



Federation of European Accountants

Office of the Secretary
PCAOB

Sent by email:
comments@pcaobus.org

Brussels, 26 July 2016

Subject: The Federation comments on the PCAOB Proposal to “Strengthen Requirements for Auditor Supervision of Other Auditors”

Dear Sir or Madam,

- (1) The Federation of European Accountants (the Federation) appreciates the opportunity to comment on the PCAOB Proposal to “Strengthen Requirements for Auditor Supervision of Other Auditors”. Our main comments are summarised hereafter.
- (2) The IAASB is in the process of reassessing the approach of ISA 600 and acknowledges the differences with the PCAOB’s approach in its recent Invitation to Comment *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*. The PCAOB and the IAASB should seek to learn from each other’s work in this area to identify the right common approach; it would be helpful if the revised PCAOB standards could be compatible with the IAASB standards, except where jurisdictional particulars dictate otherwise.
- (3) The development and application of quality control systems within firms and across networks have been critical in enhancing audit quality in the last decade. The lead auditor work on the quality control systems of other auditors is key to many group audits’ approach. The proposal acknowledges the importance of quality controls, but dismisses their value, which risks acting as a disincentive to apply them. Consequently, the Federation believes that the factors to be considered in AS 2101.B6 should be expanded to include reference to the other auditor’s quality control system. In addition, the Federation also suggests that when the other auditor operates in a non-US jurisdiction, the existence of a robust auditor oversight regime would be a further factor in this context.

- (4) As they stand, the proposals treat the logistics of complex group audits as if they were simpler than they actually are. These proposals seem to disregard the current logistical aspects of real complex group audits by specifically requiring the lead auditor to bypass middle level auditors at regional level in certain instances. In particular, the proposal for the lead auditor to inform directly the second other auditors of certain specific matters in addition to informing the first other auditors is inappropriate and could be seen as encouraging a level of distrust, potentially undermining the authority within the chain of command. To cope with clients' complex business environments, auditors have developed a range of approaches to work in accordance with how corporates are organised globally. Multi-layered audits are common, barriers to access information prevalent. Lead auditors may decide to use the work of other auditors, send their own people in, use questionnaires, review files either on site or remotely, use translators in meetings with other auditors, have schedules or reports translated. They may focus on quality control policies and procedures or ignore the work performed by other auditors. However, they cannot make any general assumptions, the conduct of such audits very much depends on specific facts and circumstances. For instance, it is not always better for the lead auditor to perform the work than for the other auditors, it is not always better to visit locations than to review files remotely, and it is not always better to review files than it is to use questionnaires.
- (5) The proposals, taken as a whole, seem to be underpinned by a belief that lead auditors should trust no-one except when obliged to, and that they should seek to perform the work themselves wherever possible. This approach is practically unworkable in today's modern audit environment. The Federation is of the opinion that the proposals give insufficient emphasis to the concept of delegation foreseen in AS 1201.05.
- (6) The proposals also appear to be about 'tightening up' requirements, and making sure that the lead auditor is sufficiently involved in the audit. They also ensure that other auditors perform their work as expected. At this point, governments and regulators who play an important role in improving the audit quality, including the PCAOB and the SEC, should continue the dialogue to overcome the long-term structural barriers to these objectives. The dialogue with non-US audit regulators should also continue to focus on finding workable solutions for both auditors and regulators.
- (7) Moreover, the proposals appear to be designed to deal with problems the PCAOB has experienced in inspecting audits in specific jurisdictions. While the PCAOB needs to address the problem at different levels, requiring through auditing standards information the PCAOB and auditors have been unable to obtain through regulatory dialogue is questionable as an approach and unlikely to improve audits in practice. These structural issues should not be dealt with within standards only and the dialogue with non-US audit regulators should continue to focus on finding workable solutions for both auditors and regulators.
- (8) The existence of networks is important and should be discussed in the PCAOB standards. The lead auditor's consideration as to the suitability of another auditor should involve an assessment of various factors taken in combination rather than in isolation.

Our detailed responses to the questions included in the Proposal are set out in the Annex below. For further information on the Federation's letter, please contact Hilde Blomme on +32 (0)2 893 33 77 or via email at hilde.blomme@fee.be or Eleni Ashioti on +32 (0)2 893 33 87 or via email at eleni.ashioti@fee.be from the Federation's team.

Kind regards,

On behalf of the Federation of European Accountants,



Petr Kriz
President



Olivier Boutellis-Taft
Chief Executive

About the Federation of European Accountants

The Federation of European Accountants represents 50 professional institutes of accountants and auditors from 37 European countries, with a combined membership of over 875,000 professional accountants working in different capacities. As the voice of the European profession, the Federation recognises the public interest.

The Federation is in the EU Transparency Register (No 4713568401-18).

Annex: Responses to Questions

Questions 1 & 2: Background and Reasons to Improve Auditing Standards and Discussion of Proposed Amendments

- (1) The reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors. We acknowledge the PCAOB's efforts to include incremental improvements in the standards to address audit deficiencies in the work of other auditors which the lead auditor did not address or identify in so far as they impact the quality of the audit. The fact that the lead engagement partner needs to take a risk-based approach necessarily means that not all types of deficiencies as noted by the PCAOB inspection teams will be addressed by revising the responsibilities of the lead auditor.
- (2) The proposals appear to be about 'tightening up' requirements, and making sure that the lead auditor is sufficiently involved in the audit. They also ensure that other auditors perform their work as expected. Governments and regulators, which play a significant role in improving audit quality in general and cross-border group audits in particular, should continue dialogue to overcome the long-term structural barriers to these objectives.
- (3) The proposals also appear to be designed to deal with problems the PCAOB has experienced in inspecting audits in specific places. While the PCAOB needs to address the problem at different levels, requiring through auditing standards information the PCAOB and auditors have been unable to obtain through regulatory dialogue is questionable as an approach and unlikely to improve audits in practice. These structural issues should not be dealt with within standards only and the dialogue with non-US audit regulators should continue to focus on finding workable solutions for both auditors and regulators.
- (4) The PCAOB proposals do not seem to be risk-based, but very much rules-based and prescriptive. The requirement in relation to documentation, in particular, is highly prescriptive. The objective of this requirement seems to be to facilitate review by the regulators without a need to refer to the other auditors. We question how this will improve audit quality in practice. Understanding what has been done is better achieved through file review with coordination, involving discussions between the lead auditor and the other auditors, especially when the files are in a foreign language. In addition, there will be many situations in which evaluating the engagement partner's determination of the firm's sufficiency of participation is a formality. A risk-based approach would require a review taking into account the specific facts and circumstances.

Question 3: Discussion of Proposed Amendments

- (5) One particularly important issue not discussed in the PCAOB's proposals relates to the interaction between the lead auditor firm with its network. The existence of networks is important and should be considered within the standards. However, given the current jurisdictionally-focused audit regulatory system, regulation on a network-wide level is still a challenge. After giving appropriate consideration and providing documentation, it would be appropriate if firms could rely on aspects of the networks' organisation, systems, and controls. Networks are necessary and their complexity is expected to evolve in order to follow the economic trends whereby operating and corporate models are becoming more and more complex, using for instance off-shoring, shared-service centres, etc.

- (6) This notwithstanding, the lead auditor’s consideration as to the suitability of another auditor should involve an assessment of various factors (appendix B of AS 2101) taken in combination, rather than in isolation. For example, whilst shared training arrangements may be a persuasive argument in favour of a particular firm in certain engagements, this criterion may need to be weighed in combination with factors such as knowledge and experience in a particular industry. We also wonder whether the factors included in the above mentioned appendix B are comprehensive enough. Quality control and/or regulatory oversight aspects of the firm could be considered as very relevant factors to be considered.
- (7) In addition, further guidance might be helpful on the following aspects:
- How to determine materiality where there is a large number of insignificant components;
 - What constitutes sufficient appropriate evidence in groups where non-significant components represent a large proportion of the group;
 - The approach to be taken when using/auditing shared service centres;
 - Qualitative considerations regarding the sufficiency of participation.

Questions 4-12: Economic Analysis

- (8) There is a need to consider the impact on small- and medium-sized practitioners (SMPs), as the proposals predominantly address issues faced by very large audit firms. In addition, SMPs are often involved in group audits in the capacity of other auditors.
- (9) Moreover, the requirements included in the proposals are likely to raise costs. the PCAOB notes that, while auditors incurring higher costs to implement the proposed requirements may have difficulty justifying the changes to the audited entity, they may pass “at least part” of those costs to the client. The occurrence of such costs is inevitable, however the PCAOB should not comment on how additional costs should or are likely to be absorbed. We wonder whether a proper cost-benefit analysis has been performed to ensure that these additional costs have a real impact on audit quality.
- (10) The fact that quality control is not recognised as a factor to assess the suitability of the other auditor may have the unintended consequence of reducing quality controls applied in practice. Furthermore, quality controls facilitate the use of output with reduced testing thereof. If reduced testing is not permitted, the purpose of quality controls may be put into question.
- (11) In relation to the amendments proposed in AS 1201 *Supervision of the Audit Engagement*, we recognise the PCAOB’s effort to require the lead auditor to focus only on those areas where they identify that reviewing the work undertaken by another auditor is the most warranted.
- (12) As concluded by the Board, we agree that providing interpretive guidance, increasing inspections or enforcement actions alone would be less effective in achieving the Board’s objectives than in combination with amending auditing standards. We strongly support this holistic approach, but we also urge the PCAOB to further consider the impact of inspection and enforcement as there is scope for more change in these areas to effectively improve audit quality.
- (13) Lastly, we agree with the Board’s decision not to propose:
- A requirement based on quantitative thresholds;
 - Additional criteria for determining sufficiency of participation based on the location of the company’s principal assets, operations, and corporate offices;
 - Requiring the lead auditor to gain an understanding of the qualifications of all engagement team members outside the lead auditor’s firm.

