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Office of the Secretary
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Subject: Comments on PCAOB Rulemaking Docket Matter No. 042 (PCAOB Release 2017-005) Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm

The California Society of CPA's ("CalCPA") Accounting Principles and assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee has provided responses to the specific questions set forth in the release below.

Question:

1. **Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?**

The Committee supports the Board's additional criteria based on the evaluation of risk and the importance of the locations or business units for which the lead auditor performs procedures (on a disaggregated basis). The Committee agrees that qualitative considerations should be given prominence in the evaluation, while still taking into account quantitative considerations.

2. **Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?**

The Board's reference to the quantitative sufficiency criterion ("The participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.") does reflect what the profession has long utilized in practice. The Committee also agrees with the Board's position that the additional sufficiency standard creates a presumption that the lead auditor will not divide responsibility with an audit firm (or firms) that audits a majority of the company's assets or revenue.

However, the Committee believes that because SEC and other regulatory rules are subject to change, the PCAOB should replace the proposed explicit 50% quantitative threshold reference with a general requirement that the engagement partner consider existing regulatory requirements, including for example, those established by the SEC. The Committee also recommends that: (1) the provision for documenting an exceptional situation to presumptive regulatory requirements (including the 50% threshold provision) be included to provide flexibility, and (2) the Board clarify that the quantitative evaluation should not be performed to the exclusion of the evaluation of the relative importance of individual business units audited by the lead and other auditors.

To accomplish these objectives, the PCAOB could establish a third item "c" in paragraph .B2 of the proposed changes to AS 2101 noting that an engagement partner should also take into account the following incremental matter:

> *c. Existent regulatory requirements which may preclude the engagement partner's firm from serving as lead auditor, including for example, requirements established by the Securities and Exchange Commission. In the rare circumstances in which the engagement partner believes the objectives of presumptive regulatory requirement(s) can be met by alternative means, the lead auditor must document the information that demonstrates that the objectives were achieved.*

The Committee is not aware of additional challenges that need to be considered regarding the implementation of the revised requirement.

3. Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

The Committee supports the Board's consideration of a requirement for the lead auditor to obtain 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 from each other auditor that it is in compliance with independence and ethics requirements. This requirement is more robust than the current process, whereby the lead auditor typically can limit its procedures to obtaining confirmation that the other auditor is familiar with, and has complied with, the SEC and PCAOB independence requirements. The Committee also supports the Board allowing the acceptance of the other auditor's representations regarding compliance to encompass all covered persons of that firm versus the current practice of obtaining representations only from the individuals assigned to the engagement team.

However, the Committee believes the Board's additional requirement to obtain an understanding of the other auditor's "process for determining compliance" should be accompanied by further clarification of the means to obtain such information as it may not be operational as currently drafted. The Committee also suggests that the Board include its rationale for not allowing "reliance" on network independence standards. It would be helpful to understand if this presumption can be overcome in a situation where a network has sufficient procedures in place to ensure compliance by member firms, assuming the network has established definitive independence guidance, and the network firms are subject to periodic inspections. Otherwise, some practitioners may find the only way to satisfy the Board's proposed requirement would be to obtain the other auditor's independence process documents as set forth in the other auditor's quality control document and perform inquiries tantamount to those undertaken in an inspection or peer review. The Committee believes that such a requirement is unnecessary and may duplicate procedures performed during the other auditor's peer review or PCAOB inspections and made evident within corresponding review/inspection reports.

4. Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

The Committee believes the Board's additional requirement to obtain an understanding of the other auditor's "process for training and assigning personnel" at the firm wide level for determining compliance should be accompanied by further clarification of the means to obtain such information as it may not be operational as currently drafted. The Committee also suggests that the Board include its rationale for not allowing "reliance" on network training and personnel assignment standards. It would be helpful to understand if this presumption can be overcome in a situation where a network has sufficient procedures in place to insure compliance by member firms, assuming the network has established definitive training and the qualification requirements for persons assigned to PCAOB audits, and the network firms are subject to periodic inspections. The Committee believes it is sufficient to gain an understanding of the background and training of those specific individuals to be assigned to the PCAOB audit, rather than focusing on the other auditor's system of training and supervision specified in that firm's quality control document. The Committee believes the Board's proposed expansion of the lead auditor's responsibilities regarding evaluating the other auditor's independence, training and assigning personnel to be the equivalent of performing "inspection like procedures" that are unnecessary in the context of a specific audit engagement, especially for network firms. As discussed in the Committee's response to Question 3 above, the Board should provide further clarification, including under what circumstance the lead auditor could place reliance on the other auditor's PCAOB inspection reports, network inspection findings or peer review reports, if available.

5. **Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?**

The Committee supports the Board's requirement to obtain a summary memorandum from the other auditor, and the provision to allow tailoring the contents of all communications between the lead auditor and other auditor depending on the nature of the work performed on the audit by other firms (without specifying the contents of such communications).

6. **Are the proposed new additions to AS [12]01.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?**

The Committee supports the additional proposed guidance in AS 1201.B2 regarding the level of detail in the other auditor's documentation to be obtained and reviewed by the lead auditor. The Committee also believes the extent of the lead auditor's review are scalable in accordance with the requirements in proposed Appendix B of AS 1201.

7. **Are the revised proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?**

The Committee believes the Board's proposed requirements for the lead auditor to obtain, review and retain certain documents related to the work performed by the other auditors, including the work of the second tier auditor(s) in a multi-tiered audit as reasonable under the circumstances.

8. **Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?**

The Committee believes the Board's proposal to allow for a situation in which financial statements of a component are prepared under a different financial accounting framework (IFRS for example), by having either the lead or referred-to auditor audit the conversion adjustments, to be appropriate and clear.

9. **Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal?**

The Committee believes the proposed amendments and new standard are appropriately integrated into the existing PACOB auditing standards.

10. Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

The Committee believes the most significant additional cost factor arising from the revisions to the original proposal is the expansion of work required to be undertaken by the lead auditor to obtain an understanding of the other auditor's process for determining compliance with the PCAOB's independence and ethics requirements and process for training and assigning personnel. These requirements will be more burdensome on smaller registered audit firms, and may have the negative affect of reducing the available pool of interested firms able and willing to perform these types of audits in a cost effective manner. The Committee has no additional comments.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

Matthew J. Lombardi
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants