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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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Second 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 Release No. 2021-005
September 28, 2021

PCAOB Rulemaking
Docket Matter No. 042

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is requesting additional comment on proposed amendments to its auditing standards related to the supervision of audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report. This release is a second supplemental request for comment ("2021 SRC") on amendments that were first proposed in a 2016 proposing release ("2016 Proposal") and were revised in a 2017 supplemental request for comment ("2017 SRC"). This request for comment seeks commenters' views on revisions that the Board is considering for adoption, and on other matters discussed in this release. The Board also welcomes comments on any other aspects of this project.

Public Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board's website at pcaobus.org. Comments also may be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 042 in the subject or reference line and should be received by the Board by November 30, 2021.

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I. EXECUTIVE SUMMARY

We are requesting additional comment on proposed amendments to our auditing standards, including the adoption of a new auditing standard (collectively, "proposed amendments" or "proposal"). The proposed amendments would strengthen requirements that apply to audits involving accounting firms and individual accountants that are outside the accounting firm that issues the auditor's report ("other auditors" and the "lead auditor," respectively). In these audits, the lead auditor issues the auditor's report, but other auditors often perform important audit work so that sufficient appropriate audit evidence is obtained to support the lead auditor's opinion in the auditor's report. The roles of other auditors have become more significant as companies' global operations have grown. In addition, the new auditing standard is designed to update requirements for the relatively uncommon situations in which the lead auditor divides responsibility for the audit with another accounting firm ("referred-to auditor").

Working with other auditors can differ from working with people in the same firm, creating challenges in coordination and communication. These challenges can lead to misunderstandings about the nature, timing, and extent of the other auditors' work and can reduce the quality of the audit. It is important for investor protection that the lead auditor adequately plan and supervise the work of other auditors so that the audit is performed in accordance with PCAOB standards and provides sufficient appropriate evidence to support the lead auditor's opinion in the auditor's report.

To address concerns about the responsibilities of the lead auditor in supervising other auditors' work, in 2016 we proposed amendments for public comment. Commenters were largely supportive of the proposed amendments. They also requested clarification of some matters and offered suggestions for further improvements to the amendments. In response to the comments, in 2017 we issued a supplemental request for comment on proposed revisions to the amendments. Commenters on the 2017 SRC largely supported the proposed revisions and offered further input and suggestions for change.

Since the issuance of the 2017 SRC, we have continued to review the work performed in audits involving other auditors, and to engage with stakeholders and standard setters in this area. During this time, we have also continued to consider how the proposed amendments address the concerns underlying the rulemaking and the helpful information provided by commenters.

Today we are requesting comment on additional revisions to the proposed amendments. The proposed revisions included in this release are designed to: adjust certain requirements to better take into account the lead auditor's role in the audit; address certain scenarios encountered in practice; revise certain proposed definitions to reflect recent amendments to the Board's standards; and improve the readability of the amended standards.

This second supplemental request for comment (i) discusses significant comments received on the 2017 SRC, (ii) presents the revisions to the proposed amendments that we are considering for adoption (described throughout this 2021 SRC as amendments we are proposing or revising), and (iii) requests comment on those revisions and related matters. We also welcome comment on any other aspect of the proposed amendments. After this round of public comment, the Board intends to consider the comments received and decide whether to adopt final amendments.

II. BACKGROUND

A. Audits Involving Other Auditors

As discussed in the 2016 Proposal[1] and 2017 SRC,[2] audits of many companies, including multinational corporations, involve work that is performed by auditors other than the firm issuing the auditor's report.[3] The work of such other auditors may account for a significant share of the audit and may involve areas of high risk of material misstatement. Existing PCAOB standards include requirements to supervise other auditors or to use and assume responsibility for their work after performing specific but limited procedures.[4] It is important for investor protection that the lead auditor adequately plan and supervise the work performed by other auditors so that the audit is performed in accordance with PCAOB standards and provides sufficient appropriate evidence to support the lead auditor's opinion in the auditor's report.[5]

Working with other auditors can pose challenges in the coordination and communication between the lead auditor and other auditors. Without adequate supervision by the lead auditor, deficiencies in other auditors' work can result in deficient audits.[6] In the years before the 2016 Proposal, PCAOB oversight activities had identified audit deficiencies relating

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1 *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 Release No. 2016-002 (Apr. 12, 2016).

2 *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 Release No. 2017-005 (Sept. 26, 2017).

3 For more recent information on the extent of the use of other auditors, *see* Section IV.A below.

4 *See* 2016 Proposal at Section II.A, which discusses the applicability of AS 1201 and AS 1205. Lead auditors also may divide responsibility for the audit with another audit firm, although these situations are relatively uncommon. *See id.*; 2017 SRC at Section II.B; proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

5 *See* 2016 Proposal at Section II.

6 *See id.*

to the work performed by other auditors and the lead auditor's role in the audit.[7] Since the 2016 Proposal and 2017 SRC, the Board has continued to observe deficiencies in these circumstances.

