July 29, 2016

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


Dear Ms. Brown:

This letter provides the U.S. Government Accountability Office’s (GAO) responses to the Public Company Accounting Oversight Board’s (PCAOB) release number 2016-002, Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm. GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

As described in the proposal, the PCAOB seeks to strengthen the lead auditor’s existing requirements and impose a more uniform approach to the lead auditor’s supervision of other auditors. Such changes are intended to increase the lead auditor’s involvement in and evaluation of the work of other auditors and thus improve the quality of audits, among other things.

In general, we believe the PCAOB’s proposed changes to its standards related to the supervision of audits involving other auditors and dividing responsibility for an audit will improve audit quality. Our responses to the specific questions and related recommended revisions are included in the enclosure to this letter.

If you questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

Enclosure
Enclosure: Responses to Questions

1. Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

We believe that it is appropriate for the Public Company Accounting Oversight Board (PCAOB) to consider ISA 600 (as well as the results of IAASB’s post-implementation review) and the results of PCAOB’s inspections. We are not aware of other issues that should be considered.

2. Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor’s work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?

The proposed amendments to existing standards generally appear appropriate, except as noted in our responses below. We note that significant changes are achieved via appendix B to AS 2101 and appendix B to AS 1201. The PCAOB may consider whether it is more appropriate to include such audit requirements within the body of the corresponding standard, because it may appear to be of less importance if included as an appendix. Also, we have noted specific comments on certain proposed amendments in our responses to the questions below.

As to different business, language, cultural, and other differences between lead auditors and other auditors, the lead auditor needs to be able to effectively work with other auditors and review the other auditors’ work given these differences. However, we do not believe that requiring specific procedures is necessary.

3. Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the Board should address? Should the Board’s standards be amended to address other responsibilities of the lead auditor? Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105?

We have not identified any other areas of improvement in existing standards relating to the auditor that involve other auditors that the PCAOB should address.

4. The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.
We are not providing comments related to this question.

5. The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.

We are not providing comments related to this question.

6. The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

We are not aware of additional benefits that the PCAOB should consider.

7. The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider?

We are not providing comments related to this question.

8. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?

We are not providing comments related to this question.

9. Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?

We concur with the PCAOB’s proposed requirement for lead auditor supervision because ultimate accountability is with the lead auditor. We do not believe the proposal requires further clarification of the other auditor's responsibilities.

10. Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?

In general, we believe the proposal for dividing responsibility is adequate and appropriately considers audit quality.
11. The Board requests comment generally on the alternative approaches that the Board considered but is not proposing, as described in this release. Are any of these approaches, or any other approaches, preferable to the approaches the Board is proposing? What reasons support those approaches over the approaches the Board is proposing?

We have consistently advocated for robust standards that are in harmony among the various standard setters. While the proposed approach generally should improve the quality of audits, we believe that the PCAOB should reconsider harmonizing the “other auditor” changes to better align with AU-C 600 and ISA 600.

12. Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations?

We are not providing comments related to this question.

13. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

We are not providing comments related to this question.

14. The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

We believe that the proposed standard should be applied consistently for all PCAOB audits.

15. How much time following SEC approval would accounting firms need to implement the proposed requirements?

We are not providing comments related to this question.

16. Are the proposed definitions of: (a) “engagement team,” (b) “lead auditor,” (c) “other auditor,” and (d) “referred-to auditor” appropriate? Do the proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?
The definitions proposed in the standards appear appropriate. However, we have consistently advocated for robust standards that are in harmony among the various standard setters, so the PCAOB should reconsider the use of terminology that harmonizes with AU-C 600 and ISA 600.

17. Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?

To the extent that such personnel work under the direct supervision of the lead auditor, and such personnel comply with the corresponding requirements (e.g., independence, ethics, knowledge, skills, etc.), such personnel may be treated as part of the lead auditor.

18. Are there any situations in practice where applying the new definitions of “engagement team” and “other auditor,” including related requirements, would present practical challenges?

The applying of the new definitions of “engagement team” and “other auditor” may present challenges for firms who generally use AU-C 600 or ISA 600 as the definitions are not consistent. As noted in previous responses, we recommend that the PCAOB reconsider the use of terminology that harmonizes with AU-C 600 and ISA 600.

19. Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor’s report?

A requirement can help the lead auditor to specifically identify and document the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities, regardless of whether the individuals identified are part of the office issuing the auditor’s report.

20. To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of “lead auditor” references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?
The references to existing standards appear to describe adequately the responsibility to seek planning and supervision assistance from qualified engagement team members.

21. The proposed requirements for determining whether a firm’s participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm’s participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company’s principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?

Since the focus of the proposed requirement for determining whether a firm’s participation is sufficient for it to serve as the lead auditor is based on the risks of material misstatement, it should be left to a firm to decide based upon a consideration of the relative risk of material misstatement. We do not believe that alternative or additional criteria are necessary for determining whether a firm’s participation is sufficient.