Question 13: Considerations for Audits of Emerging Growth Companies

- (14) Nothing to report.

Questions 14: Applicability of the Proposed Requirements to Audits of Brokers and Dealers

- (15) Nothing to report.

Question 15: Effective Date

- (16) The proposed requirements would require 18 months to implement as a minimum.
- (17) In addition to training and the update of methodologies generally, group reporting instructions would need to be amended. The first year under the new regime would require additional planning and scoping, as well as re-negotiation of the terms of engagement in some cases.

Questions 16-59: List of Appendices

Questions 16-20: Terminology – Proposed Definitions

- (18) Some revisions in the wording of definitions need to be considered, such as the notion of the term of “lead auditor” which seems quite legalistic.
- (19) The proposed definition of engagement team includes “[...] other professional staff employed or engaged by the lead auditor or other accounting firms”. The focus should be more about who is supervising the work, rather than who is responsible for the remuneration. The requirement for the lead auditor to specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor is unnecessary.
- (20) The proposals seem to be underpinned by a belief that lead auditors should trust no-one except when obliged to, and that they should seek to perform the work themselves wherever possible. This approach is practically unworkable in today’s modern audit environment.
- (21) Last but not least, reference to existing standards that describe making appropriate assignments of engagement responsibilities are sufficient. There is no need for the PCAOB to explain further or repeat itself as it is less likely to change auditor behaviour than having a robust inspection and enforcement of words that are already clear.

Questions 21-30: Proposed Amendments to AS 2101 Audit Planning

- (22) The important point, with respect to determining the sufficiency of a firm’s participation to serve as the lead auditor in an audit that involves other auditors or referred-to-auditors, is that the lead auditor should be able to explain the rationale behind deciding on the level of involvement and why it is sufficient to conclude on this part of the group audit. Some criteria proposed in AS 1201 for determining whether the firm’s participation is sufficient are unworkable and do not allow to adapt to the specific facts and circumstances. Professional judgement should be factored in when determining the level of participation.
- (23) The sufficiency of participation cannot be considered in isolation, the manner in which the lead auditor interacts with the other auditors is critical. Examples should be provided to show how the audit approach changes in situations where participation is sufficient or not.

- (24) The PCAOB's proposals focus on the audit of a large proportion of the relevant risks, but statutory requirements focus on the consolidated financial statements. The two are often mutually exclusive because of group structures. The proposals as they stand would mean that either no-one could serve as the lead auditor, or two auditors would need to be appointed in some cases, one for statutory purposes and one for PCAOB purposes.
- (25) Although Appendix B refers to "discussions" with other auditors, it seems to suggest that one-way written communications should be the norm. Appendix 4, paragraph. AS 1202.B2a in particular, states that the lead auditor should obtain information, but does not refer to a two-way communication or a need for the other auditors to pass information regarding risks. A timely and two-way communication between the lead engagement team and the other auditors should be encouraged. To this end, the Federation suggests that the required direction under AS 1201.05b for engagement team members (which under the proposals would now include other auditors) to communicate with the engagement partner/ engagement team be expanded to refer specifically to audit risks arising during the audit.
- (26) The proposals to the requirements for determining the locations and business units at which audit procedures should be performed appear to relate to information access issues rather than to better enhance the focus of the audit effort.
- (27) In addition, we consider that more evidence is not necessarily better evidence. A list of working papers reviewed will not help assess the quality of the risk assessment or conclusions.
- (28) Lastly, we consider important the requirement proposing that "at the beginning of an audit that involves other auditors, the lead auditor should gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision". In most cases, significant components will be audited by the statutory auditors following local laws and regulations. However, while it is crucial to have knowledge of the other auditors and ensure that they are competent and have sufficient experience, this should be performed on a case-by-case basis. Therefore, we would favour a more risk-based consideration rather than the bright line in the proposal.