To address challenges related to other auditors' involvement, some accounting firms have enhanced their internal requirements concerning the supervision of other auditors. These enhancements appear to have contributed to improvements in the quality of work performed by other auditors. Other firms, however, have not significantly improved their approach to the supervision of other auditors. Observations from PCAOB oversight activities indicate that investor protection could be further improved by, among other things, the lead auditor's increased involvement in and evaluation of the work of other auditors.[8]

B. 2016 Proposal and 2017 Supplemental Request for Comment

In April 2016, we proposed amendments to PCAOB standards to strengthen existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors.[9] The proposed amendments were intended to increase the lead auditor's involvement in, and evaluation of, the work of other auditors, enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors, and facilitate improvements in the quality of the work of other auditors. The proposed amendments also included a proposed new standard that would apply when the lead auditor divides responsibility for an audit with another accounting firm (i.e., referred-to auditor) and refers to the referred-to auditor's report in the lead auditor's report.

In brief, the proposed amendments in the 2016 Proposal would:

- Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*. As a result of the rescission of AS 1205, the lead auditor, instead of being able to use the "work and reports" of other auditors under AS 1205, would be required to (i) when assuming responsibility for the other auditors' work, supervise the other auditor under AS 1201 , and (ii) when dividing responsibility for the audit with a referred-to auditor, comply with proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

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7 *See id.* at Sections II.B.2(i) and II.B.2(ii).

8 *See id.* at Sections II.B.2(iv) and II.C. In addition, the International Auditing and Assurance Standards Board is in the process of amending its standards in this area. It has an ongoing project on group audits, which included issuing an exposure draft of proposed revisions to ISA 600. *See Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, IAASB Exposure Draft – Proposed ISA 600 (Revised) (Apr. 27, 2020).

9 *See* 2016 Proposal at Section II.

- Amend AS 1201, *Supervision of the Audit Engagement*. These amendments would provide additional direction to the lead auditor on how to apply the principles-based provisions of the standard to the supervision of other auditors. Specifically, the lead auditor would be required to perform certain procedures to supervise other auditors' work. Notwithstanding the specificity of the new procedures, the engagement partner (whose firm is the lead auditor) would remain responsible for the supervision of the entire audit.

- Amend AS 2101, *Audit Planning*. These amendments would incorporate and update certain requirements from AS 1205, and amend certain existing requirements to specify that they be performed by the lead auditor. For example, the amendments would enhance the requirements related to the engagement partner's assessment of whether his or her firm performs sufficient work on the audit to warrant serving as lead auditor.

- Adopt a new standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*. The new standard would retain, with modifications, many of the current requirements in AS 1205 that apply when the lead auditor divides responsibility with the referred-to auditor and refers to its report in the lead auditor's report. The new standard also would establish certain new requirements.

- Define the terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor," to operationalize the proposed requirements.

- Amend certain other requirements in PCAOB standards for audits involving other auditors. One example is a revision to AS 1220, *Engagement Quality Review*, to require the engagement quality reviewer to evaluate the engagement partner's assessment of whether his or her firm performs sufficient work on the audit to warrant serving as lead auditor.

We received 23 comment letters on the 2016 Proposal.[10] Commenters generally supported the Board's objective of improving the quality of audits involving other auditors. Some expressed concerns or requested clarification about certain proposed requirements in areas such as determining the lead auditor's sufficiency of participation, supervising the work of other auditors, or dividing responsibility with another auditor in certain situations.

In response to the input from commenters, we issued a supplemental request for comment on the 2016 Proposal in September 2017.[11] The 2017 SRC discussed significant comments received and presented revisions to the proposed amendments while leaving the

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10 *See* 2017 SRC at 6-7 (discussing comment letters received on the 2016 Proposal).

11 *See* 2017 SRC.

overall proposed approach to the supervision of other auditors intact. In brief, the proposed revisions in the 2017 SRC included revisions that addressed the following areas:

- Criteria used by the lead auditor to determine the sufficiency of its participation in the audit.
- Information obtained by the lead auditor from other auditors regarding their relationships with the audit client that could affect the independence of the audit.
- Other auditors' policies and procedures related to the assignment and training of personnel.
- Documentation that the lead auditor is required to obtain from other auditors in a multi-tiered audit.

We received 22 comment letters on the 2017 SRC. Commenters generally expressed continued support for the project's objectives, and a number of commenters also suggested changes to, or requested clarification or guidance on, certain proposed requirements. The Board has considered all of these comments in formulating the revisions to the proposed amendments.

C. Purpose of This Request for Comment

As described further below in this release, the Board is proposing for comment additional revisions to the proposed amendments. In brief, key revisions would:

- Add a new consideration for the engagement partner to take into account – namely, the extent of his or her firm's supervision of other auditors' work – when determining the sufficiency of the firm's participation in the audit for purposes of carrying out the responsibilities of a lead auditor.
- Modify the proposed amendments relating to other auditors' compliance with independence and ethics requirements and other auditors' knowledge, skill, and ability, so that the amendments take into account certain practical challenges in obtaining information about other auditors, but continue to strengthen the responsibilities of the lead auditor.
- Clarify certain proposed supervisory procedures to address comments that suggested the requirements were confusing and to avoid duplication of documentation requirements of other PCAOB standards.
- Reorganize the proposed amendments to AS 1201 and AS 2101 by moving the paragraphs of two proposed appendices (Appendix B of AS 1201 and Appendix B

of AS 2101) to the body of each respective standard, to enhance the readability and usability of the amendments and better facilitate implementation.

- Clarify the approach to audits involving multiple other auditors, including eliminating duplication of responsibilities between the lead auditor and other auditors.

