~~The lead auditor's determination of each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements is~~ The requirements of this paragraph are not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.

Note: If the lead auditor becomes aware of information during the course of the audit that (1) contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, or (2) suggests that the other auditor's policies and procedures may not be appropriate, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

II. Supervision and review

While we support the notes that have been added to clarify the intended risk-based approach to supervision, review and the documentation to be obtained by the lead auditor, we believe additional clarification of a number of requirements is necessary. It is important that senior members of the other auditor engagement team be able to assist the engagement partner of the lead auditor in fulfilling his or her responsibilities pursuant to AS 1201 when they have the appropriate knowledge, skill, and ability to do so. In our view, it is generally the other auditors who are in the best position to supervise and execute on the day-to-day responsibilities of the portion of the audit on which they are reporting. We remain concerned that the increased supervisory responsibilities placed on the lead auditor may reduce the time the lead auditor can devote to areas of heightened risk, which could adversely impact audit quality if incremental efforts with little benefit are introduced, especially towards the end of the audit.

Clarifying that other auditors can function as supervisory team members

AS 1201.04 allows the engagement partner to seek assistance from appropriate engagement team members in fulfilling their responsibilities related to the supervision of the audit, including reviewing engagement team members' work ("supervisory team members"). In the April 2016 proposal, the PCAOB indicated that supervisory team members can be from the partner's firm or from outside the firm,[3] which we understand can include partners and managers of the other auditors. We believe it is important to explicitly carry this guidance from the release forward and directly incorporate it into AS 1201.

Knowledge, skill, and ability of other auditors

We agree with the description of the lead auditor's expected considerations in accordance with proposed AS 2101.B6b, as this requirement appropriately focuses on "other auditors who assist the lead auditor with planning and supervision." We believe the PCAOB could more explicitly acknowledge that such individuals can also assist the lead auditor in complying with AS 1201.05c in relation to reviews.

The release identifies the lead auditor's own experience working with the other auditor as a possible source of information about the other auditor's knowledge, skill, and ability.[4] We believe the effort that is necessary to gain an understanding of the other auditor's knowledge, skill, and ability is affected by factors

3 See page 13 of the April 2016 release.

4 See page 16 of the release.

such as previous experience with, or knowledge of, the other auditor and the degree to which the lead auditor and the other auditor are subject to common policies and procedures (i.e., within the same network). There are often important network-level policies and procedures, including in relation to common training curriculum and monitoring of quality, that provide the lead auditor with information relevant to considering whether the other auditor has the appropriate knowledge, skill, and ability. We believe these policies and procedures, together with the lead auditor's experience in working with the other auditor, can be leveraged to a great extent. The necessary assessment is likely greatest for new other auditors or, for example, when there are significant changes in senior members of an other auditor's team, and significantly less may be necessary in subsequent years.

Inquiring about other auditors' policies and procedures relating to assignment and training

While we support the requirement in AS 2101.B6b to gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision, we are concerned with the proposed requirement in AS 2101.B6a to make inquiries (at the firm level) about other auditors' policies and procedures, including for training. We do not believe inquiries about other auditors' policies and procedures would be necessary or effective in all cases. We believe the lead auditor's risk-based approach to supervision and review is premised on the other auditor making appropriate assignments of significant engagement responsibilities. In addition, how other auditors of non-affiliated firms assign and train individuals may be confidential and proprietary in nature. When not part of the same network, the other auditor's firm is likely to provide a high-level response to inquiries regarding the training and assignment of individuals. Such response may not provide the lead auditor with evidence of the knowledge, skill, and ability of the other auditor. We are therefore concerned this requirement would incur significant time and cost without a commensurate benefit to audit quality. However, we believe the PCAOB could consider requiring the lead auditor to inquire whether the other auditor is satisfied that members of the other auditor's team have the requisite training and experience.

Our recommendations

We suggest a note be added to AS 1201.04 as follows:

.04 The engagement partner may seek assistance from appropriate engagement team members in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in the standard with respect to the supervisory responsibilities assigned to them.