22. What are the practical challenges with applying the proposed engagement partner’s determination of the firm’s sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?

Challenges can still exist, particularly when the company is undergoing significant valuation changes via acquisition or significant growth in revenue, especially late in the period under audit. However, the engagement partner’s determination of the firm’s sufficiency of participation in the audit can be reconsidered during the audit to address the changes. This may result in changes in the lead auditor or adding a referred-to auditor. We do not believe changes are necessary to address these challenges.

23. Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?

As presented in our response to question 22, a company undergoing significant changes in valuation via acquisition or significant growth in revenue, especially late in the period under audit, may cause changes in the firm serving as lead auditor. The proposed changes, including adding a referred-to auditor, help to address these circumstances.

24. The proposed sufficiency determination would apply for audits in which the lead auditor supervises the work of other auditors and audits in which the lead auditor divides responsibility for the audit with another firm. Should there be
different requirements for the divided-responsibility scenario, for example, should there be additional criteria that require increased lead auditor participation in a divided responsibility scenario? If so, what should those requirements be?

We do not believe that there is a need for different requirements for the divided-responsibility scenario as it relates to the proposed lead auditor sufficiency determination.

25. Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?

The proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appear appropriate and clear.

26. Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics, registration, and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?

The additional proposed requirements for the lead auditor when planning an audit that involves other auditors—which address independence and ethics, registration, and qualifications of and communications with other auditors—appear appropriate and clear.

27. The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?

We are not providing comments related to this question.

28. Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?

The requirement appears narrow and does not ensure that the lead auditor fully understands the qualifications of the other auditors. The requirement should be broader to cover the other auditors participating in the work, not just those assisting with
planning and supervision. In addition, it is not clear how in a multitiered audit the lead auditor would gain an understanding of those assisting the lead auditor with planning and supervision at the different tiers.

29. Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their workpapers appropriate and clear? If not, what changes to the proposed requirements are necessary?

The proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their workpapers appear appropriate and clear. However, see our responses to questions 34 and 35 for comments related to the communication with other auditors in a multitiered audit.

30. Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

The proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed appear to be clear and appropriate.

31. Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor’s work appropriate and clear? If not, how should the proposed requirements be revised?

The proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor’s work appear appropriate and clear.

32. Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?

The PCAOB may consider clarifying that the proposed requirements do not preclude the lead auditor from performing additional procedures to ensure the quality of the other auditor’s work. This would clarify that the lead auditor has flexibility to request or perform additional procedures (for example, visiting the other auditor).

33. Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?
The requirements for the written report from the other auditor appear sufficiently clear, and the requirements appear appropriately scalable to the nature and significance of the work referred to by the other auditor.

34. Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the 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 proposed requirements be revised?

We suggest the example in AS1201 paragraph .B3, explaining when the lead auditor directs one other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor, could be clarified to more clearly explain the supervisory procedures involving a multitiered audit.

35. In a multi-tiered audit where the lead auditor directs the first other auditor to perform certain procedures with respect to the second other auditor, is the proposed requirement that the lead auditor inform directly all other auditors of certain other specific matters appropriate? If not, how should the proposed requirements be revised?

The lead auditor directly informing all auditors appears appropriate. For instances where there is communication with a second other auditor, it may be useful for the lead auditor to inform the first other auditor of the nature and timing of the communication to the second other auditor.

36. In a multi-tiered audit, is the proposed requirement for the lead auditor to evaluate the first other auditor’s supervision of the second other auditor’s work clear? If not, how should the proposed requirements be revised?

The requirement for the lead auditor to evaluate the first other auditor’s supervision of the second other auditor’s work appears clear, but it may be helpful to include an example of how a lead auditor should address deficiencies in the first other auditor’s supervision of the second other auditor. In the multitier example, the PCAOB may consider reemphasizing the lead auditor’s responsibility for all the work, independent of whether the lead auditor depends on the other auditor’s supervision of other tier auditors.

37. Do the proposed requirements sufficiently cover the types of multi-tiered structures used today? If not, what other multi-tiered structures are used and what changes are needed to appropriately cover those situations?

We are not providing comments related to this question.
38. Do issues exist when the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor that should be addressed in AS 2101, for example, with respect to the qualifications of other auditors? What are the issues and what proposed requirements should be added to appendix B of AS 2101?

We are not providing comments related to this question.

39. Should certain of the proposed supervision procedures be required to be performed by individuals at the office issuing the auditor’s report versus the firm issuing the auditor’s report? If so, which procedures? Why should such required procedures be confined to individuals located at a particular office of the firm issuing the auditor’s report?

Given the nature of electronic workpapers and virtual communication, we question the need to require review by individuals at a particular office, assuming they are appropriately supervised.