- Revise certain definitions to take into account changes to PCAOB auditing standards that have been adopted since the 2017 SRC.

- Amend Appendix B, *Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results,* of AS 1105, *Audit Evidence*, to distinguish it from requirements involving other auditors or referred-to auditors, by using a more descriptive term, "investee auditor" (including in situations involving equity method investees), and making certain other clarifying edits.

The appendices of this release present the proposed revisions that the Board is considering adopting after receiving comments in response to this release:

- Appendix 1 presents the current proposed amendments to the auditing standards, compared to the version contained in the 2017 SRC.[12]

- Appendix 2 presents the revisions to the proposed new standard, AS 1206, compared to the version contained in the 2017 SRC.

- Appendix 3 presents the current proposed amendments to the auditing standards, compared to the PCAOB standards as they currently exist.

This release contains questions and requests for comment on proposed rule text and other matters. Readers are encouraged to respond and also to comment on any aspect of the release or amendments not covered by the questions. In addition, the Board continues to consider for adoption the proposed amendments in the 2016 Proposal and 2017 SRC that are not specifically discussed in this release.[13] For all comments submitted, commenters are

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[12] Appendix 1 does not include proposed amendments that the Board is not substantially revising from how they were presented in the 2017 SRC. Appendix 3 (which compares current proposed amendments to existing PCAOB standards) does include those amendments.

[13] *See, e.g.,* proposed amendments to AS 1015, *Due Professional Care in the Performance of Work* (to note that other auditors are responsible for performing their work with due professional care, i.e., in compliance with PCAOB standards); proposed amendments to AS 1220 (to require the engagement quality reviewer to evaluate the lead auditor's assessment of whether it performs sufficient work on the audit to warrant serving as lead auditor). The full text of all of the proposed amendments (other than necessary conforming amendments to be made to other standards) is in the appendices to this release.

encouraged to provide reasoning to support their views and any empirical data relevant to their comments.[14]

Questions:

1. In recent years, have there been changes to auditor practices related to the use of other auditors?

2. Have there been changes to issuer circumstances (e.g., evolving structures, use of new technology) that affect how audits of multinational companies are conducted, including with regard to work performed by other auditors?

III. REVISIONS TO THE PROPOSED RULE TEXT

A. Reorganization of the Proposed Amendments

As shown in Appendix 1 of this release, the revised proposed amendments to AS 2101 (audit planning) and AS 1201 (audit supervision) appear in the body of each standard and in Appendix A (definitions) of AS 2101. As originally proposed, most of the amendments to these standards would have been in a new Appendix B of each standard. A commenter on the 2017 SRC expressed confusion about whether the requirements of proposed Appendix B of AS 1201 would be in place of, or in addition to, the requirements of paragraph .05 of AS 1201. Another commenter on the 2016 Proposal recommended that we consider including the amendments in the body of the standards rather than in appendices because they may appear to be of less importance if included as an appendix.

We are proposing to relocate the paragraphs of proposed Appendix B of both AS 2101 and AS 1201 to the body of each standard. As noted, the proposed amendments for audits involving other auditors would apply in combination with the existing requirements. Placing the amendments within the related existing requirements is designed to enhance the readability and usability of the amendments and to better facilitate their implementation. Relocating the amendments is not designed to make them appear more or less important.

Conforming amendments, which were included in the 2016 Proposal, will be included in the adopting release for these amendments.

[14] Studies, memoranda, or other substantive items may be added by the Board or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Board's website. To ensure direct electronic receipt of such notifications via e-mail, subscribe to PCAOB updates at http://pcaobus.org/About/Pages/PCAOBUpdates.aspx.

B. Definitions of Engagement Team, Lead Auditor, Other Auditor, and Referred-to Auditor

The proposed amendments in Appendix A of AS 2101 define the terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor." In the 2016 Proposal and 2017 SRC, the definitions of these terms would have been in each of AS 1201, AS 1206, and AS 2101. To reduce repetition, we are revising the proposed amendments to locate the definitions in only one standard – AS 2101 – with cross-references in the other standards (i.e., AS 1201 and AS 1206) to the definitions in AS 2101 where applicable.

1. Definition of "Engagement Team"

See paragraph .A3 of AS 2101 in Appendix 1

Under existing PCAOB standards, the engagement partner is responsible for proper supervision of the work of engagement team members.[15] The term "engagement team" is commonly used in PCAOB standards but has not been expressly defined. We did not receive comments on the proposed definition of "engagement team" in response to the 2017 SRC. In this release, we are revising the proposed definition to conform to amendments to AS 1201 that we adopted after the 2017 SRC. Subparagraph (2) of the revised definition conforms to terminology used in Appendix C, *Supervision of the Work of Auditor-Employed Specialists,* of AS 1201, which the Board adopted in 2018.[16] As revised, the definition of "engagement team" would include:

(1) Partners, principals, and shareholders of, and accountants[17] and other professional staff employed or engaged by, the lead auditor or other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201; and

(2) Specialists who (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist their firm in obtaining or evaluating audit

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15 *See* AS 1201.03.

16 *See Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018).

