November 30, 2021

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

Re: PCAOB Release No. 2021-005, Rulemaking Docket Matter No. 042:
Second 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

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions.

The CAQ appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2021-005: *Second 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* (individually the proposed amendments and proposed standard, respectively, and collectively, the Second Supplemental Request for Comment or Release).

As we have previously expressed, the CAQ shares the PCAOB's goal of improving audit quality and supports the PCAOB's continued consideration of revisions to auditing standards guiding the supervision of other auditors.[1] In the time since the Board's initial proposal and first supplemental request for comment were issued,[2] there have been considerable changes in the ways public companies prepare and auditors audit financial information. Specifically, the technology available to share data and work remotely has significantly evolved as public companies and their auditors become increasingly more global. This was accelerated due to the pressing need to operate in a remote or

[1] See the CAQ's initial and second comment letters on this topic dated July 29, 2016 and November 15, 2017, respectively.
[2] The Board issued Release No. 2016-002: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Audit Firm* (the Initial Release) on April 12, 2016 and Release No. 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 First Supplemental Request for Comment) on September 26, 2017.

CENTER FOR AUDIT QUALITY
555 13th Street NW, Ste 425 E
Washington, DC 20004

(202) 609-8120
www.thecaq.org

hybrid environment as a result of the COVID-19 pandemic. Interactions between public companies and their auditors, as well as lead auditors and other auditors or referred-to auditors are less dependent on physical location allowing for increased flexibility and effectiveness.

Technology is being used to effectively support the direction and supervision of other auditors and facilitate the timely review of their work in a remote environment. The need to provide clarity for the relationships between lead auditors and other auditors as part of this important standard setting project has become increasingly relevant in light of these worldwide developments. We do not believe these developments have been fully taken into account in the Release and further revisions are needed to ensure the final amendments and final standard appropriately recognize these developments, including providing clarity for how the requirements can be met when considering the circumstances that exist today and practical changes that will arise in the future.

We appreciate the careful consideration the Board has given to comment letters received in connection with both the initial proposal and the first supplemental request for comment. We acknowledge that certain changes proposed by the PCAOB appear to be moving toward a more practical way to achieve the Board's desired outcome to improve audit quality. In this letter, we offer for the Board's consideration our views regarding certain items in the Second Supplemental Request for Comment.

<u>Overall Changes</u>

- Q1 – *In recent years, have there been changes to auditor practices related to the use of other auditors?*
- Q2 – *Have there been changes to issuer circumstances (e.g., evolving structures, use of new technology) that affect how audits of multinational companies are conducted, including with regard to work performed by other auditors?*

In recent years, there have been a number of changes in auditor practice as it relates to the use of other auditors, as well as changes to issuer circumstances that affect how audits of multinational or other companies are conducted with regard to work performed by other auditors.

A significant change is the auditor's ability to work effectively in a largely remote environment. The ways companies prepare financial information and auditors audit that information has evolved considerably both out of necessity and through technological advances. We expect this practice to continue with the rise in popularity and effectiveness of the hybrid work model. This has dramatically changed 1) the physical locations from which both finance professionals and auditors work, 2) the ways these individuals interact with each other (e.g., video conference versus meeting in-person), and 3) the ways in which information is exchanged in connection with the preparation of financial information and the execution of the audit, including increased leverage of technology and virtual tools.

While the pandemic accelerated the remote work and virtual environment trends, the audit has been evolving gradually in this direction for many years, which enabled the quick transition that occurred in 2020. Even before the pandemic, financial reporting systems and audit evidence available were increasingly becoming electronic. Audit workpapers have long been electronic at many firms and often may be accessible by reviewers remotely, although law or regulation in particular jurisdictions may impact the manner and extent of their accessibility.

The proposed amendments and proposed standard focus on the relevance of both the physical location of individuals performing work related to an audit, and the ways that information should be exchanged between parties within an audit, often in writing. In our view, these proposals do not clearly contemplate recent changes in the financial reporting ecosystem. We refer to a few issues that stem from this concept in responses to the questions below.

We also believe that it is critically important that the Board consider developments regarding the modernization of other auditing standards that have been approved since the initial proposal was issued or are expected to be approved in the near future. For example, many stakeholders recognize that International Standard on Auditing (ISA) 600 is an important standard in improving the quality of multi-location audits. The Exposure Draft of proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ED-600),[3] approved for exposure in March 2020, is a substantive revision of ISA 600. We expect ISA 600 (Revised) will be approved before the end of 2021. It will be difficult for auditors to implement the PCAOB's proposed amendments and proposed standard if they were to compete, or be incompatible, with features of ISA 600 (Revised). We encourage the Board to take this and any other recent, relevant auditing or professional standards into account to minimize differences with the proposed amendments and proposed standard.

