NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 30, 2017, that relates to *Proposed Amendments Relating To The Supervision of Audits Involving Other Auditors And Proposed Auditing Standard—Dividing Responsibility for the Audit With Another Accounting Firm.* The other topics discussed during the November 29-30 2017 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: https://pcaobus.org/News/Events/Pages/SAG-meeting-Nov-2017.aspx

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

+ + + + +

STANDING ADVISORY GROUP

+ + + + +

MEETING

+ + + + +

THURSDAY
NOVEMBER 30, 2017

+ + + + +

The Advisory Group met in the Academy Hall, FHI 360, located at 1825 Connecticut Avenue, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

PCAOB BOARD OF DIRECTORS

JAMES R. DOTY, Chairman
LEWIS H. FERGUSON, Board Member
JEANETTE M. FRANZEL, Board Member
STEVEN B. HARRIS, Board Member

STANDING ADVISORY GROUP

MARTIN F. BAUMANN, PCAOB, Chief Auditor and Director of Professional Standards
JOAN C. AMBLE, President, JCA Consulting, LLC
PRAT BHATT, Senior Vice President, Corporate Controller, and Chief Accounting Officer, Cisco Systems, Inc.
HON. RICHARD C. BREEDEN, Chairman and CEO, Breeden Capital Management, LLC
J. ROBERT BROWN, JR., Lawrence W. Treece Professor of Corporate and Director, Corporate and Commercial Law Program, University of Denver Sturm College of Law
PETER C. CLAPMAN, Senior Advisor, CamberView Partners, LLC
LEONARD L. COMBS, U.S. Chief Auditor, PricewaterhouseCoopers LLP
CHARLES M. ELSON, Edgar S. Woolard, Jr., Chair of Corporate Governance, and Director, John L. Weinberg Center for Corporate Governance, University of Delaware
SYDNEY K. GARMONG, Partner in Charge, Regulatory Competency Center, Crowe Horwath LLP
KENNETH A. GOLDMAN, Public company board member
L. JANE HAMBLEN, Former Chief Legal Counsel, State of Wisconsin Investment Board
ROBERT H. HERZ, Chief Executive Officer, Robert H. Herz LLC and Executive-in-Residence, Columbia Business School, Columbia University
PHILIP R. JOHNSON, Former Nonexecutive Director, Yorkshire Building Society
JEAN M. JOY, Director of Professional Practice and Director of Financial Institutions Practice, Wolf & Company, P.C.
DAVID A. KANE, Americas Vice Chair, Assurance Professional Practice, Ernst & Young LLP
W. ROBERT KNECHEL, Frederick E. Fisher Eminent Scholar in Accounting and Director, Center for International Research in Accounting and Auditing, University of Florida

JON LUKOMNIK, Executive Director, Investor Responsibility Research Center Institute, and Managing Partner, Sinclair Capital, LLC
DOUGLAS L. MAINE, Limited Partner and Senior Advisor, Brown Brothers Harriman & Co.
MAUREEN F. McNICHOLS, Marriner S. Eccles Professor of Public and Private Management and Professor of Accounting, Stanford University
LIZ D. MURRALL, Director, Stewardship and Reporting, The Investment Association
KAREN K. NELSON, M.J. Neeley Professor of Accounting, Texas Christian University
JEFFREY D. NUECHTERLEIN, Managing Partner, Nue Capital LLC
JEREMY E. PERLER, Partner and Director of Research, Schilit Forensics
SANDRA J. PETERS, Head of Financial Reporting Policy, CFA Institute
BRANDON J. REES, Deputy Director, Office of Investment, AFL-CIO
CHARLES V. SENATORE, Executive Vice President, Head of Regulatory Coordination and Strategy, Fidelity Investments
DAVID SHAMMAI, Senior Governance Specialist, APG Assent Management
DEBRA SMITH, Chief Operating Investment Officer, CalSTRS
WENDY B. STEVENS, Partner, WeiserMazars LLP
DAVID M. SULLIVAN, National Managing Partner - Quality & Professional Practice, Deloitte & Touche LLP
SIR DAVID P. TWEEDIE, Chairman, International Valuation Standards Council
JOHN W. WHITE, Partner, Corporate Department, Cravath, Swaine & Moore LLP