17 *See* paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "accountant." (This footnote referring to Rule 1001 is included in the definition of "engagement team" appearing in proposed AS 2101.A3.)

evidence with respect to a relevant assertion of a significant account or disclosure.[18]

The definition would exclude:

(1) The engagement quality reviewer and those assisting the reviewer (to whom AS 1220, applies)[19];

(2) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206; and

(3) Engaged specialists.[20]

2. Definition of "Lead Auditor"

See paragraph .A4 of AS 2101 in Appendix 1

The proposed amendments define the term "lead auditor" in AS 2101 as:

(a) The registered public accounting firm[21] issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and

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[18] The description of auditor-employed specialists in the 2017 SRC was "specialists whose work is used on the audit and who are employed by the lead auditor or by another accounting firm participating in the audit."

[19] Reviewers under Appendix K of SEC Practice Section ("SECPS") Section 1000.45, *SECPS Member Firms with Foreign Associated Firms That Audit SEC Registrants* (known as Appendix K reviewers) would not be considered members of the engagement team. Those reviewers, similar to the engagement quality reviewer, do not make decisions on behalf of the engagement team or assume any of the responsibilities of the engagement team.

[20] AS 1210, *Using the Work of an Auditor-Engaged Specialist*, establishes requirements that apply to the use of specialists engaged by the auditor's firm. Appendix A (*Using the Work of a Company's Specialist as Audit Evidence*) of AS 1105 sets forth the auditor's responsibilities for using the work of a specialist employed or engaged by the company. (This footnote referring to AS 1210 and AS 1105 is included in the definition of "engagement team" appearing in proposed AS 2101.A3.)

[21] *See* paragraph (r)(i) in PCAOB Rule 1001, which defines the term "registered public accounting firm." (This footnote referring to Rule 1001 is included in the definition of "lead auditor" appearing in proposed AS 2101.A4.)

(b) The engagement partner and other engagement team members who both:[22]

(1) Are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report (or individuals who work under that firm's direction and control and function as the firm's employees); and

(2) Assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.[23]

The term "lead auditor" is not currently used in PCAOB auditing standards. The term "principal auditor" is used in several standards, and it would be replaced by "lead auditor" in those standards. The proposed amendments to AS 1201 and AS 2101 would use the term "lead auditor" to refer to the firm and its personnel who are responsible for carrying out the responsibilities required of lead auditors.

Commenters on the 2017 SRC asserted that certain individuals who participate in the audit in practice function in the capacity of employees of the firm or an equivalent capacity (e.g., employees of network affiliate firms on secondment arrangements to the lead auditor).[24] To reflect those arrangements in the definition, the proposed amendments include such individuals in the definition of lead auditor and make a conforming change to the definition of

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[22] The proposed definition has been revised to insert the word "both" to clarify that paragraphs (1) and (2) must both be satisfied for a person to be considered within the definition of "lead auditor."

[23] *See* paragraph .05a of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, which describes making appropriate assignments of significant engagement responsibilities. *See also* paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*, according to which "[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability …." (This footnote referring to AS 2301 and AS 1015 is included in the definition of "lead auditor" appearing in proposed AS 2101.A4.)

[24] Some commenters to the 2016 Proposal suggested that the lead auditor definition be expanded to include qualified individuals outside the firm issuing the auditor's report who assist with planning and supervising the audit. In light of the purpose of this rulemaking to increase the lead auditor's involvement in, and evaluation of, the work of other auditors, we are not proposing to make additional changes to the definition of lead auditor. The commenters' concerns about the lead auditor's ability to assign certain planning and supervisory procedures to qualified individuals outside the firm are addressed in proposed amendments to planning (discussed below in Section III.E.3 for multi-tiered audits) and supervision (discussed below in Section III.D.3 for supervision generally and in Sections III.E.1 and III.E.2 for multi-tiered audits) requirements.

other auditor.[25] To further clarify this approach, the proposed amendments include a note in paragraph .A4 of AS 2101 to illustrate that individuals such as secondees[26] who work under the direction and control of the firm issuing the auditor's report (and who assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit) would function as the firm's employees and therefore fall under the definition of lead auditor. Importantly, the responsibilities of the engagement partner and other appropriate engagement team members for considering the independence and knowledge, skill, and ability, and for planning and supervising the work of these individuals[27] under PCAOB standards would be the same as for employees of the lead auditor's firm who work on the audit.

3. Definitions of "Other Auditor" and "Referred-to Auditor"

For the term "other auditor," see paragraph .A5 of AS 2101 in Appendix 1; and for the term "referred-to auditor," see paragraph .A6 of AS 2101 in Appendix 1.

Currently, PCAOB standards do not define the term "other auditor," but its meaning is described or implied by the requirements in which it is used. For example, in AS 1215.18 and .19, the term other auditor includes "auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms." In AS 1205, depending on the context, the term other auditor refers either to the firm whose work and report is used by the lead auditor or the firm with whom the lead auditor divides responsibility for the audit.

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[25] In the 2017 SRC we discussed these situations in Section III.F.1 of the release, but we did not include such individuals in the proposed rule text. *See* 2017 SRC at 34-35 ("The Board agrees that, under the auditing standards amended by its proposal, secondees 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.") (footnotes omitted).

[26] For this purpose, the term "secondee" refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices of the registered public accounting firm issuing the auditor's report, for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer). (This footnote discussion is included in the definition of "lead auditor" in proposed AS 2101.A4.)

