PCAOB Rule Making Docket No. 042

Response to Request for Public Comment on the PCAOB's Proposed New Requirements for Lead Auditors Use of Other Auditors

I am a retired KPMG audit partner. I spent 26 years at KPMG, including 17 years as an audit partner. I also spent nine years at the PCAOB leading inspections of audits of US public companies and foreign private issuers. I was also the Regional Leader of the PCAOB's Orange County and Los Angeles offices. Currently, I provide expert witness services in disputes involving accounting, auditing, and corporate governance. I recently published a book titled "***The Truth About Public Accounting – Understanding and Managing the Risks the Auditors Bring to the Audit***."

I am responding specifically to questions 6 and 7 of the PCAOB's Proposed New Requirements for Lead Auditors Use of Other Auditors. Those questions and my comments are repeated below.

PCAOB Question 6: Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, clear and appropriate? Are there any practical challenges associated with the proposed amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

AS 2101 *Audit Planning* includes a caption preceding paragraph .06 that reads "Preliminary Engagement Activities – Additional Considerations of Audits Involving Other Auditors or Referred Auditors." I am concerned that the proposed revisions to this standard omit several considerations about the use of "other auditors" that are important for the lead engagement partner to consider in order to appropriately plan and supervise the work of other auditors. Below are the considerations I believe have been omitted:

1. The auditing profession has evolved in individual countries at varying rates across the globe. Jurisdictions where auditors face greater legal liability for failed audits have tended to make faster progress on the road to audit quality. This risk differential should be considered in engagement planning and in determining the appropriate level of lead partner supervision.
2. While the largest audit firms generally have some sort of "global organization," the reality is that the structure of the global network firms is more akin to the United Nations with limited consistency across member firms. The global organizations of these audit firms lack the clout of a multinational corporation headquarters to drive consistency from country to country (although audit methodologies have migrated toward increasing commonality with some variation for local country requirements).
3. There are varying degrees of audit regulation from country to country.
4. There are varying PCAOB inspection success rates by firm by country.
5. There are varying audit firm internal inspection success rates by country.
6. There are varying inspection success rates on inspections conducted by the global firm (in firms where a global inspection function exists).
7. There are varying rates of audit failures by firm and by country.

8. There are varying levels of fraud risk from country to country (kickbacks, bribes, money laundering). There are third party resources that regularly measure and report on these risks by country.
9. There is risk that "in country" work will be prioritized over "referred work from other countries."
10. There are varying degrees of cooperation by country audit practices with US regulators (i.e., no cooperation currently from the PRC).
11. Varying language challenges, including cultural nuances that can undermine effective auditing and communications.
12. Prior year experience with the "other auditor" engagement teams is another data point to be considered.

Some might suggest this is onerous. However, a "global office" repository of this information may already exist. The global office can streamline the dissemination of this information to those lead engagement partners who need it. Think of the global office as a service bureau providing a report that will help lead partners manage the risk that global network firms bring to the global audit.

These risk factors should be spelled out in the PCAOB's proposed standard rather than left to chance.

PCAOB Questions 7: Are the proposed amendments to AS 1201 regarding procedures to be performed by the lead auditor with respect to the supervision of work performed by other auditors appropriate and clear? Are there any practical challenges associated with the proposed amendments? If so, what are the specific challenges, and how could the proposed requirements be modified to address them?

Paragraph .09 on Appendix 3 (page A3-19) seems to imply that the level of detailed description of audit procedures communicated to the lead engagement partner can vary based on the extent of supervision contemplated by the lead audit partner. The reality is that someone is going to develop a detailed audit program to be executed by the audit team. If that is going to happen, why not share the detailed audit program with the lead engagement partner? I realize that one consideration might be that the audit program is written in something other than English. Let's set that concern aside for a moment.

At one extreme, you may have the lead partner telling the "other auditor" to do a full scope audit with a set level of materiality – and the "other auditor" takes the ball and runs with it. The "other auditor reports back, "We conducted the scope of audit you requested and here are the issues and adjusting entries we identified." This level of communication can give rise to an expectation gap which exposes investors to an avoidable audit failure. This can also be a problem in specialized industries where the other auditor may not be very familiar with 1) the unique auditing challenges, 2) the relevant accounting, auditing, or disclosure framework, or 3) simply how to approach the audit.

There are two other reasons to make sure there is a detailed meeting of the minds on the scope of procedures to be performed:

- The negotiation of audit fees for work at the foreign locations can be a headache. The US firm is typically looking for the foreign audit work to be performed during the peak of the busy season. Fee pressures can have an adverse effect on the level of attention devoted by the "other auditor."
- The other auditor will naturally want to prioritize service to their home country clients because the level of service provided to those clients more directly affects client retention (whereas the level of service provided to the audit of a foreign subsidiary of a US firm is less likely to jeopardize the recurring work in the foreign location). There is an elevated risk that the best and brightest may not get assigned to the referred work.

Long story short, these are real threats to audit quality. This risk of short-cuts or getting short-changed can be reduced if the lead engagement partner sees the detailed audit program.

Now back to the language issue. Someone will need to bear the cost of translation. However, once this is done, translation costs should be sharply reduced in future years because the scope of work would be less likely to change significantly over time.

I hope you find these comments helpful.

Sincerely,

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