OBSERVERS

SUSAN COSPER, Financial Accounting Standards Board
BOB DACEY, Government Accountability Office
ANN DUGUID, Financial Industry Regulatory Authority
HARRISON GREENE, Federal Deposit Insurance Corporation
MARC PANUCCI, Securities and Exchange Commission
MIKE SANTAY, Grant Thornton
ARNOLD SCHILDER, International Accounting and Assurance Standards Board

PCAOB STAFF

DIMA ANDRIYENKO, Associate Chief Auditor
LISA CALANDRIELLO, Assistant Chief Auditor
BRIAN DEGANO, Associate Chief Auditor
JOHN FIEBIG, Senior Deputy Director, Division of Registration and Inspections
MARION KOENIGS, Deputy Director, Accountant, Division of Enforcement and Investigations
PAT McNAMEE, Deputy Chief Auditor
JENNIFER RAND, Deputy Division Director and Deputy Chief Auditor
BARBARA VANICH, Associate Chief Auditor
JESSICA WATTS, Associate Chief Auditor
KEITH WILSON, Deputy Chief Auditor

MR. BAUMANN: …

The next standard that we want to discuss that we proposed deals with the supervision of audits involving other auditors. And you got a feeling when we talked about Form AP the other day, it seems like a long time ago, I mean, yesterday. That in some audits there can be 20 other audit firms that participate around the world. And it was mentioned earlier that there could be different cultures.

Richard Breeden was pointing out different cultures in Japan or other countries with respect to how those auditors think and behave, and what their characteristics are. And so this proposal dealt with what the IAASB calls group audits. We called it supervision of audits involving other auditors in multi-location audits.

What is the lead auditor's responsibility in terms of supervising those potentially many other auditors around the world, who can do a very large portion of the audit?

Dima Andriyenko is going to give us an update on the comments we received.

MR. ANDRIYENKO: Thanks, Marty. There are a number of comments made today and yesterday about the use of other auditors including in multinational audits. I got comments yesterday and questions at the dinner table in that area. So this is the area that we're going to cover now.

And as you know, and I should probably advance to my slide. There we go.

As you know, in 2016 the PCAOB proposed a number of amendments to its auditing standards that govern planning and supervision of audits that involve other firms and accountants outside the accounting firm that issues the auditor's report on the company's financial statements. The amendments are intended to increase the involvement by the lead auditor in the work of other auditors. Enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors. And also to facilitate improvements in the quality of the work of other auditors.

The Board also proposed a new standard for less common situations in which the lead auditor divides the responsibility for the audit with another accounting firm.

In September this year the PCAOB issued a supplemental request for comment or SRC to address certain issues that are raised in comment letters on the proposal.

The SRC includes incremental targeted revisions to the proposed requirements in a number of areas that you can see on the slide. That is serving as the lead auditor, the lead auditor's responsibilities for considering the qualifications of other auditors, supervision, including supervision in multi-tiered audits, and divided responsibility audits.

The comments were due on November 15. And on this slide you can see the breakdown of comments that the Board received. Twenty-one in total from a number of affiliations.

And as you can see on the slide, most of the letters came from accounting firms and associations of accountants. Investors, academics, others also commented on the document.

This slide gives you a flavor for some comment -- high level themes in comment letters. And we're going to go through the, you know, more detailed overview on subsequent slides.

In general, the commenters continue to support the Board's efforts in enhancing the standards for the use of other auditors. And in particular, the commenters support the scalable risk-based approach to the supervision of other auditors' work.

And under such an approach, as you might remember, the lead auditor's involvement should be commensurate with a number of factors, including the competence of the other auditors and also the risks of material misstatement associated with that work. Commenters appreciated the Board's efforts in considering the feedback in the proposal. And they said that several revisions in the SRC were responsive to the questions raised with respect to the proposal.