[27] In addition to secondees, other examples of individuals who, depending on the terms of the arrangement, might work under the direction and control of the firm, assist the engagement partner with planning or supervisory activities, and function as employees, include leased personnel in firms with alternative practice structures and temporary contractors who work alongside other lead auditor personnel on the audit.

To clarify existing and proposed requirements, the proposed amendments would use the term other auditor to describe the engagement team members and, if applicable, their firm that are outside the firm issuing the auditor's report. The proposed amendments would define the new term "referred-to auditor" to describe a firm with which the lead auditor divides responsibility for the audit.

The definition of other auditor in this release is a revision of the version appearing in the 2017 SRC to reflect changes in the definition of lead auditor, which are discussed directly above in Section III.B.2. The individuals who assist the engagement partner in planning or supervisory responsibilities under the direction and control of the firm issuing the auditor's report and function as that firm's employees would be *excluded* from the definition of other auditor because they would be *included* in the definition of lead auditor.

The proposed amendments define the terms "other auditor" and "referred-to auditor"[28] in AS 2101:

Other auditor –

(a) A member of the engagement team who is not:

(1) A partner, principal, shareholder, or employee of the lead auditor or

(2) An individual who works under the direction and control of the registered public accounting firm issuing the auditor's report and functions as that firm's employee; and

(b) A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.

Referred-to auditor –

A public accounting firm, other than the lead auditor, that performs an audit of the financial statements and, if applicable, internal control over financial reporting, of one or more of the company's business units[29] and issues an auditor's report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead

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[28] Since the 2017 SRC, the only change to the proposed definition of "referred-to auditor" is the addition of a footnote reference to AS 1206.

[29] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

auditor's report on the company's financial statements and, if applicable, internal control over financial reporting.[30]

Questions:

3. Are the proposed definitions of "lead auditor" and "other auditor," with respect to the descriptions of individuals who work under the firm's direction and control and function as the firm's employees, clear? If not, how should the definitions be revised?

C. Planning the Audit

1. Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors

See paragraphs .06A and .06B[31] of AS 2101 in Appendix 1

The proposed amendments would enhance the requirements related to the engagement partner's assessment of whether the participation of his or her firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements. Previously, as of the 2017 SRC, we had proposed two considerations for an engagement partner to take into account – the risks of material misstatement and the importance of the locations or business units covered by the firm's audit procedures. The amendments we are proposing would add a new, third consideration for the engagement partner to take into account – the extent of the firm's supervision of other auditors' work.

Currently, for audits within the scope of AS 1205, the standard provides that when significant parts of the audit are performed by other auditors, the auditor must decide whether its own participation is sufficient to enable it to serve as the principal auditor (i.e., lead auditor) and report as such on the financial statements. The Board's proposals in 2016 and in 2017 would modify and move the current requirement from AS 1205 to AS 2101 (audit planning), thus making it applicable to all audits involving other auditors.

Under the amendments we proposed in 2016 and 2017, the engagement partner would be required to determine – taking into account certain considerations – whether the participation of the engagement partner's firm in the audit involving other auditors or referred-

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[30] *See* AS 1206, which sets forth the lead auditor's responsibilities regarding dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting, with a referred-to auditor.

[31] The discussion below is focused on the revisions to proposed AS 2101.06A-B (which were in paragraphs .B2 and .B3, respectively, of the proposed amendments to AS 2101 in the 2017 SRC).

to auditors is sufficient for the firm to serve as lead auditor. As noted in the 2016 Proposal, this approach was intended to increase the likelihood that the firm issuing the auditor's report performs audit procedures for a meaningful portion of the company's financial statements.

Commenters on the 2016 Proposal and 2017 SRC largely agreed with the concept of determining sufficiency of the lead auditor's participation in the audit, but raised questions about considerations the engagement partner would be required to apply. The 2016 Proposal included one consideration – risks of material misstatement associated with the portion of the company's financial statements audited by the lead auditor. In response to comments received on the 2016 Proposal about circumstances in which the primary financial reporting decisions are made, and consolidated financial statements are prepared in locations or business units that do not constitute a significant portion of the company's operations, the 2017 SRC added another consideration. The additional consideration was the importance of the locations or business units covered by the lead auditor's audit procedures.[32]

A number of commenters on the 2017 SRC responded favorably to providing the importance consideration – noting generally that it would more directly enable the engagement partner to consider both quantitative and qualitative factors when determining the sufficiency of participation. Some commenters, however, viewed the framework with two considerations (risk and importance) as still impracticable for certain audits. In their view, the two considerations would not adequately address audits of companies with highly dispersed structures, especially those whose headquarters, financial reporting function, and major operations are outside the company's corporate domicile. In particular, some commenters noted that applicable laws and regulations might require the company's audit report to be issued by a firm located in the jurisdiction where the company is domiciled, but a substantial portion of the audit to be performed by firms licensed to practice in jurisdictions where the major operations and management are located. To improve the practicability of the proposed requirements, the commenters suggested taking into account the engagement partner's firm's extent of supervision of other auditors' work when making the sufficiency determination.