Definitions

- Q3 – *Are the proposed definitions of "lead auditor" and "other auditor," with respect to the descriptions of individuals who work under the firm's direction and control and function as the firm's employees, clear? If not, how should the definitions be revised?*

Given the flexibility in location from which audit professionals may execute their work, as demonstrated throughout the COVID-19 pandemic, we have concerns that the definition of "secondee" included as a footnote within the definition of lead auditor in the Release is overly prescriptive.

Footnote 5 of AS 2101.A4 refers to the definition of a secondee as, "a professional employee of an accounting firm in one country who is **physically located in another country**, in the offices of the registered public accounting firm issuing the auditor's report, for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer)" (emphasis added).

In practice, there are increasingly more circumstances whereby audit firms use secondees, who are directed and supervised by the lead auditor, without requiring them to relocate from the country where the secondee's accounting firm is domiciled. In such circumstances, the secondee is treated no differently than employees from the lead auditor's firm who are working remotely within its country of domicile. We believe this footnote contradicts the diversity of ways in which the auditing profession has evolved secondee staffing models. Thus, this proposed definition of secondees could be challenging to apply in practice as it focuses on form over substance. A remote secondee works under the direction and supervision of the lead auditor in fact and in appearance other than physical location. We strongly encourage the Board to consider this circumstance in the 'secondee' definition.

The following is a suggested revision to proposed footnote 5 to AS 2101.A4:

> For this purpose, the term "secondee" refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices works under the direction and control of the registered public accounting firm issuing the auditor's report in another country, and functions as that firm's employee for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer).

[3] See ED-600.

We acknowledge that a 'secondment arrangement' is defined within the PCAOB's *Staff Guidance – Form AP, Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101, Reports on Audited Financial Statements*, issued on February 16, 2017 (Staff Guidance on Form AP). As such, the impact of any changes made to the definition of 'secondee' within the proposed amendments should be considered within Staff Guidance on Form AP and any other relevant locations.

Lead Auditor Determination

- Q4 – *Are the proposed considerations regarding serving as the lead auditor in an audit that involves other auditors or referred-to auditors – based on the importance of the locations, risks of material misstatement, and extent of the engagement partner's firm's supervision – appropriate and clear?*

We agree with the intent of the Release to increase the likelihood that the firm issuing the auditor's report performs audit procedures for a meaningful portion of the company under audit's financial statements.[4] We are generally supportive of the modifications made to the proposed amendments regarding the determination of the lead auditor because they better accommodate circumstances in which companies may have significantly dispersed operations. The addition of the third criterion for such determination, the extent of supervision, is useful in bringing a qualitative balance to the determination of the lead auditor. However, we find that the proposed amendments are still too prescriptive such that firms may be challenged to make this determination on the three listed factors alone. Determining the lead auditor involves significant professional judgment, considering both quantitative and qualitative factors. While the proposed amendments provide for three criteria in making this determination, they do not comprise a complete set of factors to be considered for purposes of making such determination, and it is not clear whether certain audit-specific factors may be considered implicitly within the three stated criteria. Additionally, the lead auditor often may not be able to fully consider certain criteria in an audit with divided responsibility, such as the identified risks of material misstatement related to the location or business unit audited by a referred-to auditor.

There is significant diversity in issuer financial reporting structures and the operation of audits involving other auditors. Therefore, auditors need to consider the facts and circumstances applicable to the audit engagement, including, but not limited to, legal restrictions in certain jurisdictions, the legal domicile of the issuer under audit, the location(s) of its books and records, and the location(s) of its executives and key decision makers. There are also factors related to the auditor and audit engagement that should be considered (e.g., professional licensing requirements, the lead auditor's knowledge of, and experience with, the other auditor, and the business environment and culture in which the other auditor operates). Given the level and types of judgment required in making this determination, we encourage the Board to allow for the ability to consider additional relevant factors in proposed AS 2101.06A. This could be done in a manner similar to AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, when critical audit matters (CAMs) were introduced. In part, AS 3101.12 states, "the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit," and then it references six specific factors for consideration in the determination of CAMs. Applying this principles-based approach to AS 2101.06A would provide additional factors for consideration when applying judgment related to the three listed criteria. We believe it would be appropriate for the proposed amendments to allow other relevant factors to be considered based on the facts and circumstances at both the issuer and audit firm levels.

Providing audit firms with the ability to consider other relevant factors, in addition to those included in the proposed amendments, would allow for the application of professional judgment when it is unclear how the three stated criteria should be interpreted, or if certain audit-specific factors may be implicitly

[4] Page 16 of the Second Supplemental Request for Comment.

considered within those criteria. Other factors should be considered in making the lead auditor determination in combination with the three stated criteria in the proposed amendments. Thus, we encourage the Board to consider modifying AS 2101.06A to provide for a more principles-based approach.