And at the same time, a number of commenters raised questions with respect to other revised requirements in the SRC. And provided a number of suggestions on how those requirements could be modified. So we're going to discuss some of these areas of comment in more detail on the following slide. Okay.

So, we're going to start with the comments on the revised requirements to determine whether a firm's participation in the audit is sufficient to serve as the lead auditor.

Now the importance criterion. So when determining whether a firm may serve as a lead auditor, the proposal required considering the risk of material misstatement associated with the portion of the audit that the lead auditor audits.

And then the SRC added another criterion that would specifically require considering the importance of the location or business unit, or locations and business units audited by the lead auditor. So this was done in response to comments received on the proposal, where some of the commenters were concerned that in some audits, no firm involved in the audit would meet the criterion, the risk criterion in the proposal.

In comments on the SRC, some of the commenters agreed with the proposed provisions. And they said it would be appropriate to consider both risk and importance. And a number of commenters however, still believed that even with the added importance criterion, some firms' participation might still not be sufficient to serve as lead auditor. And some of those commenters suggested adding a criterion based on whether a firm was licensed in the jurisdiction where the company is incorporated.

The next bullet is the 50 percent threshold for the divided responsibility audits. And as you can see, it deals with those less common situations when the lead auditor divides the responsibility for the audit.

So, for these audits, the SRC proposed an additional criterion for serving as the lead auditor. And it is meant, this criterion, to reduce the likelihood that the lead auditor would divide responsibility for the audit with a firm or a number of firms that audit more than 50 percent of the company's assets or revenues.

So with respect to this area of the proposal, the 50 percent threshold, for the most part commenters agreed with adding this 50 percent threshold.

And it would be analogous, this threshold would be analogous to the one that appears in the staff guidance set forth in the SEC Corp Fin's financial reporting manual.

But some commenters indicated that this proposed threshold could be either redundant or inconsistent with the guidance in Corp Fin's manual in part because the SRC used different terminology, slightly different terminology then in Corp Fin's manual.

So they recommended that the PCAOB either not include the 50 percent threshold or phrase it using the language in Corp Fin's manual. And emphasize that there's -- it would not change practice, and it would not establish a bright line for compliance.

Let's move onto the next bullet that deals with the lead auditor's responsibilities for considering other auditor's qualifications.

The original proposal would require the lead auditor to understand each other auditor's knowledge of independence and ethics requirements. And also experience in applying them. And obtain a written representation from each other auditor that it is in compliance with the requirements.

Some commenters on the original proposal questioned the practicability of obtaining an understanding of each individual engagement team member at the other auditor.

So in consideration of these and other comments, one of the revisions in the SRC was to require that the lead auditor understand the other auditor's process for determining compliance with independence and ethics requirements.

Now with respect to the other auditor's knowledge, skill, and ability, the proposal, the original proposal would require the lead auditor to understand the qualifications of engagement team members who assist the engagement partner in planning and supervising the audit.

And then as suggested by some commenters in the proposal, the SRC expanded the requirements, and added one that would cover other team members, including non-supervisory team members. And then under the SRC the lead auditor should inquire about the other auditor's policies and procedures in that area, specifically dealing with training and assignment of personnel, who work on PCAOB audits.

Overall, commenters agreed that the lead auditor should perform certain procedures in this area with respect to the other auditor's compliance with ethics and independence. And also with respect to the other auditor's knowledge, skill, and ability.

While they supported of certain proposed requirements, some commenters raised questions about proposed provisions that relate to understanding the other auditor's process for determining compliance with ethics and independence, and also inquiry about the policies and procedures related to training and assignment of personnel to PCAOB audits.

And the reasons for that were given such as that the other auditors may be unwilling or unable to share the -- with the lead auditors, detailed information about such policies and procedures.

And this could be because of either statutory restrictions on sharing of this information, or perhaps privacy concerns.

And even if the other auditor shared this information with the lead auditor, how the engagement partners at the lead auditor would lack expertise in interpreting such information and making the evaluations.

Some other commenters also added that the proposed procedures would go beyond the existing practice. In particular, with respect to the affiliated firms where other auditors affiliated with the same network as the lead auditor.