In light of comments received on the 2017 SRC and after further analysis, the proposed amendments include a third consideration for making the sufficiency determination – the extent of the engagement partner's firm's supervision of other auditors' work. This addition is designed to allow for a more comprehensive determination of the prospective lead auditor's involvement. Under the proposed amendments, the engagement partner would take into account the three considerations (importance, risk, and extent of supervision) in combination to determine whether the full range of its involvement in the audit constitutes sufficient participation to serve as lead auditor. The resulting framework of considerations[33] should

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[32] *See* 2017 SRC at 9.

[33] For divided responsibility engagements, see the proposed last paragraph of AS 2101.06A in Appendix 1 for the "50-percent threshold" that should be met *in addition* to determining the sufficiency

enable lead auditors to effectively address the range of scenarios encountered in multi-firm and multi-jurisdictional audits when determining the sufficiency of lead auditor participation.

Further, the proposed amendments include a reminder in a new paragraph AS 2101.06B, concerning existing requirements. The new paragraph states that, in an audit that involves other auditors performing work regarding locations or business units, the involvement of the lead auditor (through a combination of planning and performing audit procedures and supervision of other auditors) should be commensurate with the risks of material misstatement associated with those locations or business units. The new proposed paragraph draws from existing requirements in AS 1201, AS 2101, and AS 2301, which require greater auditor involvement in areas of greater risk.[34]

Question:

4. Are the proposed considerations regarding serving as the lead auditor in an audit that involves other auditors or referred-to auditors – based on the importance of the locations, risks of material misstatement, and extent of the engagement partner's firm's supervision – appropriate and clear?

2. Other Auditors' Compliance with Independence and Ethics Requirements

See paragraphs .06D and .06F of AS 2101 in Appendix 1

The proposed amendments to AS 2101 relating to auditor independence and ethics requirements build on the existing, overarching responsibility of the auditor to comply with independence and ethics requirements.[35] Commenters on the 2016 Proposal and 2017 SRC generally agreed with the proposed requirements for the lead auditor regarding other auditors'

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of participation. Additionally, the proposed amendments provide that, in multi-tiered audits (which are discussed below in Section III.E), only the lead auditor's supervision of the first other auditor and other auditors directly supervised by the lead auditor is taken into account in the sufficiency determination.

[34] *See* footnote 4C to proposed AS 2101.06B, which refers to: AS 1201.06 (introduction of paragraph, "To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, …"); AS 2101.11 ("The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit."). *See generally* AS 2301 (stating that "The objective of the auditor is to address the risks of material misstatement through appropriate overall audit responses and audit procedures.").

[35] *See* AS 2101.06b. As noted above, the use of "independence and ethics requirements" in this release refers to PCAOB independence and ethics requirements and U.S. Securities and Exchange Commission ("SEC") independence requirements.

compliance with these independence and ethics requirements. However, several commenters raised questions about certain aspects of the proposed amendments, which we seek to address in this release, as discussed below in Sections III.C.2.i through v.

i. Understanding the Other Auditor's Knowledge and Experience; Obtaining an Affirmation about Policies and Procedures[36]

See paragraphs .06Da and .06Db(1) of AS 2101 in Appendix 1

The proposed amendments in the 2017 SRC would have required the lead auditor to gain an understanding of each other auditor's process for determining compliance with, and experience in applying, the independence and ethics requirements.[37] Those amendments were designed to position the lead auditor to identify matters that warrant further attention when determining the other auditor's compliance with the requirements.[38]

Some commenters stated that obtaining information described in the proposed amendments could be complicated by certain practical challenges, such as confidentiality restrictions in some jurisdictions and other auditors' concerns about sharing proprietary or sensitive information. Some commenters suggested that the lead auditor not be required to *determine each* other auditor's compliance with independence and ethics requirements, but rather obtain information about the other auditors' compliance. Commenters also suggested alternative approaches, such as obtaining a written representation from the other auditor regarding processes it uses for assessing compliance with independence and ethics requirements. Other suggestions included inquiring about the other auditor's knowledge of independence and ethics requirements and its experience in applying those requirements.

After consideration of comments received, the proposed amendments include several revisions to balance the need for relevant information about the other auditors' compliance and the potential challenges in obtaining the information, as follows.

In response to certain commenters and to emphasize that the lead auditor should perform procedures specified in the proposed amendments pursuant to fulfilling its obligation

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[36] *See* Section III.E.3 below, which discusses that, in multi-tiered audits, proposed AS 2101.06E would allow the lead auditor to seek assistance from the first other auditor in performing the procedures described in proposed AS 2101.06D. *See also* proposed AS 1206 (in Appendix 2) for requirements relating to audits involving referred-to auditors.

[37] This proposed requirement was in the 2017 SRC; the 2016 Proposal would have required the lead auditor to gain an understanding of each other auditor's knowledge of SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. *See* 2017 SRC at 11 and 2016 Proposal at A4-21.

[38] *See* 2017 SRC at 12.

under AS 2101.06b, the initial paragraph of AS 2101.06D would be revised from the version proposed in the 2017 SRC so that it expressly refers to the lead auditor's existing responsibility. This existing responsibility in AS 2101.06b requires the auditor to "[d]etermine compliance with independence and ethics requirements." As revised, the initial paragraph of AS 2101.06D would require the lead auditor to perform certain procedures "in conjunction with determining compliance with" independence and ethics requirements pursuant to paragraph .06b of AS 2101.

With regard to AS 2101.06Da, the proposed amendments would require that the lead auditor obtain[39] an understanding of the other auditor's knowledge of independence and ethics requirements and its experience in applying the requirements,[40] rather than gaining an understanding of each other auditor's process for determining compliance with, and experience in applying such requirements (as would have been required under the 2017 SRC). In addition, in response to questions from some commenters about the practicability of applying the requirement to individual engagement team members, the proposed amendments would further clarify that, if the other auditor is a firm, information provided to the lead auditor may cover the firm and engagement team members who are partners, principals, shareholders, or employees of the firm.[41] For other auditors who are not part of a firm (which would be relatively uncommon), the amendments would apply at the individual level.

Further, instead of requiring the lead auditor to obtain an understanding of the other auditor's process for determining compliance, the proposed amendments have been revised to require that the lead auditor obtain from the other auditor and review a written affirmation[42] as to whether the other auditor has policies and procedures that provide reasonable assurance that it maintains compliance with independence and ethics requirements. If the other auditor does not have such policies and procedures, the lead auditor would be required to obtain from the other auditor and review a written description of how the other auditor determines its compliance with the independence and ethics requirements.[43]

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[39] The verb used in the proposed requirement has changed from "gain" to "obtain" to more closely align with terminology used in existing PCAOB standards when required to "obtain an understanding."

[40] *See* proposed AS 2101.06Da.

[41] *See* proposed note to AS 2101.06D.

[42] The proposed amendments use the term "affirmation" for certain communications within the engagement team (*see*, *e.g.,* AS 2101.06Db, AS 2101.06F, and AS 2101.06Hb), to better differentiate them from certain communications outside the engagement team, which are described in the amendments as "representations" (*see*, *e.g.,* proposed AS 1206).

[43] *See* proposed AS 2101.06Db(1).

The proposed amendments would also remove the proposed first note to AS 2101.B4 in the 2017 SRC,[44] which generally pointed out the lead auditor's obligation to reevaluate compliance in light of changed circumstances during the audit. In a new paragraph, the proposed amendments instead would contain more specific requirements for the lead auditor to (i) inform the other auditor of changes in circumstances of which the lead auditor becomes aware, and (ii) request that the other auditor update its affirmations and descriptions for changes in circumstances of which the other auditor becomes aware (including changes communicated by the lead auditor), and provide those documents to the lead auditor upon becoming aware of such changes.[45] We are proposing this revision to provide the lead auditor with information necessary for it to reevaluate compliance with independence and ethics requirements under existing PCAOB standards.[46] Some registered firms have already adopted policies and procedures that provide for communications similar to those required by the proposed amendments.

In determining compliance with independence and ethics requirements with respect to each other auditor pursuant to AS 2101.06b, the nature and extent of the lead auditor's procedures will depend to a large extent on the types of information available to the lead auditor about the other auditor. Examples of types of information that may be relevant to the nature and extent of the lead auditor's procedures include (i) the type, frequency, and substance of independence and ethics training that the other auditor provides to its personnel who participate in the audit and (ii) the other auditor's policies and procedures for determining that the firm and its personnel comply with independence and ethics requirements, including PCAOB Rule 3520, *Auditor Independence*. Sources of relevant information about the other auditor may differ depending, for example, on whether the lead auditor and other auditor are affiliated with the same network of accounting firms. In practice, some networks have procedures for sharing among select personnel of member firms certain information about the results of internal or external inspections of the affiliates, conducted either by the network itself or by outside parties such as the PCAOB.

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[44] That proposed note stated that the "lead auditor's determination of each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances."

[45] *See* AS 2101.06Dc, which would apply to all affirmations and descriptions required by paragraphs .06Da and .06Db.

[46] *See* note to AS 2101.06b.

ii. Obtaining a Written Description of the Other Auditor's Covered Relationships[47]

See paragraph .06Db(2) of AS 2101 in Appendix 1

Under the proposed amendments, the lead auditor should obtain from the other auditor and review 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[48] that may reasonably be thought to bear on independence pursuant to the requirements of Rule 3526. This proposed requirement, introduced in the 2017 SRC and revised in this release as discussed below, is designed to assist the lead auditor in obtaining information for determining compliance with SEC and PCAOB independence requirements, and to facilitate auditor communications under PCAOB Rule 3526.[49]

Some commenters on the 2017 SRC asked whether requiring the lead auditor to obtain a description of the other auditor's relationships would be consistent with Rule 3526. In particular, the commenters asked whether the lead auditor would be required to obtain and disclose to the audit committee information regarding an other auditor who is not affiliated with the same network of accounting firms as the lead auditor. These commenters pointed out that, when the Board adopted Rule 3526, it stated that it "expects the primary auditor's report to either include any covered relationships of any secondary auditors not affiliated with the firm or state that it does not do so."[50] One commenter also stated that privacy laws in certain jurisdictions may complicate obtaining the required information from an other auditor.

To avoid any confusion, we are proposing to add to AS 2101.06Db(2) a phrase clarifying that the lead auditor is required to obtain information about the other auditor's relationships

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47 *See* Section III.E.3 below, which discusses that, in multi-tiered audits, proposed AS 2101.06E would allow the lead auditor to seek assistance from the first other auditor in performing the procedures described in proposed AS 2101.06D. *See also* proposed AS 1206 (in Appendix 2) for requirements relating to audits involving referred-to auditors.