We suggest the following revision to proposed AS 2101.06A:

> In making this determination, the engagement partner should take into account the following, <u>as well as other relevant factors specific to the audit</u> in combination:

<u>Supervision of Other Auditors</u>

- Q7 – *Are the proposed amendments to AS 1201 regarding procedures to be performed by the lead auditor with respect to the supervision of work performed by other auditors appropriate and clear? Are there any practical challenges associated with the proposed amendments? If so, what are the specific challenges, and how could the proposed requirements be modified to address them?*

We agree with the purpose of the proposed amendments to improve the lead auditor's oversight of other auditors by applying AS 1201 to all audits involving other auditors for whose work the lead auditor assumes responsibility. It is important that the lead auditor takes responsibility for the overall audit process through appropriate supervision of other auditors involved in the audit. However, we have concerns that the proposed amendments included within AS 1201.08-.12 are overly prescriptive. More specifically, we encourage the Board to consider modifying the proposed amendments regarding 1) the determination of the extent of documentation from the other auditor to be reviewed by the lead auditor, 2) the ways in which risks of material misstatement and responses to such risks are communicated between the lead auditor and the other auditor, and 3) input received from the other auditor regarding risks of material misstatement and responses to such risks.

<u>Extent of documentation from other auditor to be reviewed by the lead auditor</u>

In our view, the proposed amendments do not provide a clear framework to enable a lead auditor to determine the necessary extent of documentation from the other auditor to be reviewed by the lead auditor. Doing so is important because, in our view, it directly affects what documentation may be reviewed by the lead auditor.

Paragraph 12 of proposed AS 1201 indicates that the minimum requirement regarding the extent of documentation from the other auditor to be reviewed by the lead auditor is described in paragraph 19 of AS 1215, *Audit Documentation*, and suggests that the lead auditor may direct the other auditor to provide additional specified documentation. We believe that the proposed amendments should clarify that the level of incremental information that may be reviewed by the lead auditor when the minimum is insufficient is based on the facts and circumstances of an audit engagement. There is a spectrum of documentation that could be reviewed by the lead auditor that would be determined by the level of work being performed or risks being addressed by the other auditor, among other factors. For example, the lead auditor may determine that it is only necessary to review the minimum required documentation per AS 1215.19 from the other auditor who is performing very limited work relative to the totality of audit procedures being performed in connection with the audit of the consolidated financial statements. Similarly, the lead auditor could determine that it is necessary to review more documentation from the other auditor who it has assessed to have a lower level of knowledge, skill, and/or ability.

Given this, it would be beneficial for the proposed amendments to acknowledge that the determination of the extent of documentation from the other auditor to be reviewed by the lead auditor should take into account 1) the nature of the location or business unit at which the other auditor will perform audit procedures, 2) the nature, timing, and extent of procedures to be performed by the other auditor, and 3) the knowledge, skill, and ability of the other auditor evaluated in accordance with AS 1201.06D. We believe this will provide the lead auditor with a clearer basis for making judgments regarding the extent of its supervision of the other auditor.

We highlight that these changes are particularly necessary in light of the way communications with, and supervision of, other auditors occurs when the other auditor's firm is part of the same network of firms. The proposed amendments do not appear to acknowledge that the level of effort in complying with 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, different approaches may be acceptable, and there may be limitations on what information can reasonably be obtained in relation to their firms' system of quality control, which might suggest increased involvement is necessary.

Communication of risks of material misstatement and responses to those risks
Regarding the identification and communication of risks of material misstatement and the responses designed to address those risks, the requirements under the proposed amendments state that the lead auditor should:

- inform the other auditor in writing of the identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit (AS 1201.08b(1)),
- obtain and review a written description of the audit procedures to be performed pursuant to the scope of work described in AS 1201.08a (AS 1201.09), and
- discuss and communicate, in writing, any subsequent changes to the planned audit procedures to the other auditor (AS 1201.10).

We are concerned that requiring that all such communications be made in writing is overly burdensome and often may not be necessary (e.g., if the lead auditor and other auditor are part of the same network performing procedures using a common methodology). As noted on page 33 of the Release, the proposed amendments are intended to promote proper supervision of the other auditors' work by the lead auditor and proper coordination of work performed by the lead auditor and other auditors.

These proposed requirements do not appear to acknowledge the ways in which the lead auditor and the other auditor often communicate in practice, which are ongoing and iterative in nature. Similarly, the proposed amendments do not appear to consider changes to mechanisms of communication employed by lead auditors and other auditors. These have improved significantly in recent years, particularly in light of technological advances in communication tools demonstrated by the successful shift to a hybrid work environment. Such advancements have demonstrated that the lead auditor and the other auditor can communicate effectively in real-time regarding risks of material misstatement and responses to those risks telephonically or via video meetings. Effective two-way communication like this between the lead auditor and the other auditor helps to set expectations for the other auditor and promotes the lead auditor's direction and supervision of the other auditor, which is the intention of the proposed amendments.