Note: The supervisory team members can be from the engagement partner's firm or from outside the firm and can include other auditors who assist with planning, supervision, or review.

We suggest the requirement in AS 2101.B6 be amended as follows:

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

.a Inquire of ~~about~~ the other auditor~~s' policies and procedures relating to the:~~ as to whether the other auditor is satisfied that appropriate individuals have been assigned to the engagement,

including that they have had sufficient training and experience regarding the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations;
~~(1) Assignment of individual to audits conducted under PCAOB standards; and~~
~~(2) Training of individuals who perform procedures on audits conducted under PCAOB standards, regarding the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations;~~

.b Gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning, ~~or~~ supervision, or review, including their:

…

.c …

Note: The requirements of this paragraph are not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.

Note: The nature and extent of the lead auditor's procedures are affected by various factors, including the lead auditor's knowledge of the other auditor's quality control policies and procedures and the lead auditor's previous experience with the other auditor.

Finally, we believe the language in AS 1201.B1 could cause confusion as to the required approach. It should be clear that the requirements in the appendix to AS 1201 reflect what the PCAOB believes are the requirements to be met when other auditors are involved in the engagement, and not in addition to paragraph .05 of the standard. This could be accomplished with the following edits:

.B1 For engagements that involve other auditors, this appendix describes procedures to be performed by the lead auditor with respect to the supervision of the other auditors' work, in conjunction with the required supervisory activities set forth in this standard. ~~The requirements of this appendix supplement the requirements in paragraph .05 of this standard. In performing the procedures described in this appendix the lead auditor should determine the extent of supervision of the other auditors' work in accordance with paragraph .06 of this standard.~~

Balance of responsibilities between the lead auditor and the other auditor

We note the current requirements in AS 2110.49-.51 with respect to discussions among engagement team members in differing locations regarding risks of material misstatement and believe the PCAOB intends to leverage these requirements in setting out the proposed requirement in AS 1201.B2a(2) related to informing the other auditor of the identified risks of material misstatement.

It is important for the lead auditor to communicate to other auditors their views on significant risks that have been identified and other potential risks of material misstatement that may be relevant to the other auditor's work. But it would not be effective or efficient if the PCAOB were to require the lead auditor to consider all likely sources of potential misstatement ("LSPMs") at the assertion level for each location or business unit where an other auditor performs work. The release appears to at least partially acknowledge this perspective, noting "any risks not identified by the lead auditor in its initial communication to the other auditor would be covered by an existing provision in AS 1201 to instruct the other auditors to bring any significant auditing issues, including any additional risks of material misstatement identified by the other auditor, to the attention of the engagement partner or other team members who perform supervisory activities."[5]

In many cases, the lead auditor's initial risk assessment is a starting point, and, especially with full-scope audits, we would expect the other auditors to have an important role in extending that assessment through to the detailed LSPM level. To illustrate, when scoping a multi-location audit, the lead auditor determines the nature, timing, and extent of other auditors' involvement by considering the significance of the component and identified risks at the component. When an other auditor is requested to perform a full-scope audit or an audit of specific account balance at a location, and the lead auditor is satisfied as to the other auditor's knowledge, skill, and ability, we believe the other auditor is best placed to perform the detailed risk assessment at the assertion level and develop appropriate responses to those risks. The lead auditor's supervision and review would then focus on the documentation from the other auditor provided in accordance with AS 1215.19 and the summary memorandum, and the lead auditor, working with the other auditor, could refine the other auditor's risk assessment or response as necessary, taking into account the results of procedures at the component or the impact of other efforts by the lead auditor or other auditors, and could request additional documentation as necessary.

Our recommendation

We suggest the following revision to proposed AS 1201:

.B2 In supervising the work of other auditors, the lead auditor should:

a. Inform the other auditor of the following in writing:

(1) The scope of work to be performed by the other auditor; and

(2) Tolerable misstatement,[19] <u>significant risks and other significant matters affecting</u> the ~~identified~~ risks of material misstatement,[20] and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated [21] relevant to the work requested to be performed.

