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November 15, 2017

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

Re: PCAOB Release No. 2017-005, Rulemaking Docket Matter No. 042:
*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 an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

The CAQ welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) 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* (individually the proposed amendments and proposed standard, respectively, and collectively, the Supplemental Request for Comment or Release).¹ This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

As we have previously expressed, the CAQ shares the PCAOB's goal of improving audit quality and supports the PCAOB's consideration of revisions to auditing standards guiding the supervision of other auditors as public companies and their auditors become increasingly global.² In general, we appreciate the careful consideration the Board has given to comment letters received on 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 Accounting Firm*³ and the explanations in the Supplemental Request for Comment which provide the Board's perspective and considerations on

¹ See <https://pcaobus.org/Rulemaking/Docket042/2017-005-other-auditors-SRC.pdf>.

² See the CAQ's [comment letter](#) on this topic dated July 29, 2016.

³ See <https://pcaobus.org/Rulemaking/Docket042/2016-002-other-auditors-proposal.pdf>.

the comments. In this letter, we offer for the Board's consideration our views regarding certain amendments to existing and proposed auditing standards as outlined in the Supplemental Request for Comment.

Our views are organized into the following sections:

- I. Comments on Amendments to Auditing Standard 2101, *Audit Planning* (AS 2101)
- II. Comments on Amendments to Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201)
- III. Other Matters

I. Comments on Amendments to Auditing Standard 2101, *Audit Planning* (AS 2101)

Definitions

Lead Auditor

The Supplemental Request for Comment clarifies the lead auditor definition by stating "seconded from other accounting firms and employees of shared service centers working under the lead auditor's guidance and control (as with other individuals who work in the role of firm employees) should be treated as employees of the lead auditor's firm."⁴

We suggest further clarifying the definition of lead auditor by adding the following note to AS 2101.A4 (as well as in other applicable standards where lead auditor is defined):

Note: Individuals working under the lead auditor's guidance and control (which may include secondees from other accounting firms, employees of shared service centers, and other individuals who work in the role of firm employees) should be treated as employees of the lead auditor's firm for purposes of defining the lead auditor.

Other Auditor

In the context of other auditors' compliance with independence and ethics requirements, the Board clarified the definition of other auditor in footnote 20 on page 12 of the Release text, which states:

"The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm."

This clarification, as it relates to the definition of other auditor, is important as certain proposed amendments could otherwise be interpreted such that the lead auditor would be required to perform certain procedures for individual members of the other auditor's engagement team, which may result in unnecessary effort and cost.

We suggest further clarifying the definition of other auditor by adding the following note to AS 2101.A5 (as well as in other applicable standards where other auditor is defined):

⁴ Supplemental Request for Comment, page 34.

Note: The definition of "other auditor" includes both a firm and individuals from that firm. Certain requirements would typically be applied at the firm level, as a practical matter. For participating persons who are not part of a firm, certain requirements would be applied at the individual level, as applicable.

Lead Auditor Determination

The Board has proposed changes to AS 2101.B2 to add the “importance of the locations or business units for which the engagement partner’s firm performs audit procedures in relation to the financial statements of the company as a whole, taking into account quantitative and qualitative factors” as a criterion in determining the sufficiency of participation to serve as lead auditor. We still have concerns that there could be scenarios where no one auditor would meet the criteria of proposed AS 2101.B2, such as when no individual auditor audits the risks of material misstatement associated with a larger portion of the company’s financial statements.

The determination of a lead auditor should take into account other qualitative considerations, such as legal and licensing requirements of certain jurisdictions.

For example:

Company A is domiciled in the US. Most of the officers and directors are based in the US. However, substantially all the operations take place in Country B, including all accounting and back office functions. Further, substantially all day-to-day accounting and financial reporting decisions are made in Country B with direction from the US-based management. Accounting Firm X in the US may not meet the sufficiency requirement for lead auditor under the proposed amendments because the risks of material misstatement associated with the larger portion of the company’s financial statements are directly audited by Accounting Firm Y in Country B, and it is not clear how to apply the relative importance criterion in this circumstance. However, Accounting Firm Y from Country B cannot meet the legal and regulatory requirements to issue an auditor’s report for Company A, because Accounting Firm Y cannot meet the licensing requirements in the US. Similarly, Accounting Firm X may not be able to directly perform audit procedures in Country B because of licensing or other laws and regulations governing public accounting in Country B. We believe, however, that if Accounting Firm Y is under the direction and supervision of Accounting Firm X and as such, there is sufficient involvement of Accounting Firm X in the work performed by Accounting Firm Y, Accounting Firm X can serve as lead auditor.

Other Auditors’ Compliance with Independence and Ethics

We believe it is important for the lead auditor to consider whether the other auditor has complied with the Securities and Exchange Commission (SEC) independence and PCAOB independence and ethics requirements (collectively, Regulatory Independence/Ethics Requirements). The Board is considering an amendment to AS 2101.B4, which states:

In an audit that involves other auditors, the lead auditor should determine each other auditor’s compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor’s (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements...⁵

⁵ Supplemental Request for Comment, page A2-12.

We have significant concerns related to the implementation of this proposed amendment. Requiring each lead auditor at an engagement team level to gain an understanding of each other auditor's processes (even at the firm level of the other auditor) represents a significant change in existing practice, without a clear understanding of the added benefit. It is the responsibility of each audit firm to maintain systems and processes to comply with Regulatory Independence/Ethics Requirements. To require the lead auditor to take on the responsibility for assessing another firm's processes for compliance with Regulatory Independence/Ethics Requirements would be difficult, if not impossible to execute due to practical challenges. As a result, we do not believe such a requirement will necessarily strengthen compliance and could add significant costs.

We do not believe the proposed amendment (AS 2101.B4a) would be effective as the lead auditor may not be in the best position to evaluate the processes of the other auditor's firm, which include a complex evaluation typically performed by specialized subject matter experts at a firm level. In addition, policies and procedures are proprietary to firms which may hinder the other auditor's ability to share this information. There are practical challenges due to data privacy and confidentiality restrictions particularly with out-of-network other auditors and other auditors in certain jurisdictions. Consequently, the lead auditor may not be able to effectively gain an understanding of the process for determining compliance with Regulatory Independence/Ethics Requirements as they are likely to receive a generic type response. In addition, the proposed amendment would not be efficient as it would result in a duplication of effort across many engagement teams, for both lead auditors and other auditors.

The written representation has an important role to play in considering the independence of the other auditor. Relying on a written representation is premised on consideration of a firm's system of quality control, which we believe is a crucial element of the supervision of audits that involve other auditors. We believe this is only appropriate after the auditor has obtained evidence that the other auditor has a system of quality control that is designed and operating effectively. This evidence provides the basis for relying on the system of quality control and ultimately, the written representation from the other auditor. Only when there is no such basis for reliance on the system of quality control should the lead auditor consider performing incremental procedures.

We recommend amending AS 2101.B4 as follows:

.B4 In an audit that involves other auditors, the lead auditor should ~~determine~~ obtain evidence about each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

~~a. Gaining an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements; and~~

~~b. Obtaining from each other auditor:~~

(1) 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; and

(2) A written representation stating that:

(a) The other auditor has appropriate policies and procedures in place for assessing compliance with SEC independence requirements and PCAOB

independence and ethics requirements, including consideration of matters that may reasonably be thought to bear on independence; and

(b) It is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any noncompliance.

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, or the appropriateness of the other auditor's policies and procedures, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

Related to the note above in AS 2101.B4, the Release text states “[r]elevant information about the other auditor may come either directly from the other auditor *or from other sources, such as regulatory reports or news articles.*”⁶ This statement causes uncertainty as to whether there is an expectation for the lead auditor to undertake a search for such information to comply with the requirements contained in the standard itself.

Qualifications of and Communication with Other Auditors

In determining the locations or business units at which audit procedures should be performed, proposed AS 2101.14 states the lead auditor should hold discussions with and obtain information from the other auditors or referred-to auditors, as necessary, to identify and assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit. This requirement encompasses all risks of material misstatement and not only the significant risks, and as such would go well beyond current standard practice in that such granular discussions would not necessarily take place between lead auditors and each other auditor, although it might be an appropriate response in certain circumstances, based on the judgment of the lead auditor.

In addition, there could be particular challenges in engaging in these discussions with auditors of equity method investees because the lead auditor or company does not have the right or ability to interact with the other auditor. It is our understanding that the investee's auditor may not be under any obligation to engage in such discussions with the lead auditor and provide such detailed information. For many noncontrolling investments, company management may not always have direct access to investee management to arrange for the company's auditor to perform the proposed procedures, and in some cases the company may not be entitled to such information pursuant to the terms of the investment arrangement. The Release notes these requirements are conditioned on, and limited to, the extent to which such discussion is necessary to identify and assess the risks to the consolidated financial statements associated with the location or business unit. However, we believe it is necessary for the PCAOB to provide guidance on how the lead auditor would comply with these requirements if direct interaction with an other auditor is not possible.

We note that the PCAOB is considering wider changes to the auditing standards relating to *Auditing Accounting Estimates, including Fair Value Measurements*.⁷ The PCAOB should consider aligning the requirements of these proposed amendments and changes to auditing standards relating to *Auditing Accounting Estimates, including Fair Value Measurements* to achieve its objectives when finalized.

⁶ Supplemental Request for Comment, page 14.

⁷ PCAOB Release No. 2017-002.

The Board is also considering a new requirement for the lead auditor to inquire about the other auditors' policies and procedures relating to assignment and training of individuals, and gaining an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision.⁸ While we agree that consideration of the other auditor's knowledge, skill, and ability is important to determine the nature, timing, and extent of supervision necessary (and this is already required by AS 1201.06), inquiring about how other auditors assign individuals to audits and train individuals may not be practical for the lead auditor, as such policies and procedures may be considered confidential and proprietary in nature. Consequently, the lead auditor may not be able to effectively gain the necessary understanding of the policies and procedures related to the assignment and training of individuals to the audit as they are likely to receive a generic type response. If the lead auditor did receive detailed policies and procedures from the other auditor, we are concerned this requirement would incur significant time and cost without a benefit to audit quality. Gaining an understanding of the knowledge, skill, and ability of other auditors who assist the lead auditor with planning, supervision, or review enables the lead auditor to appropriately vary the extent of supervision.

We suggest the following revision to proposed AS 2101.B6:

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

~~a. Inquire about other auditors' policies and procedures relating to the:~~

~~(1) Assignment of individuals to audits conducted under PCAOB standards; and~~

~~(2) Training of individuals who perform procedures on audits conducted under PCAOB standards, regarding the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations;~~

~~b. Gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning, ~~or~~ supervision, or review, including their:~~

~~(1) Experience in the industry in which the company operates; and~~

~~(2) Knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations, and their experience in applying the standards, rules and regulations;~~

II. Comments on Amendments to Auditing Standard 1201, *Supervision of the Audit Engagement (AS 1201)*

Lead Auditor Communications

The proposed approach in paragraph .B2a(2) of AS 1201 would require the lead auditor to inform the other auditor, in writing, of the "tolerable misstatement, the identified risks of material misstatement and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed."

This requirement to communicate identified risks of material misstatement presents a significant increase in the communications and level of work currently being performed in relation to interactions between lead auditors and all other auditors, and we do not believe it will necessarily have a commensurate benefit. We

⁸ AS 2101.B6.

believe communicating *all* identified risks of material misstatement in all cases is too broad of a requirement. We have a concern that the lead auditor may not always be in a position to identify the complete listing of risks at a location or business unit, and the other auditor should be leveraged in this regard. We suggest modifying the proposed amendments to require communication by the lead auditor of significant matters identified from discussions with engagement team members of risks of material misstatement as required by Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement* (AS 2110) paragraphs .49 - .51.

When the other auditor performs a full scope audit of the location or business unit, the other auditor is required to identify the risks of material misstatement at the location or business unit level. In these situations, the other auditor can communicate such risks to the lead auditor.

We suggest the following revision to proposed AS 1201.B2:

.B2 In supervising the work of other auditors, the lead auditor should:

a. Inform the other auditor of the following in writing:

(1) The scope of work to be performed by the other auditor; and

(2) Tolerable misstatement, significant matters identified from discussions with engagement team members of the identified risks of material misstatement as required by AS 2110.49-.51, and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed.

Review of Specified Documentation, including Summary Memorandum

Proposed amendment AS 1201.B2c requires the lead auditor to “[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed....” We believe that in a risk-based approach, the determination of documentation to be reviewed is determined by multiple factors, including the professional competence of the other auditors and the risks of material misstatement addressed by their work. For example, there could be a scenario where the lead auditor determines that they only require additional documentation related to significant risks, which would be duplicative of the requirements of Auditing Standard 1215, *Audit Documentation* (AS 1215) paragraph 19b. Auditors would benefit from guidance and examples related to the new requirements proposed in AS 1201.B2. We request that the Board clarify that there may be certain situations where it is not necessary to obtain specified documentation beyond AS 1215.19 (such as if the lead auditor determines that the extent of supervision provided is sufficient and they were involved in the planning, execution, and conclusions regarding the procedures performed by the other auditor).

In situations where the lead auditor determines it appropriate to direct the other auditor to provide workpapers, there should be some acknowledgement that there may be restrictions in certain jurisdictions. In particular, when non-network firms are used, the ability of the lead auditor to obtain workpapers or language barriers might broadly affect the lead auditor’s ability to review workpapers. It would be useful for the Board to acknowledge that specified documentation obtained by the lead auditor may include a summary of the procedures performed.

Therefore, we suggest the following revision to proposed AS 1201.B2c:

Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed, as necessary.

The Board is considering a revision to AS 1201.B2d to require the lead auditor to obtain a summary memorandum instead of a written report describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion. The Board should clarify that there may be certain situations where it is not necessary to obtain a summary memorandum beyond the requirements of AS 1215.19.

Multi-tier Audits

The Board is considering the following revision to AS 1201.B3:

"...The lead auditor should obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor (paragraph .B2d). In addition, if the lead auditor directed the first other auditor to perform the procedures in paragraph .B2a, the lead auditor should obtain, review, and retain a copy of the communications required by paragraph .B2a or equivalent documentation of the first other auditor's communication. The lead auditor remains responsible for obtaining, reviewing, and retaining the documentation required by AS 1215.19."

We are concerned about the requirement for the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor. This requirement would likely result in unnecessary duplication of effort and incremental cost without a commensurate benefit to audit quality. While we agree the lead auditor should evaluate the first other auditor's supervision of the second other auditor's work, we believe this evaluation occurs when the lead auditor obtains and reviews the information provided by the first other auditor to the lead auditor. The Supplemental Request for Comment is unclear as to how the level of activities required by the lead auditor to supervise other auditors might vary in different circumstances, and how the downstream reviews can be leveraged by the lead auditor. Although the text of the proposed amendments is explicit in allowing the lead auditor to vary the extent of supervision,⁹ requiring the lead auditor to obtain, review, and retain the summary memorandums of each other auditor in a multi-tier audit is not commensurate with a risk-based supervisory approach.

In a multi-tier audit structure, there can be very important processes and controls that occur at a regional level before "rolling up" to consolidated totals. By requiring the lead auditor to obtain, review, and retain the summary memorandum of the second other auditor, the proposed amendment introduces duplication between the activities of the lead auditor and the first other auditor. We are concerned this will have a negative effect on audit quality, because the lead auditor may decide not to use a first other auditor in order to avoid duplicative reviews (and therefore increased costs) of the second other auditor's summary memorandum. We believe it is important for the lead auditor to have the ability to rely on the first other auditor as it relates to supervising the second other auditor. For example, the first other auditor may have a unique understanding of how the information from the other entities within that region aggregate into the regional totals. The first other auditor may also have insight into the risks associated with the other entities within that region, whereas the lead auditor might not have similar insight and, as a result, a risk of material misstatement may not be identified or assessed. Additionally, there could be language barriers between the second other auditor and lead auditor as well that hinder the ability of the lead auditor to review the work of the second other auditor. In these situations, we believe it would be ineffective and inefficient to require the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor.

⁹ AS 1201.06.

We therefore believe AS 1201.B3 should not require the lead auditor to obtain, review, and retain the summary memorandum of the second auditor, unless determined necessary by the lead auditor (e.g., due to risk or other audit matters). If the knowledge, skill, and ability of the first other auditor is not appropriately considered in determining the supervisory approach, the lead auditor may spend time that is unwarranted reviewing the work of a competent second other auditor. This may result in less time for the lead auditor to focus on higher risk areas, especially during the execution and completion phases of the audit, which could therefore have a detrimental effect on audit quality.

Therefore, we suggest the following revision to proposed AS 1201.B3:

.B3 In some audits, the engagement team may be organized in a multi-tiered structure. For example, an other auditor might audit the financial information of a location or business unit that includes the financial information of a sub-location or subunit audited by a second other auditor. As another example, an other auditor might assist the lead auditor in supervising a second other auditor.²⁴ In these situations, the lead auditor may direct the first other auditor to perform the procedures in paragraph .B2 with respect to the second other auditor on behalf of the lead auditor, if appropriate pursuant to the factors in paragraph .06. The lead auditor, in supervising the first other auditor, should evaluate the first other auditor's supervision of the second other auditor's work. To do so, the lead auditor may request information provided to the first other auditor by the second other auditor as deemed necessary. ~~The lead auditor should obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor (paragraph .B2d). In addition, if the lead auditor directed the first other auditor to perform the procedures in paragraph .B2a, the lead auditor should obtain, review, and retain a copy of the communications required by paragraph .B2a or equivalent documentation of the first other auditor's communication.~~ The lead auditor remains responsible for obtaining, reviewing, and retaining the documentation required by AS 1215.19 from the first other auditor.

Further, in a multi-tier audit structure, it is unclear whether the lead auditor can delegate supervision of the requirements in AS 2101.B4 and AS 2101.B6 (understanding of independence, ethics, and qualifications) to the first other auditor. If the first other auditor is supervising the second other auditor, we believe the first other auditor is in the best position to understand independence, ethics, and qualifications of the second other auditor. Therefore, delegation by the lead auditor of such responsibilities to the first other auditor should be permissible and the standards should be modified accordingly.

III. Other Matters

Economic Impact

In its Supplemental Request for Comment, the Board states that it “has preliminarily concluded that the impact of the revisions discussed in this release relative to the 2016 Proposal would be negligible from an economic perspective – in other words, they would not significantly change the analysis set forth in the 2016 Proposal.”¹⁰ We believe the proposed amendments in the Supplemental Request for Comment will have a significant economic impact for auditors and companies as we have begun to identify in this letter. Implementation will also require significant investment in information technology solutions that will work across jurisdictions. Different firms utilize different systems today, and as such, these solutions will be complicated and expensive to develop.

¹⁰ Supplemental Request for Comment, page 42.

Effective Date

The preparation for, and the implementation of the proposed standard and proposed amendments 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 proposed standard and proposed amendments also may differ based on resources and staffing available.

Many of the changes proposed would need to be incorporated into the overall audit plan, and communicated to other auditors; therefore, implementation of the changes at the audit 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 revised standards 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.

In order for firms to sufficiently prepare, we strongly recommend that the proposed standard and proposed amendments 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 quarter).

The CAQ appreciates the opportunity to comment on the 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.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

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