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Via E-Mail

December 3, 2021

Office of the Secretary
Public Company Accounting Oversight Board
100 F Street NE
Washington, DC 20549

Re: PCAOB Rulemaking Docket Matter No. 042: 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 Acting Chair DesParte:

The CFA Institute appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("Board's") *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* ("Supplemental Release").

CFA Institute is a global, not-for-profit professional association of more than 178,000 members, as well as 157 member societies around the world. Our members include investment analysts, portfolio managers, advisers and other investment professionals. We have a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is to help ensure that corporate financial reporting and disclosures – and the related independent audits – provided to investors and other end users are reliable and of high quality.

We note that the Board's Supplemental Release contains additional proposed amendments to the auditing standards that have not appeared in prior Board publications. The Board first proposed changes in 2016, and in 2017, the Board proposed additional amendments. On September 28, 2021, through this Supplemental Release, the Board proposed further changes as a result of its continued review of work performed in the audits involving other auditors and the Board's engagement with stakeholders and standard setters.

Investors rely heavily on the accuracy, transparency, and reliability of the financial information they receive from public companies in order to allocate capital and make voting decisions. The Securities and Exchange Commission ("SEC" or "Commission") has long recognized that the importance of timely and accurate financial reporting cannot be overstated. For example, in December 2019, a unanimous Commission publicly stated:

> *High quality, reliable financial statements form the bedrock of our U.S. capital markets.*[1]

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[1] See SEC Chairman Jay Clayton, SEC Commissioner Robert J. Jackson, Jr., SEC Commissioner Hester M. Peirce, SEC Commissioner Elad L. Roisman, SEC Commissioner Allison Herren Lee, Statement on Appointment of New Chair and Five New Members of the Financial Accounting Foundation Board of Trustees, and Appointment of Next Chair of the Financial Accounting Standards Board (December 19, 2019), available at https://www.sec.gov/news/public-statement/statement-commission-2019-12-19-fasb-gasb-trustees.

We welcome the opportunity to provide our perspectives on the additional proposed amendments. We agree with the Board that audit quality related to multi-location audits should be improved. We also note that the improvements to the auditing standards related to audits involving other auditors has appeared on the Board's standard-setting agenda for more than ten years. Accordingly, we encourage the Board to move forward with its finalization of the amendments in a timely manner. As the Board observes, multiple audit firms are involved in approximately one out of every three issuer audits, with inspection findings of deficiencies that have persisted at an unacceptably high level (30% or higher) for nearly a decade.[2] Consequently, we strongly support Acting Chair Duane DesParte's statement[3] that "*it is…imperative that the [PCAOB]…finish this important project…*"

Summary of Our Letter

As companies' global operations have grown, the use and role of other auditors has become more significant and has evolved. Audits that involve multiple auditors in other jurisdictions and audits involving multiple auditors present unique challenges in the planning, supervision, and execution of the audit. We agree with Board Member Jurata's succinct point[4]: *"[T]he use of other auditors is pervasive and sometimes risky, so this is a key area for protecting investors."*

In general, we are supportive of the need to increase audit quality in this area and the Board's project on multi-location audits and the professional responsibilities of auditors involved in those audits. We agree with a number of the provisions but are concerned that the Board's approach may be too narrowly anchored to defining terms of art that have operated within the auditing profession for decades. Technology continues to reshape the present-day audit with digital technologies and data analysis becoming mainstays of any audit engagement. Moreover, audit firms embraced a "virtual" audit in response to the global pandemic.

We agree with the Board and previous commenters that the proposed audit standards relating to audits involving other auditors are scalable and should be applicable to the audits of Emerging Growth Companies (EGCs) as well.

We agree with the Board that all auditors participating in an audit must comply with the Audit documentation requirements of AS 1215, *Audit Documentation*. Moreover, the audit documentation must remain accessible to the lead auditor throughout the mandatory retention period.

In the sections which follow, we set forth our views on the use and definition of terms; the knowledge, skill, and ability of and communication with other auditors; the legacy requirements of Appendix K; and the lead auditor's responsibility in a tiered audit.

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[2] PCAOB Release No. 2021-005 September 28, 2021, *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,* "following a peak deficiency rate in 2012 and 2013 of approximately 40 percent, deficiency rates declined and have remained relatively consistent since then at approximately 30 percent."

[3] Duane M. DesParte, Acting Chair, PCAOB, *Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors*.

[4] Rebekah Goshorn Jurata,, Board Member, PCAOB, *Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors*.

Newly Defined Terms

The Supplemental Release proposes new definitions to certain terms and the creation of new terms, including “engagement team,” “lead auditor,” “other auditor,” “referred-to auditor,” and “investee’s auditor.” We are concerned that the proposed definitions, which are fairly prescriptive, may be out of date as soon as the Board adopts a final standard and will increasingly be so as the profession evolves. The terms used by audit firms are not ubiquitous. Nor are the terms commonly used among audit standard setters. (e.g., while the PCAOB uses the term “specialist”, the IAASB uses the term “expert”). Further, while the definitions are overly precise in certain ways, they are vague in other ways. For example, consider the multi-pronged approach for determining whether a “specialist” is or is not a member of the engagement team: For specialists to be considered members of the engagement team, the specialist must (1) be an employee of an audit firm involved in the audit, (2) assist the firm, (2a) obtain evidence or (2b) evaluate evidence. Such evidence is conditioned on the following attributes: “with respect to a relevant assertion of a significant account…” The Supplemental Release does not specify why these modifiers are necessary and appropriate.

The proposed definition of engagement team does not encompass newly developed audit technologies or processes that audit firms have developed or implemented, such as service delivery centers, centers of excellence, or other auditor-engaged specialists that may or may not be subject to the lead auditor’s system of quality control. We do not agree with the Board that at all times (now and in the future) shared service centers will be employees of the lead audit firm.

The term also fails to address the increasing use of digital audit tools. We believe that a definition of engagement team could also encompass any device or process with digital audit capabilities, such as those involving artificial intelligence (AI), rules-based anomaly detection, or complex risk assessments that embed machine learning. Whether samples are determined or selected by individuals or an algorithm operating independently or whether inventory is observed by human eyes or by the eyes of a drone guided by AI, the lead auditor should be responsible for the proper planning, supervision, and execution of the audit regardless of the individuals involved or computers, drones, or other techniques deployed.

In sum, we respectfully request the Board to reconsider its approach to these definitions. Rather than adopt a checklist approach for the definitions or the currently used nomenclature, we suggest that the definitions address the necessary roles and responsibilities regarding the planning, supervision, and execution of an audit engagement. We provide the following example as an alternative way to address the challenges we identified above:

> *Engagement Team: Individuals, organizations, technology, or independent processes that participate or meaningfully contribute to the planning, supervision, or execution of audit procedures (or review procedures concerning an interim review) related to a registered auditor’s audit or review report (whether issued or not).*

Further, the Board’s Supplemental Release provides for a number of exclusions but does not provide the reasoning or any basis for the exclusion of certain firm employees that are involved in the planning, supervision, or execution of the audit, such as the Appendix K reviewer, from the definition. We encourage the Board to consider an inclusive approach when assigning definitions to key terms that withstands the test of time and the continued rapid evolution of the audit profession.

Knowledge, Skill, and Ability of and Communications with Other Auditors

As the Supplemental Release and the persistence of inspection deficiencies confirm, the current "gain an understanding" standard of the lead auditor, which typically occurs though inquiry of and written confirmation from the other sub-auditors is no longer fit-for-purpose. A review of SEC and PCAOB enforcement matters demonstrates that audit failures occur either because the other auditor misrepresents its competency, or the lead auditor fails to adequately understand the other auditor's knowledge, skill, and ability because it is based on representation rather than observation.

In recognizing the weakness of this inquiry-only model, the Board has proposed a new requirement for the lead auditor to "determine another auditor's compliance with independence and ethics." We are very supportive of this new provision and applaud the Board for its proposal. We also note that Board's Rule 3526, which provides for communications to the audit committee, only requires communication from the lead auditor (the registered accounting firm and its affiliates) to the audit committee. Accordingly, we believe the proposed new requirement – with respect to the lead auditor determining compliance about another auditors' independence and ethics rather than simply inquiring about it – aligns more consistently the responsibility to make such determination with the communication. While we always embrace more communication between auditors and the audit committee, and Rule 3526 does not require communication about compliance by other auditors of independence and ethics rules, aligning the lead auditors' responsibility in determining and communicating compliance regarding independence and ethics is more effectively integrates responsibility and communication.

The lead auditor should use all available data and information to affirmatively conclude that the lead auditor's reliance on the knowledge, skills, and ability of the other auditor(s) is reasonable. All available data and information should include the firm's cumulative knowledge from all interactions with the other auditor. The lead auditor should only assign tasks where there is a reasonable expectation of proficiency. If information comes to the lead auditor's attention suggesting any deficiency, the lead auditor should determine whether the deficiency affects the ability to rely on the other auditor. Moreover, if the lead auditor has little or no information available, the lead auditor should consider whether the absence of such data or information is an inherent limitation that prevents an affirmative conclusion that reliance on the other auditor is reasonable.

Of equal importance is the degree of information asymmetry that may exist between auditors. For example, the lead auditor may become aware of potential fraud risk indicators that may not be available to an auditor of a subsidiary located in another jurisdiction. However, the other auditor should be informed of the potential fraud risks since they may be relevant to the quality and sufficiency of the work of the other auditor. The lead auditor should be responsible for reducing information asymmetry among all auditors to enhance overall audit quality and mitigate detection risk to a relatively low level.

We Question the Continued Retention of Legacy SECPS Appendix K

Appendix K was developed before the dissolution of the AICPA's SEC Practice Section (SECPS)[5] and creation of the PCAOB. Accordingly, the application of Appendix K is limited to the non-US firms that were formerly members of the SECPS, prior to its dissolution. The PCAOB has also created its own regulatory regime, including registration with the PCAOB of all firms that audit SEC issuers and improvements to auditing standards.

Appendix K requirements were created to address the SEC's requirement for foreign private issuers (FPIs) with financial statements prepared using a basis other than US GAAP to be reconciled with US GAAP. The SEC was rightfully concerned of the poor quality of such reconciliations, which was a frequent area of staff comment. In 2007, the SEC eliminated this requirement for FPIs that prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Further, as the profession has evolved, a relatively small percentage of FPIs were audited by non-US firms not affiliated with global networks.

Furthermore, the responsibilities of the reviewers under Appendix K appear nebulous at best. The Supplemental Release states that the Appendix K reviewer is excluded from the definition of engagement team, but there is no justification for this exclusion. Moreover, it appears that a lead auditor may be unable to justify reliance on other auditors that lack the quality control environment and procedures to address and monitor compliance with all applicable US requirements (PCAOB standards, US GAAP as issued by the FASB or IFRS as issued by the IASB, and SEC disclosure rules and regulations). We urge the PCAOB to re-consider how Appendix K is expected to contribute to audit quality in the future, whether Appendix K remains fit-for-purpose, and whether Appendix K should be retained within the audit standards.

Lead Auditor's Responsibility in a Multi-Tiered Audit

The Supplemental Release includes amendments to the auditing standards that may suggest the ability of the lead auditor to delegate supervisory responsibility. We believe that the lead auditor must be responsible for the proper planning, supervision, and execution of the entire audit.

We question, however, the threshold set forth in the Supplemental Release that a lead auditor need only audit 50 percent or more of the company's assets or revenues (a significant portion of the audit). We believe the lead auditor's analysis as to whether it can reasonably serve as the lead auditor must consider all the facts and circumstances rather than simply consolidated assets or revenues. In certain cases, income from continuing operations or another quantitative metric may be more relevant.

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[5] The SECPS was administratively created by the AICPA in 1977, in consultation with the SEC, and required member public accounting firms to subject their professional practices to peer review and oversight by the POB and the SEC. AICPA membership requires that members who provide attest services to an SEC client be employed by or affiliated with a public accounting firm that is an SECPS member. The SECPS was dissolved upon the termination of the Public Oversight Board on May 1, 2002.

CFA Institute

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Thank you for your consideration of our views and perspectives. If you have any questions or seek further elaboration of our views, please contact Robert P. Peak at robert.peak@cfainstitute.org or Sandra J. Peters at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

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