Information to be obtained from the other auditor

We support the clarifying notes that have been added in AS 1201.B2. We believe the requirement in AS 1201.B2b for the lead auditor to review the other auditor's description of the audit procedures to be performed should be based on the risk of material misstatement. We also agree that the nature, timing, and extent of documentation to be requested from the other auditor (including planning documentation as well as the summary memorandum) should depend on the lead auditor's judgment as to the necessary level of review of the work of the other auditor.

Accordingly, we do not envision it would be necessary for the lead auditor to review the nature, timing, and extent of the other auditor's planned procedures in certain cases. In addition, it would neither be effective nor efficient for the lead auditor to obtain and review a description of the other auditor's detailed procedures on each financial statement line item. In circumstances when the other auditor is to perform a

[5] See page 18 of the release.

full-scope audit, and both firms are part of a network with a common methodology, the lead auditor would already have an understanding of the procedures the other auditor would be required to perform in order to provide a full-scope opinion in accordance with the network's methodology. The same would be true when the other auditor is to perform an audit of specific account balance at a location. However, the lead auditor may need to have a greater degree of involvement in directing the other auditor as to the specified procedures that are less than what would be required under the firm's methodology for a full-scope audit or an audit of a specific account balance, to the extent such procedures need to be individually tailored to the engagement.

The release acknowledges that the requirement to obtain a summary memorandum from the other auditor would be generally consistent with existing audit practice. [6] We think it would be clearer for the standard to explicitly note that the summary memorandum describing the other auditor's procedures, findings, conclusions and, if applicable, opinion could also include the documentation required to be provided in accordance with AS 1215.19. We appreciate the discussion in the release that the form and content of the communications of the results of the work performed by the other auditor can vary depending on the nature of the work performed and whether the communication occurs between affiliated firms in the same network.[7] However, we have concerns with the new requirement proposed in AS 1201.B2c that directs the other auditor to provide specified documentation for review. As the documentation in the summary memorandum and to comply with AS 1215.19 is often extensive, we believe in many circumstances the lead auditor may not find it necessary to request additional documentation for review. However, we agree with the PCAOB's statement that the lead auditor may need to request from the other auditor and review certain audit documentation in areas involving higher risk or significant judgment.[8]

Separately, as highlighted in our response to the April 2016 proposal, 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. In such circumstances, if the lead auditor determines it necessary to review specified documentation as contemplated by AS 1201.B2c, we believe the lead auditor may need to review such documentation on-site in the other auditor's country. The lead auditor may need to further tailor their approach to supervision and review depending on the challenges that are encountered. For example, we note that many jurisdictions have a statutory requirement for workpapers to be maintained in the local language. This may necessitate the involvement of translators, or the lead auditor could accomplish the objectives of a review through a combination of review of the summary memorandum and documentation in accordance with AS 1215.19 and discussion with the other auditor. We believe it is important for the standard to allow appropriate flexibility in the lead auditor's approach to obtaining, reviewing, and retaining documentation.

Our recommendation

We suggest AS 1201.B2c be deleted and incorporated into .B2d as follows:

> ~~.B2c Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed;~~

[6] See page 19 of the release.

[7] See page 19 of the release.

[8] See page 21 of the release.

.B2d Obtain ~~from the other auditor~~ and review a summary memorandum describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion~~;~~ and consider whether it is necessary to review any additional documentation; and

Note: The lead auditor should inform the other auditor of the necessary level of detail of the other auditor's summary memorandum ~~information described in paragraphs .B2c and .B2d~~ (e.g., information for certain accounts and disclosures), which detail should be determined based on the necessary extent of supervision of the other auditor's work by the lead auditor.

Note: The summary memorandum may include the documentation described in AS 1215.19.