Given the iterative nature of the risk assessment process, these parties may agree on changes to the audit plan at various points throughout the audit. This may be executed through a conference call or video meeting. As written, the proposed amendments appear to require that any risks of material misstatement relative to the work to be performed by the other auditor, designed responses to those risks, or changes to those risks or designed responses resulting from that discussion would need to be re-communicated between the lead auditor and the other auditor, *in writing*, even if those topics were discussed and understood by and between each party via a conference call or video meeting. Thus, the requirements within the Release may inadvertently create an added administrative and cost burden to re-communicate these discussions without an incremental benefit to overall audit quality.

We agree that the initial risk assessment relative to the work to be performed by the other auditor should be communicated, in writing, by the lead auditor to the other auditor and that the initial written description of the audit procedures to be performed by the other auditor and documentation required by AS 1215.19 should be communicated, in writing, by the other auditor to the lead auditor. However, we do not believe that every iteration of the risk assessment or changes to the design of audit procedures to be performed should be written and delivered between the lead auditor and the other auditor in every circumstance if they are communicated clearly through another appropriate means (e.g., conference call, video meeting, or other similar mechanism). We ask the Board to consider clarifying the proposed amendments such that the written communication of subsequent iterations of risk assessment relative to the other auditor's scope of work and changes to the design of audit procedures to be performed by the other auditor are not required in every circumstance, and that the lead auditor can apply judgement in determining if such written communications should be made in writing depending upon its determination of extent of supervision of the other auditor.

Input from other auditors regarding risks of material misstatement

The proposed amendments are also not sufficiently clear regarding the ability of the other auditor to provide input to the risk assessment process throughout the engagement. We acknowledge that page 32 of the Release states that, "existing PCAOB standards also recognize that additional risks of material misstatement to the company's financial statements may be identified by other auditors, who could be more familiar than the lead auditor with a particular location or business unit where such risks may originate." However, this is not, but should be, clearly stated within the text of the proposed amendments. There are many circumstances in which the other auditor may be better suited to bring identified risks of material misstatements to the attention of the lead auditor throughout the iterative risk assessment process, such as when the other auditor is performing a full scope audit of a business unit within the entity under audit. The other auditor may highlight certain risks of material misstatement to the lead auditor which may be relevant to the consolidated financial statements. While the Release suggests that it may be the intent of the proposed amendments to permit the other auditor to provide input regarding the determination of risks of material misstatement, it is not clear that such discussions, which are iterative throughout the audit, could include feedback provided by other auditors.

We recommend modifying the proposed amendments such that it is clear the other auditor can be an active participant in the determination of risks of material misstatement related to the other auditor's scope of work, with appropriate oversight by and agreement with the lead auditor.

Effective Date

Consistent with the feedback we provided in our comment letter in response to the first supplemental request for comment, we continue to believe that the preparation for and the implementation of the final amendments and final standard, if they are relatively consistent with what is currently reflected in the Release, will take a considerable amount of time, especially given the global scope and the broad changes to existing practice. Implementation will likely be even more difficult for firms that do not operate in a global network, but who audit issuers that operate in multiple jurisdictions. The amount of time firms need to prepare for the final amendments and final standard also may differ based on resources and staffing availability.

Many of the changes proposed would need to be incorporated into the lead auditor's overall audit plan, and communicated to other auditors; therefore, implementation of the changes at the engagement team level will begin at the planning stage of the audit. Firm methodologies, related tools, and guidance will therefore need to be fully updated prior to the beginning of the audit year in which the final amendments and final standard become effective. Audit firms will also need to develop and implement training and effective quality control processes and procedures to support and facilitate effective implementation of the final amendments and final standard.

On pages 66 and 67 of the Release, it states that "the Board is considering whether compliance with the proposed amendments and new auditing standard 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)." We do not believe this period of time would be sufficient to support a high-quality implementation.

In order for firms to sufficiently prepare, we strongly recommend that the final amendments and final standard be effective for audits of fiscal years beginning no sooner than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth calendar quarter).

****

The CAQ appreciates the opportunity to comment on the Second Supplemental Request for Comment and would be pleased to discuss our comments or answer any questions that the staff or the Board may have regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org) or Taylor Harris (tharris@thecaq.org).

Sincerely,

Vanessa Teitelbaum, CPA
Senior Director, Professional Practice
Center for Audit Quality

cc:

PCAOB
Duane M. DesParte, Acting Chairperson
Christina Ho, Board member
Kara M. Stein, Board member
Barbara Vanich, Acting Chief Auditor

SEC
The Honorable Gary Gensler, Chair
Caroline A. Crenshaw, Commissioner
Allison Herren Lee, Commissioner
Hester M. Peirce, Commissioner
Elad L. Roisman, Commissioner
Paul Munter, Acting Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant