



CAQ Alert #2011-07 – March 23, 2011

DEAR CENTER MEMBERS

PCAOB Reminds Auditors of Concerns Regarding Using the Work of Other Audit Firms

On March 15, 2011 the PCAOB's (or the Board) Office of Research and Analysis (ORA) [issued](#) its first public [Research Note](#), *Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region*^[1], which highlights concerns regarding domestic registered firms' use of the work of other firms or using assistants engaged from outside the firm in conducting audits of companies with substantially all of their operations in another country, specifically the China region.

The Research Note is intended to reiterate concerns described in PCAOB [Staff Audit Practice Alert \(SAPA\) No. 6](#), *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm* related to situations where it appears U.S. firms are not complying with [AU sec. 543](#), *Part of Audit Performed by Other Independent Auditors*. SAPA No. 6 cites instances of non-compliance where U.S. firms provided audit services for companies with substantially all their operations in another country by having most or all of the audit performed by another firm or assistants engaged from outside the firm.

SAPA No. 6 describes factors to consider in determining the appropriate level of the firm's involvement in audit work performed by assistants from outside the firm including whether the:

- Auditor has appropriate understanding of the local (non-U.S.) business environment;
- Auditor has adequate information about the knowledge, skill and ability of assistants engaged;
- Auditor is able to plan and supervise the work of the assistants engaged including the additional travel time and expense necessary;
- Auditing procedures performed by assistants from outside the firm in combination with the auditor's own work provides sufficient competent evidential matter for an audit opinion;
- Assistants engaged have appropriate language skills;
- Auditor would have the ability to comply with the Board's documentation requirements.

The Research Note reminds auditors of the following examples of non-compliance noted in SAPA No. 6:

- A U.S. registered accounting firm retained an accounting firm in the China region, and the audit procedures performed by the other firm constituted substantially all of the audit procedures on the issuer's financial statements. The U.S. firm's personnel did not travel to the China region during the audit, and substantially all of the audit documentation was maintained by the firm in the China region. AU sec. 543 does not contemplate an auditor taking responsibility for the work of another auditor that has audited an issuer's financial statements substantially in their entirety.
- Situations in which U.S. registered firms have engaged assistants from outside the firm for audit work on companies with substantially all of their operations in another country. SAPA No. 6 describes one example where in order to perform audit procedures for an issuer operating in the China region, a U.S. firm engaged a consulting firm whose personnel could speak and read the language of the area in which the issuer's operations were located. The Board's inspection staff concluded that the U.S. registered firm's involvement in the audit work performed by the consultants was insufficient for the firm to assert that the audit provided a reasonable basis for the firm's opinion on the financial statements.

[1] The term "China Region" refers to the People's Republic of China, Hong Kong Special Administrative Region, and Taiwan. The Research Note describes a recent significant increase in Chinese reverse mergers (CRMs) utilized to gain access to U.S. capital markets and the related engagement of U.S. registered firms to conduct CRM audits where substantially all operations are in the China region. Based on the data collected by OCA, U.S. registered firms audited 74% of total CRM companies in the period under observation. The Research Note highlights this activity in conjunction with the related concerns raised in SAPA No. 6.

Please note that this summary is intended as general information and should not be relied upon as being definitive or all inclusive. The CAQ encourages member firms to refer to the Research Note, SAPA No. 6 and the applicable PCAOB auditing standards in their entirety at the hyperlinks provided.

Other Related Resources

CAQ Alert #2010-45	PCAOB Issues Guidance on Using the Work of Other Auditors and Engaging Assistants from Outside the Firm, July 26, 2010
SAPA No. 6	Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm, July 12, 2010
CAQ Alert #2010-25	CAQ Highlights of the PCAOB's April 2010 SAG Meeting, May 10, 2010 [Discussion of the Responsibilities of Principal Auditor]
PCAOB SAG Paper	PCAOB Standing Advisory Group Briefing Paper entitled, Responsibilities of the Principal Auditor, April 7-8, 2010

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