Some commenters agreed at the same time that these proposed procedures might be necessary if the other auditors are outside of the lead auditor's network.

Now as far as the recommendations given, when the other auditors are affiliated firms, a number of accounting firms who commented on the proposal indicated that the lead auditor should be able to rely on more limited information then that anticipated in the SRC. Mainly on the grounds that affiliated firms would follow their network's QC requirements.

For example, in the area of independence and ethics, some of the commenters indicated that the lead auditor should be able to rely mainly on a representation from an affiliated firm that it complies with independence and ethics requirements. And also on obtaining a list of relationships that may affect the other auditor's independence.

Now likewise, with respect to the other auditor's knowledge, skill, and ability for affiliated firms, some of the commenters indicated that the lead auditor should be able to rely on more senior personnel at the other auditor, partners and managers, and the other auditor's quality control procedures that is to ensure that other personnel, the non-supervisory personnel are appropriately qualified to perform PCAOB audits.

Several commenters did add that the lead auditor has to have grounds for relying on the effectiveness of the other firm's quality control procedures. They should have some information about the effectiveness of those procedures.

Okay. We're going to move onto the next slide that deals with comments received in the area of supervision of other auditors.

Instructing of auditors. Here the proposal and the SRC would require that the lead auditor inform the other auditors in writing of the number of items that include identified risk of material misstatement to the company's financial statements that are relevant to the other auditor's work.

In general, commenters agreed that the lead auditor should communicate to the other auditor significant risks at the entity level. But many commenters interpreted the proposed provisions as a requirement for the lead auditor to identify all risks as the assertion level for each location or business unit and communicate those to the other auditors, in which case they argued the other auditor would be in the better position to perform this task and not the lead auditor.

Next is reviewing the other auditor's work. The original proposal would require that the lead auditor request from the other auditor, specified documentation with the idea that the extent of the lead auditor's review of documents submitted by the other auditor beyond what's already required today by PCAOB standards, would depend on certain factors such as the competence of the other auditors, the nature of the work they performed, and also the risks of material misstatement.

The SRC also further clarifies how the risk-based supervisory approach would apply to the lead auditor's request for the documentation, and also review of the other auditor's work.

Here again, generally commenters were in agreement that the lead auditor should review the work performed by the other auditors. And several commenters agreed with the clarifications that are provided in the SRC.

But, a number of those who commented in this area, they believe that the proposal could be interpreted as requiring the lead auditor always, always to review the detailed working papers of the other auditors.

And they argued that in some cases such a detailed review by the lead auditor would not be necessary. They also argued that the working papers maybe prepared in a foreign language, which would further complicate the review by the lead auditor.

And some commenters suggested that the lead auditor should be allowed to obtain information about the other auditor's work by other means. For example, through discussions with the other auditors.

The next bullet is supervision in multi-tiered audits. And here the proposal and the SRC addressed audits where there are multiple tiers of other auditors.

Which could be where another auditor or audit location whose financial statements, financial information includes financial information of yet another sublocation that is audited by yet another other auditor. Sort of the second other auditor.

The proposal outlined the supervisory responsibility that the lead auditor may direct the first other auditor to perform with respect to the next tier, the second other auditor.

And what the SRC did, it expanded the list of those procedures. So, the lead auditor can direct the other auditor, the first auditor to perform additional procedures with respect to the second auditor.

And in general the commenters welcomed this change, the expansion of the list of procedures that the lead auditor may direct the first other auditor to perform. And they did agree that the lead auditor should evaluate the supervision of the first other auditor.

But a number of commenters raised questions about the lead auditor should always be required to review the documentation of both auditors. And that's a change that the SRC proposed for the lead auditor to look at the working papers, certain specified working papers of both other auditors.

So, the commenters said that in some situations this requirement would result in a duplication of review by the lead auditor of the work that the first other auditor already does.

Okay. We're going to move onto our final side. With other areas of comments on the SRC.

The first area is divided responsibility audits. And here the SRC would retain the standard that was included in the original proposal for audit engagements in which the lead auditor divides responsibility with other firms, a firm or firms.

The SRC made some revisions to the standard. Mainly to allow the lead auditor under certain conditions to divide responsibility when the company's financial statements and the subsidiary's financial statements that are audited by the referred to auditor are prepared to use in different financial reporting frameworks.

And this change was generally welcomed by the commenters because it was responsive to concerns that were raised with respect to the restriction in the proposal.

And at the same time, with respect to another requirement to obtain information from and discuss certain matters with the referred to auditor, they noted that it could be difficult to implement, because the lead auditor, and I guess that's what Len referred to, in some instances may not be able to even get in touch and communicate with the other firm.

Economic impact. In the SRC the Board asked for comments on the economic impact of the revisions included in the SRC.

And in several areas like the ones that we discussed in the previous slides, where commenters raised questions about the proposed or revised requirements, they indicated that implementing them would be either costly -- would be costly and may not provide financial benefits to audit quality.

And finally, effective date. Most commenters suggested that the Board make any final requirements effective no sooner than two years from the date they would be approved by the SEC.

So, we're ready to take questions and comments. Thank you.

MR. BAUMANN: Liz Murrall?

MS. MURRALL: Thank you, Marty. And I thank you very much for that presentation. It was very helpful.

I referred to this before in past meetings. And I apologize if I'm repeating myself.

But the U.S. is not the only market where it's local auditors that audit multinational groups. But my understanding is, it's the only market where you have this referred to auditor or division of responsibilities.

And I suppose my concern is, I mean, in other markets the lead auditor has to take responsibility. Regardless, they have to do whatever procedures are necessary.

And my concern is, is that having this referred to auditor could be perceived internationally as almost a limitation of scope. And I just -- I'm just questioning why the U.S. has to adopt this and other capital markets don't have the need to?

MR. ANDRIYENKO: Well, this is not a requirement for the other auditors or for any auditor to adopt this particular framework.

I guess it -- what the proposal does, and the SRC did, they recognize that in certain markets, U.S. for example, there may be instances where it is necessary.

Where otherwise the lead auditor could not -- there would be limitation on scope because the lead auditor would not be able to perform supervisory procedures. Which is the other -- the other option.

So it's not -- the proposal is not directing auditors to adopt a certain framework. It accommodates certain circumstances that exist in certain markets.

MR. BAUMANN: The situation occurred for instance if the company has an equity investment where it doesn't have the ability really to influence the activities down at the equity investment.

You know, it's owned by a variety of parties. But yet it's material to their financial statements. And the equity investment is audited by another firm.

And the lead auditor doesn't have the ability to gain insight into that other auditor's work papers to understand the qualifications of that other auditor because the company itself doesn't have the ability to force that equity investment to share -- to have its auditor share information with the lead auditor.

So, there really could be a scope restriction in the context that the lead auditor just doesn't have insight into the financial statements or the audit work or the risks of that equity investment for instance.

And so this accommodates the possibility to say when that occurs, you can divide responsibility with that other audit firm and say, the lead auditor we did an audit of this company, except that 20 percent of the revenues and net income are audited by another firm whose report has been filed.

There's very few instances and Dima and -- what's the approximate number of these divided responsibility situations?

MR. ANDRIYENKO: Oh, fewer than 50.

MR. BAUMANN: So, I think it does come up. I think Arnold, I think you've heard this was an issue.

And as you look at your group, audit standard has been risen as a question as to what do we do. And we believe audit firm, or the audit firm can't have access to certain aspects of it.

So, I think it's a question that's also being addressed as part of the group audit look at by the international auditing standard. The good -- the good part of this, is there's only about 50 situations where this occurs today.

But, we recognize your point and it's -- it is a careful one for us to think about. And we understand your concern there.

Jeanette Franzel?

MS. FRANZEL: Regarding the comments that we received that under this criteria some auditors might not be able to qualify as the lead auditor, did the commenters give us data or analysis?

Are we talking about three audits? Or three hundred here? And just what's the magnitude really of the potential issue?

MR. ANDRIYENKO: We do not have a number of audits in the comment letters. They say that it's -- those situations exist.

But, we do not have the numbers.

MS. FRANZEL: So it might be helpful for us to get some data from those commenters so that we can understand how big of an issue would this potentially be.

MR. ANDRIYENKO: Hm-mm.

MR. BAUMANN: Yeah. So our follow up will include trying to understand the issue that the commenters raised. Agreed.

…

David Kane?

MR. KANE: Thanks, Marty. My comment is on the lead auditor as well. I mean, since Jeanette raised it.

I do think this is one that requires some further study. I'm not sure, to answer Jeannette's question, I could give you an exact number, because it depends on how you set the base.

Right? Do you say it's 50 percent? Do you say, you know, based upon this important characteristic or criterion which requires some judgement?

But I do think spending some extra time is going to be helpful. Because I'm increasingly seeing with globalization more decentralization.

So you've got tax haven -- oh, sorry, tax, you know, domicile in one area. You may have corporate headquarters in another.

You may have a shared service center in a third one, fourth. It can end up being five locations that could ultimately impact this determination.

So it may not be as much of an issue even if you do the analysis here and now. But I think it's going to increase over time.

So, I think getting a model that can be able to stand the test of time so we don't end up in situations. And I think the reason, and I'm just emphasizing it here is, because that really leaves you in a rock and a hard place.

Because if it's required to get a report in a certain state for example, and it has to be with a firm registered in that state, and foreign auditors cannot perform work there, what does the company do?

Because in that circumstance then you can't get an audit opinion. And it just leaves them and the audit committee kind of in a tough spot here as well as us.

So, it's those particular types of circumstances that I'm most concerned about. But I'd be happy to do any type of outreach and provide you any information that would be helpful.

MR. BAUMANN: Yes. We'll be looking for more information from what was in the comment letters. But the comment letters were very useful. And we'll analyze them all.

Wendy Stevens?

MS. STEVENS: Thank you, Marty. And as a smaller firm we've been pretty involved in the dialogue and the reach out and the response to the earlier ones that you were bringing up.

So I just -- I wanted to make sure and be clear that there's not going to be -- that the request from the smaller firms isn't for special dispensation to not do the procedures that are going to be prescribed.

It's more in the principles and the criteria of it's not one size fits all. So let's not default to one place. That's what the comments are related to.

And I think an import -- what I get out of this, what is very important is for investors and particularly audit communities to ask the questions and you'll have the opportunity in the CAMs.

Because a lot of the CAMs are going to be surrounded, are going to be with respect to estimates. And by definition also to use a specialist.

So, I encourage audit communities to ask the questions. And to ask what the auditors are doing in their procedures in that context.

Because I think those dialogs are going to be elevated as ARM rolls out in the practice phase that was recommended yesterday, as well as for real.

And then lastly on the 50 percent, I wanted to weigh in. It's 50 percent of what?

So I think that's what the clarification needs to be. How do you measure that?

We've gone through that quite a bit. And we have used the threshold as -- a 50 percent threshold that's actually what's in our quality control manual.

But there have been circumstances where we have taken a deeper dive into the company. How it's run, where it's run from.

And sometimes the 50 percent when you measure assets, doesn't necessarily represent assets or net income or revenues. It doesn't necessarily represent where the company is run and where the decisions are made.

And that's what's important in being the principal auditor. Is you have the connectivity with management and where the decisions are made.

MR. BAUMANN: Thanks for those comments.

MR. WILSON: Can I just make one -- one clarification on the question about the 50 percent.

Just a clarification that that applies only in divided responsibility scenarios. So, it is -- it is assets or revenue.

But essentially a parallel to what's in the SEC guidance today.

MS. STEVENS: We look at it in both places. Whether it's split or not. Just for clarification.

MR. WILSON: Okay. Well that's fine. But I just wanted to be sure that we were all understanding that the proposal is not imposing a 50 percent requirement for -- unless there's divided responsibility.

MR. BAUMANN: In those relatively few cases.