Questions 31-40: Proposed Amendments to AS 1201 *Supervision of the Audit Engagement*

- (29) We acknowledge the difficulties associated with many group audits arising from complex group structures, different accounting, reporting and auditing requirements, access restrictions and cultural barriers. In particular, we recognise the difficulty experienced by lead auditors and regulators alike with structural and other limitations arising from these issues. Inspection findings have also identified that auditors sometimes fall short of the required standards in conducting group audits and that there is a real need for improvement.
- (30) The proposed procedures to be performed by the lead auditor with respect to the supervision of other auditors' work are clear but we question the value of the specific documentation and communications in writing and the effect on audit quality. The requirements may aid inspection, but not audit quality and may even divert attention from more important issues.
- (31) The scalability of the proposed amendments on supervision is not clear. The statement that the lead auditors is not required to review all of the other auditors' working papers to determine whether the other auditors have performed their audit work as requested is helpful, as are the associated suggestions regarding risks and discussions. Nevertheless, they are very high level and therefore likely to be applied inconsistently in practice.

- (32) The proposed requirements for the lead auditor to inform directly the second other auditors of certain specific matters in addition to informing the first other auditors is inappropriate and could be seen as encouraging a level of distrust, potentially undermining the authority within the chain of command. The proposals seem to disregard the current logistical aspects of real complex group audits by requiring the lead auditor to bypass middle level auditors at regional level. To cope with clients' complex business environments, auditors have developed a range of approaches to work in accordance with how corporates are organised globally.
- (33) If the requirement for the lead auditor to communicate directly with second other auditors is adopted, group structures and group audit structures will not be aligned anymore. This misalignment is unlikely to be welcomed by senior management in corporates.
- (34) The core of the section on multi-layered audits deals with situations in which it is appropriate to bypass other auditors at the head of a layer, going directly to other auditors at a lower level. In a few cases, this may be appropriate but we are concerned about the lack of focus on how to use these layers in an efficient way. There is currently little practical choice but to work with such auditors and it is unlikely that the proposals will change this fact. We therefore consider that the requirement should be removed.
- (35) Moreover, it is not necessary for any proposed supervision procedures to be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report.
- (36) The Federation believes that the risk-based approach may be preferable to overly prescriptive requirements, as the latter may have unintended consequences. For example, reports of regulators around the world note situations in which - instead of working constructively with experienced and competent other auditors available locally - lead auditors send inexperienced staff for visits into locations that they do not understand economically, culturally or linguistically, and instruct them to perform work appropriate in the lead auditors' jurisdiction.
- (37) As a result, they fail to perform a proper risk assessment, but regulators too often encourage this behaviour. Such visits are often undertaken in the belief that regulators are less likely to question such an approach, than a decision to review files (too often interpreted as a cost management exercise). We strongly urge the PCAOB to avoid further requirements in this area.

Questions 41-42: Proposed Amendments to AS 1215 Audit Documentation

- (38) We are not in favour of an alternative requirement in AS 1215 "for the lead auditor to make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor". Such a requirement would be burdensome, particularly on large audit engagements, and would not improve audit quality.
- (39) The PCAOB notes hazards involved in inadequate supervision of other auditors but the proposed solution appears to be administrative in nature. It seems to be tailored to facilitate inspection, rather than to make substantive improvements. Additional information about working papers reviewed but not obtained is an administrative issue and we do not see how it will improve audit quality, giving no indication regarding substantive content, or the quality thereof.

Questions 43-44: Proposed Amendments to AS 1215 Audit Documentation

- (40) While retaining information may always, in theory, aid the inspection process, we struggle to understand how, in isolation, retaining information about:

- specific accounting areas, and
- all control deficiencies identified by other offices of the firm and other auditors

will improve audit quality. In particular, requiring the retention of information relating to specific accounting areas is also a dangerous precedent to set. In addition, deficiencies identified by the other auditor may be completely inconsequential to the lead auditor and requiring such information to be communicated unnecessarily burdens the lead auditor. Auditor professional judgement regarding the significance of these information is more important than filing documentation.

Questions 45-46: Proposed Amendment to AS 1220 *Engagement Quality Review*

- (41) The engagement quality control reviewer should not be required to re-perform the engagement partners' work in any specific respect. Requiring an evaluation of the engagement partner's determination of the sufficiency of participation sets a dangerous precedent, as it is just one of many potential issues that the reviewer may wish to evaluate depending on the facts and circumstances linked to the audit. In many cases, the evaluation of the extent of the participation should be a formality. The existing requirements for the engagement quality control reviewer are sufficient.

Questions 47-52 Proposed New Standard for Audits that Involve Referred-to Auditors

- (42) Nothing to report.

Questions 53-54: Other Considerations

- (43) It is appropriate to supersede AI 10 since the AS 1201 provides clear guidance to the lead auditors.

Questions 55-59: Additional Questions Regarding Certain Aspects of the Proposal

- (44) Nothing to report.