III. Referred-to auditors / Divided responsibility

As acknowledged by the PCAOB, many circumstances in which responsibility for the audit is divided relate to significant equity method investees, in which case the lead auditor (or the company) may not have any relationship with the auditor of the equity method investee (i.e., the right or ability to engage with that auditor). We believe the changes proposed to AS 2101.14 likely would not be practicable in these circumstances, in that the lead auditor may not be able to "hold discussions with and obtain information from the [...] referred-to auditors [...] to identify and assess the risks of misstatement..." The release notes these requirements are conditioned on, and limited to, the extent to which such discussion is necessary to identify and assess the risks to the consolidated financial statements associated with the location or business unit.[9] However, we believe it is necessary for the PCAOB to provide guidance on how the lead auditor would comply with these requirements if direct interaction with an auditor is not possible.

Sufficiency threshold in prospective divided responsibility engagements

We note the PCAOB's statement in the release that the sufficiency criteria proposed to be included in AS 2101.B2 is "analogous to a quantitative threshold that appears in staff guidance set forth in the Financial Reporting Manual of the Securities and Exchange Commission ("SEC") Division of Corporation Finance." We agree the SEC's guidance is appropriate and accommodates exceptional circumstances that occur and are supportive of incorporating the concept into PCAOB standards. However, we question why different language has been introduced, and suggest the SEC's language be used instead to make clear that the PCAOB is not intending to change practice in this regard. Alternatively, the PCAOB should reaffirm in its adopting release that there is no intention to change existing practice as a result of the change in language.

Dealing with different financial reporting frameworks

In response to Question 8, while we believe the SEC's guidance[10] is clear, we would not object to AS 1206 addressing the division of responsibility when the company and its business unit use different reporting frameworks. However, we have a number of concerns with the illustrative examples included in the release and suggest further consideration be given as to how the examples are articulated. Alternatively, the PCAOB could remove these examples and allow the lead auditor to consider the most effective description based on the facts and circumstances.

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[9] See page 28 of the release.

[10] See the *International Reporting and Disclosure Issues in the Division of Corporation Finance,* Item V, *Audit Reports and Independent Auditors*, section J, *References to Another Auditor*.

The example of divided responsibility in AS 1205 does not make reference to an audit of internal control over financial reporting. We believe it is preferable to keep the examples simple, as consideration in these cases would need to be given as to which auditor considered controls related to the conversion adjustments. Additionally, we believe there are instances when the lead auditor divides responsibility in the audit of the financial statements without dividing responsibility in the audit of internal control over financial reporting. One example occurs when dividing responsibility with the auditor of an equity method investees (the most common situation for dividing responsibility today), when internal control over financial reporting relates to the controls over amounts recorded and disclosures made by the company with respect to the equity method investment, not the investee's controls over recording transactions in the investee's accounts.

We note the requirement in AS 1206.08c to "disclose the magnitude of the portion of the company's financial statements [...] audited by the referred-to auditor." Such quantification in relation to the US GAAP totals may be straightforward when the referred-to auditor has audited the conversion adjustments. However, in Example 1, when the lead auditor has audited the adjustments, it seems inconsistent to consider the adjustments in the percentages audited by the referred-to auditor.

Example 1 also includes language noting the lead auditor's opinion is "based solely on the report of Firm ABC" in relation to B Company's financial statements. This example does not appropriately take into account that B Company's financial statements are prepared in accordance with a different financial reporting framework and the lead auditor cannot solely rely on the report on those financial statements. Rather, the lead auditor needs to rely on those financial statements, together with any conversion adjustments to arrive at US GAAP figures. Consideration may also be needed as to whether users of the report can access the conversion adjustments, for example in a footnote or a supplemental schedule.

Our recommendations

We suggest the PCAOB substantially revise the examples related to these circumstances or delete them. We offer a suggestion as to how the examples could be revised in the Appendix, although we recognize the reporting may be handled differently in practice today. We also suggest adding a reference within AS 2101 footnote 25, as well as AS 1301.10d to acknowledge the responsibility for auditing the conversion adjustments.