40. Do the proposed requirements provide sufficient emphasis on the need for two-way communication between the lead auditor and the other auditor throughout the audit? If not, what changes to the requirements are necessary to further promote such communication?

The proposed requirements are generally adequate. However, the communication requirements in multitiered structures may be improved if the PCAOB adds clarity to ensure there is adequate communication among all tiers.

41. The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?

The proposed requirement in AS 1215.19A provides additional information about the review of workpapers performed by the lead auditor, but the proposed requirement could be improved by including the purpose for the review of the workpapers.

42. The proposal does not require that the lead auditor make a list of all documents in the other auditor’s files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor’s files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?
A requirement that the lead auditor list all documents in the other auditor's files would be onerous, and it is unclear that it would improve audit quality. As noted below, we believe that the lead auditor should document important information supporting the other auditor's work. Another alternative would be for the other auditor to list the documents it has prepared throughout the audit and make the list available to the lead auditor. This way, the lead auditor would be able to determine which of the documents the other auditor has prepared that should also be reviewed by the lead auditor.

43. In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature?

We would support the PCAOB requiring the office issuing the auditor’s report to obtain, review, and retain other important information supporting the other auditor’s work. This could include his or her consideration of the other auditor’s files and include appropriate information on key areas and/or documents reviewed and significant judgments made by the other auditor and the supporting rationale. For example, information about significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual because of their timing, size, or nature. The PCAOB may also consider adding a requirement for the other auditor to communicate any other matters that may be relevant to the lead auditor or that the other auditor wishes to draw to the attention of the lead auditor.

44. In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor’s report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

As noted in our response to question 43, we would support the PCAOB requiring the lead auditor’s consideration of the other auditor’s files and include appropriate information on key areas and/or documents reviewed and significant judgments made by the other auditor and the supporting rationale. This could include other matters that may be relevant to the lead auditor, such as areas of higher risks and information on additional control deficiencies, or that the other auditor wishes to draw to the attention of the lead auditor.

45. Should there be a requirement (as proposed) for the engagement quality reviewer to focus the reviewer’s attention on the engagement partner’s determination of the firm’s sufficiency of participation in the audit?
We concur with the proposed requirement that the engagement quality reviewer review the engagement partner’s determination of the firm’s sufficiency of participation in the audit.

46. Are there any additional engagement quality review procedures that should be required for audits that involve “other auditors” or “referred-to auditors” (as proposed to be defined)?

We believe the additional requirements are sufficient.

47. Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?

The objectives of the proposed new standard appear clear and appropriate.

48. Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?

The proposed requirements for performing procedures with respect to the audit of the referred-to auditor appear clear and appropriate.

49. Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?

Paragraph .06 of the proposed AS 1206 appears clear and appropriate.

50. Paragraph .07 of the proposed new standard describes the lead auditor’s course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?

We believe that paragraph .07 should be revised to focus on issuing the report without dividing responsibilities, and if not feasible, refer the auditor to AS 3101 (currently AU sec. 508), Reports on Audited Financial Statements. For example, paragraph .07 could be reworded as follows:

.07 In situations in which the lead auditor is unable to divide responsibility with another accounting firm (e.g., due to concerns about the competence or independence of the referred-to auditor), the lead auditor should consider planning and performing procedures with respect to the relevant business unit that are necessary for the lead auditor to issue an opinion on the company’s financial statements and, if applicable, internal control over financial reporting without dividing responsibility. If that is not feasible, the auditor should consider the effect of the scope limitation in accordance with AS 3101.
51. An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

The PCAOB should monitor the changes once they take effect and determine if there is an increase in the use of the divided responsibility model by auditors and its impact, if any, on audit quality. Limiting auditors’ use of the divided responsibility model may cause unintended consequences in audits.

52. Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?

We do not believe additional requirements are necessary to describe the responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm.

53. Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor’s responsibilities under PCAOB standards?

Superseding AI 10 appears appropriate, as the PCAOB is proposing to supersede AS 1205.

54. Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

The other proposed amendments relating to inquiries about professional reputation and standing of other auditors appear appropriate and clear in the context of each requirement.

55. Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?

The proposed conforming amendments in appendix 3 of the proposal appear appropriate and clear.
56. In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101?

We did not identify any other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101.

57. Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), Communications with Audit Committees, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?

We do not believe that the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' audit responsibilities should be more specific than is currently required.

58. Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, Reviews of Interim Financial Information (currently AU sec. 722, Interim Financial Information) that involve “other auditors” or “referred-to auditors” (as proposed to be defined)? If so, what additional changes are needed?

The proposal should include changes for reviews of interim financial information under AS 4105, Reviews of Interim Financial Information (currently AU sec. 722, Interim Financial Information), that involve “other auditors” or “referred-to auditors.”

59. Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206—as opposed to AS 2503—would apply to an audit of a company’s equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?

We are not providing comments related to this question.