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Phoebe W. Brown, Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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30 November 2021

Re: 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 PCAOB Rulemaking Docket Matter No. 042

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on the 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.

We appreciate the efforts the PCAOB has made to take into account our views and those of other stakeholders, particularly our comments about the lead auditor determination and the importance of making the requirements risk-based and scalable. While we continue to support the PCAOB's efforts to strengthen the requirements for the lead auditor in an audit involving other auditors, we still have some questions about the practical application of the proposal, which could benefit from further clarification from the Board.

Our comments focus on the following areas where we believe the proposal and the changes the Board is considering making can be improved:

- Lead auditor determination
- Supervision of other auditors and identification of the risks of material misstatement
- Effective date
- Other matters

Further, we ask that the Board consider the revisions the International Accounting and Auditing Standards Board has proposed for International Standard on Auditing (ISA) 600 and minimize any differences between the ISA and PCAOB standards that may require firms to develop different systems, policies and controls. Such differences may divert resources that could otherwise be focused on audit quality and thus have the unintended consequence of adversely affecting audit quality.

Lead auditor determination

We agree with and appreciate the Board's proposal to add a consideration for making the sufficiency determination that would focus on the extent of the engagement partner's firm's supervision of other auditors' work in proposed paragraph .06Ac of Auditing Standard (AS) 2101, *Audit Planning*. We also appreciate the reminder that the involvement of the lead auditor should be commensurate with the risks. However, we still have questions about how the auditor would evaluate the factors in proposed paragraph .06A of AS 1201 in combination, especially when considering applicable legal and licensing requirements, and ask that the Board further clarify its intention.

We previously raised concerns about whether any firm would be able to serve as lead auditor in audits of companies with major operations outside of the company's corporate domicile and audits of companies subject to various laws and regulations that require the company's audit report to be issued by a firm located in the jurisdiction where the company is domiciled. While the Board acknowledged these concerns in the latest release and communicated that the framework in the latest proposal should enable lead auditors to effectively determine sufficiency of lead auditor participation in multi-firm and multi-jurisdictional audits, we believe additional guidance is necessary to illustrate when this framework would and would not result in sufficient lead auditor participation.

We believe that professional judgment is necessary to evaluate the qualitative and quantitative factors in the lead auditor determination. Our understanding is that, under the latest proposal, an engagement partner may serve as lead auditor by adjusting the extent of his or her firm's supervision of the other auditors' work to overcome instances where the other auditors are performing audit procedures for significant parts of the audit (i.e., significant based on the risks of material misstatement and importance of locations or business units as described in the proposal). However, it is unclear whether this was the Board's intent or when a combination of factors would preclude the engagement partner's firm from serving as lead auditor.

Thus, it would be helpful for the PCAOB to acknowledge that an auditor who performs relatively fewer audit procedures on global business units can still be considered the lead auditor based on legal or regulatory requirements and his or her firm's supervision of other auditors. We believe the Board should also indicate in any final standard that in cases where an auditor is best suited to issue the audit opinion, and therefore serves as lead auditor, but does not audit a large part of the entity, the Board expects the auditor's involvement in the work of other auditors to increase accordingly.

Risk of material misstatement

We support the latest proposed amendments to AS 1201, *Supervision of the Audit Engagement*, that would clarify that the lead auditor should communicate "relevant" matters to the other auditor. However, we are still concerned that the proposal would require written communications by the lead auditor to include an extensive list of all relevant risks of material misstatement identified at every in-scope component throughout the audit. We believe such a requirement would go beyond AS 2110.49-53, which requires engagement team members to discuss the risks of material misstatement. Additionally, the proposal would create an unnecessary difference with proposed ISA 600, which emphasizes two-way communication between the lead auditor and other auditors.

We believe that requiring the lead auditor to communicate all relevant risks of material misstatement in all cases would not be consistent with the Board's intent to improve supervision of other auditors, especially the Board's objective of having lead auditor involvement be commensurate with the risk of material misstatement associated with the locations audited by other auditors. Additionally, requiring the lead auditor to communicate all relevant risks of material misstatements does not recognize the other auditors' critical role in the risk assessment process, given their understanding of the business unit and culture of a location where a business unit is located. In these instances, the risk assessment process is iterative and involves two-way communication between the lead auditor and other auditors. We believe that when the lead auditor can appropriately supervise other auditors and leverage the other auditors' experiences and knowledge of the entity and the environment in which the component operates, the lead auditor should not be required to provide a list of all relevant risks of material misstatement. Instead, we believe the communication should be tailored to additional matters that warrant the attention of the other auditor.

The Board said in the 2016 proposal that its intent was to mitigate possible unintended consequences by proposing risk-based supervision requirements. Specifically, the Board said the lead auditor should focus its efforts on audit areas with the greatest risk of material misstatement to the financial statements. This should result in an appropriate focus on the riskiest audit areas, whether those areas are audited by the lead auditor directly or by another auditor under the lead auditor's supervision. Further, AS 2110.49-.53 does not contemplate the written communication of all identified risk of material misstatements, but instead requires discussion among engagement team members of the risks of material misstatement and the potential for fraud.

We recommend that, instead of requiring written communications of all relevant risks of material misstatement, the Board require the lead auditor to communicate significant matters the lead auditor is aware of that would affect risks of material misstatement already identified by the other auditors. We believe changing the focus of the requirement from a written communication to a more principles-based requirement would recognize that other auditors should be involved in the risk assessment process and that ongoing two-way communication is expected between the lead auditor and other auditors throughout the audit process. We believe this involvement can be achieved in various ways, including through relying on the other auditors' procedures, as deemed necessary by the lead auditor. The lead auditor should be able to use professional judgment taking into account, among other things, the other auditor's knowledge, skills and abilities when determining the extent of its review of the other auditor's identification of risks of material misstatement to appropriately focus its efforts on audit areas with the greatest risk of material misstatement to the financial statements. This would also be more consistent with AS 2110.49-.53, which requires a discussion of matters affecting the audit plan.

We recommend the following edits to clarify the lead auditor communication related to risk of material misstatement in proposed paragraph .08 of AS 1201 to align with the objective of AS 2110.49-.53:

> .08 The lead auditor should inform the other auditor in writing of the following matters:
>
> a. The scope of work to be performed by the other auditor; and

b. With respect to the work requested to be performed:

(1) Significant matters affecting the ~~identified~~ risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit as required by AS 2110.49-53;

(2) Matters that are relevant to the other auditor's design or performance of risk assessment procedures for purposes of the audit of the consolidated financial statements;

(3) Tolerable misstatement; and

(4) The amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.

Note: The lead auditor should, as necessary, hold discussions with and obtain information from the other auditor to facilitate the performance of procedures described in paragraph .08. For example, this may include the other auditors' understanding of the risks of material misstatement applicable to the location or business unit.

Effective date

Because the proposed changes would affect the planning for audits, audit teams must be prepared to adopt the standard at the beginning of an audit cycle. Given the expected effort required, we continue to believe that firms would need at least 18 months between Securities and Exchange Commission (SEC) approval and the beginning of the fiscal year in which a final standard is effective to implement a framework to comply with the requirements. As a result, we recommend that the standard be effective for audit periods beginning no sooner than two years after the SEC approves the final standard.

Other matters

Definition of lead auditor

We appreciate the Board's clarifications to address individuals who work under the direction and control of the lead auditor and its proposal to have the standard say that they function as employees of a firm and therefore would fall under the definition of lead auditor.

We believe the standard should expressly state that other individuals employed by a different registered accounting firm or a shared service center who work under a firm's direction would be included in the definition of lead auditor. The latest release is more explicit about this point, but the examples in footnotes 25 and 27 of the release should be included in the definition of lead auditor to make sure there is no confusion when the standard is finalized.

Definition of investee auditor

We recommend that the Board define the term "investee auditor," which it proposed adding to AS 1105, and clarify in the final amendments that the investee auditor is not considered an "other auditor." This message is explicit in the release, but it is not apparent in the proposed amendments.

Definition of other auditor and multi-tier auditor

We also recommend that the Board define "other auditor" in a manner that is more principles-based and focuses on how the auditor will be used in the audit. For example, an other auditor could be defined: "An auditor who, at the request of the lead auditor, performs work on financial information related to one or more locations or business units for the audit under the supervision of the lead auditor."

We also recommend that the Board move the definition of multi-tier auditor to Appendix A — Definitions of the standard.

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We want to again thank the Board for its consideration of this letter and the comments we previously submitted on this topic. We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst + Young LLP

Copy to:

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