IV. Other matters

Definitions

The SRC clarifies the lead auditor definition by stating "secondees from other accounting firms and employees of shared service centers working under the lead auditor's guidance and control (as with other individuals who work in the role of firm employees) should be treated as employees of the lead auditor's firm."[11] We suggest this guidance be incorporated into the standard by adding the following note to the definition of lead auditor in AS 2101.A4 (as well as in other applicable standards where lead auditor is defined):

> <u>Note: Individuals working under the lead auditor's guidance and control (which may include secondees from other accounting firms, employees of shared service centers, and other individuals</u>

[11] See page 34 of the release.

> who work in the role of firm employees) should be treated similar to employees of the lead auditor's firm for purposes of defining the lead auditor.

We suggest clarifying the definition of other auditors in AS 2101.A4 and AS 1201.A5 to specify the level (i.e., firm or individual from that firm) at which the PCAOB expects the lead auditor to apply the proposed requirements. Specifically, footnote 20 from page 12 of the Release should be incorporated into the proposed standard as follows:

> Note: The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm.

We note this footnote explicitly relates to application of the requirements in relation to independence and ethics. However, we believe this clarification of the level at which the standard applies would be important in relation to other proposed amendments (e.g., AS 2101.B6). The PCAOB should be clear that, when it is possible to perform certain procedures at a firm level, it does not expect the lead auditor to perform those procedures for individual members of the other auditor's engagement team, as this could result in unnecessary effort and cost.

Multi-tier audits

Paragraph 1201.B3 addresses circumstances in which an other auditor might assist the lead auditor in supervising a second other auditor. This requirement appears likely to create inefficiencies within the audit process by duplicating review of the second other auditor's work by the lead auditor without considering the fact that the first other auditor is normally in the best position to supervise and review the second other auditor, as well as to determine the scope of the audit, and identify risks of material misstatement at the second other auditor's location.

We recommend the proposal be amended to indicate that the nature and extent of the lead auditor's review of the work performed by the second other auditor should be determined by the lead auditor using a risk-based approach to ensure all auditors participating on the engagement are focused on the right work at the right time. The involvement of the lead auditor should vary depending on the risks associated with the audit performed by the second other auditor. In addition, the level of documentation (if any) to be obtained from the second other auditor should be left to the judgment of the lead auditor. For example, in lower risk situations, the lead auditor may be able to rely on the sufficiently detailed reporting of the first other auditor to the lead auditor (which is premised on the first other auditor reviewing the relevant documentation from the second other auditor). In higher risk situations, the lead auditor may consider it appropriate or necessary to review the summary memorandum of the second other auditor.

Determination to serve as the lead auditor

In response to Question 1, we support the change to AS 2101.B2b for the lead auditor to consider the importance of the locations or business units in determining the sufficiency of participation to serve 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. However, the release notes the Board has considered, but preliminarily rejected, including audit firm factors as criteria in the sufficiency determination (e.g., where the firm is licensed).[12] We believe it is important for the standard to consider the fact that, in certain jurisdictions (including within the US), law or regulation requires an auditor licensed in the jurisdiction to sign the auditor's report. This could create conflicts in determining the signing firm as compared to which firm might otherwise be determined to be the lead auditor, for example as a result of the company's operations primarily being outside the jurisdiction in which the auditor's report must be signed. In our view, this is a qualitative consideration that must be taken into account to find a solution that appropriately considers audit quality.

Due professional care

In response to Question 5, the proposed additions to AS 1015 and revisions to AS 1201 relating to the other auditor's responsibilities are appropriate and clear. Additionally, it is clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards.

Equity method investees

Further to our concern about the potential inability to interact with a referred-to auditor described in section III of this letter, we also question whether it is appropriate to view the auditor of an equity method investee in the same way as an other auditor, in particular if the other auditor is not within the lead auditor's network.

Interaction with proposals related to auditing accounting estimates

As outlined in our August 30, 2017 response to PCAOB Rulemaking Docket Matter No. 043, we have significant concerns as to how the proposed changes to AS 1105, *Audit Evidence*, have been articulated in relation to the valuation of investments based on investee financial condition or operating results. That response highlights our view that it may not be possible for the company's auditor to compel an investee's auditor to perform additional procedures given the lack of a relationship between the two. As drafted, certain requirements in paragraphs .A4 and .A5 of AS 1105 would result in an approach similar to situations that involve the auditor's supervision of other auditors, which may not be appropriate in certain circumstances, as we described above. We believe the PCAOB should consider our comments on both proposals holistically as it moves forward with its proposal related to other auditors, in particular in the context of equity method investees.

Effective date

Page 44 of the release notes the Board is considering whether compliance with an adopted standard and amendments should be required for audits of fiscal years beginning in the year after approval by the SEC (or for audits of fiscal years beginning two years after the year of SEC approval if that approval occurs in the fourth quarter). Given the potential impact of the proposals on the lead auditor's approach to planning and risk assessment, as well as the communications with other auditors, we believe the PCAOB should allow for implementation to take place over a minimum of two audit cycles (i.e., the proposals should become effective no sooner than for audits of fiscal years beginning two years after the year of SEC approval). Adequate lead time allows for firms to effectively implement the proposals, including training to the practice for both lead auditors and other auditors, which benefits audit quality.

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[12] See page 11 of the release.

Coordination with the International Auditing and Assurance Standards Board (IAASB)

We note the IAASB has a project on its agenda to consider revisions to ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. It is in the public interest to reach solutions that can bring about consistent, high-quality auditing standards when addressing the same or similar subject matters and auditing concepts. We encourage the PCAOB to engage in dialogue with the IAASB as the PCAOB moves forward in finalizing their proposal given the impact on firms' methodologies of having divergent standards addressing multi-location 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 Combs (973-236-5265) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Appendix

We suggest the following changes to the examples in AS 1206.

Example 1: Conversion Adjustments Audited by Lead Auditor

We did not audit the financial statements ~~and internal control over financial reporting~~ of B Company, a wholly owned subsidiary. The financial statements of B Company, which were audited by Firm ABC, were prepared under [name of financial reporting framework used by B Company] and ~~internal control over financial reporting were audited by Firm ABC, whose report has been furnished to us, and our opinion, insofar as they relate to the amounts included for B Company under [name of financial reporting framework used by B Company] and its internal control over financial reporting, are based solely on the report of Firm ABC. The financial statements of B Company under accounting principles generally accepted in the United States of America~~ reflect total assets of ~~constituting~~ $XX ~~percent~~ and $YY ~~percent~~ of consolidated assets as of December 31, 20X3 and 20X2 (subsequently adjusted by the Company to US GAAP amounts of $XX and $YY), respectively, and total revenues of ~~constituting~~ $XX ~~percent~~, $YY ~~percent~~, and $ZZ ~~percent~~ of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1 (subsequently adjusted by the Company to US GAAP amounts of $XX, $YY, and $ZZ), respectively. We have audited the adjustments necessary to convert the financial statements of B Company ~~to conform those financial statements~~ to accounting principles generally accepted in the United States of America.

Example 2: Conversion Adjustments Audited by Referred-to Auditor

We did not audit the financial statements ~~and internal control over financial reporting~~ of B Company, a wholly owned subsidiary. The financial statements of B Company, which were prepared under [name of financial reporting framework used by B Company] and included a footnote~~, the adjustments to conform~~ adjusting those financial statements to accounting principles generally accepted in the United States of America, ~~and internal control over financial reporting of B Company~~ were audited by Firm ABC, whose report has been furnished to us, and our opinion~~s~~, insofar as they relate to the amounts included for B Company under accounting principles generally accepted in the United States of America ~~and its internal control over financial reporting~~, are based solely on the report of Firm ABC. The financial statements of B Company under accounting principles generally accepted in the United States of America 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.