48 PCAOB Rule 3501, *Definitions of Terms Employed in Section 3, Part 5 of the Rules*, defines the terms "audit client" and "financial reporting oversight role."

49 Rule 3526 requires auditors, among other things, to make certain communications to the audit committee of the audit client before accepting an initial engagement, and annually thereafter, including a description, in writing, of "all relationships between the registered public accounting firm or any affiliates of the firm and the audit client or persons in financial reporting oversight roles at the audit client that, as of the date of the communication, may reasonably be thought to bear on independence." *See also* Staff Guidance, *Rule 3526(b) Communications with Audit Committees Concerning Independence* (May 31, 2019), which addresses questions that have arisen in practice regarding application of Rule 3526(b) in certain circumstances.

50 *See Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence*, PCAOB Release No. 2008-003 (Apr. 22, 2008), at 5.

with the audit client "that may reasonably be thought to bear on independence pursuant to the requirements of paragraph (b)(1) of Rule 3526."[51] The proposed amendments would not change the applicability of Rule 3526 to the lead auditor's representation *including* with respect to unaffiliated firms.

iii. Obtaining a Written Affirmation about the Other Auditor's Compliance with Independence and Ethics Requirements[52]

See paragraph .06Db(3) of AS 2101 in Appendix 1

Under the proposed amendments, the lead auditor should obtain from the other auditor and review a written affirmation as to whether the other auditor is in compliance with independence and ethics requirements with respect to the audit client, and if it is not in compliance, a written description of the nature of the instances of non-compliance. This provision was originally introduced in the 2016 Proposal (in lieu of a requirement in AS 1205.10b to make inquiries concerning the other auditor's independence), in a slightly different form. It was clarified in the amendments proposed in the 2017 SRC and would require that the lead auditor obtain and review a description of the nature of any non-compliance.

Some commenters on the 2017 SRC noted that the proposed requirement could be interpreted to require a description of any independence violation related to any client of the other auditor's firm. In light of the comments received, the proposed amendments have been clarified by adding the phrase "with respect to the audit client." The lead auditor is required to determine compliance with independence and ethics requirements in the context of a particular audit; accordingly, the information the lead auditor would be required to obtain from the other auditor would be relevant to the audit engagement in which the other auditor participates.[53]

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[51] *See* Rule 3526(b)(1) (requiring that the auditor describe at least annually in writing to the audit committee all relationships between the firm and the audit client "that may reasonably be thought to bear on independence"). Rule 3526 continues to apply under the proposed amendments.

[52] *See* Section III.E.3 below, which discusses that, in multi-tiered audits, proposed AS 2101.06E would allow the lead auditor to seek assistance from the first other auditor in performing the procedures described in proposed AS 2101.06D. *See also* proposed AS 1206 (in Appendix 2) for requirements relating to audits involving referred-to auditors.

[53] Other clarifying edits in the proposed independence and ethics requirements in Appendix 1 include substituting "affirmation" for "representation," "the other auditor" for "it," and "whether" for "or is not," and inserting the word "written" before "description" and the words "instances of" before "non-compliance."

iv. Following Up on Contrary Information[54]

See paragraph .06F of AS 2101 in Appendix 1

In the proposed amendments in the 2017 SRC, a note to paragraph .B4 of AS 2101 provided that if the lead auditor becomes aware of information that contradicts an affirmation made by an other auditor regarding its compliance with independence and ethics requirements, the lead auditor should perform additional procedures to determine the effect of the information on the independence of the other auditor. Some commenters on the 2017 SRC suggested changes to the note, primarily to more directly address situations in which the lead auditor becomes aware of information about the appropriateness of the other auditors policies and procedures.

In light of the comments received, the proposed amendments to AS 2101 include more specific directions for the lead auditor, in a separate paragraph, AS 2101.06F. That paragraph provides that if the lead auditor becomes aware of information that contradicts the other auditor's affirmation or description, the lead auditor should investigate the circumstances and consider the reliability of the affirmation or description. Further, if there were indications that the other auditor was not in compliance with independence and ethics requirements, the lead auditor should consider the implications for fulfilling its own responsibilities under AS 2101.06b and PCAOB Rules 3520 and 3526.

Under the proposed amendments, AS 2101.06F would encompass the situations described by commenters. For example, if there were indications – contrary to the other auditor's written affirmation – that the other auditor did not have relevant policies and procedures, the lead auditor would be required to investigate the other auditor's basis for affirming its compliance with independence and ethics requirements. If the investigation uncovers instances of the other auditor's failure to comply with independence and ethics requirements, the lead auditor would consider how such instances affect compliance at the engagement level. The lead auditor's determination of compliance with independence and ethics requirements (including with respect to the other auditors) is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.[55]

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[54] *See* Section III.E.3 below, which discusses that, in multi-tiered audits, proposed AS 2101.06E would allow the lead auditor to seek assistance from the first other auditor in performing the procedures described in proposed AS 2101.06D. *See also* proposed AS 1206 (in Appendix 2) for requirements relating to audits involving referred-to auditors.

[55] *See* note to AS 2101.06b.

v. Network Affiliation and PCAOB Registration Status[56]

Some commenters on the 2016 Proposal and 2017 SRC suggested that requirements for obtaining information about an other auditor should be less extensive if the other auditor and the lead auditor are affiliated with the same network of accounting firms. These commenters stated, for example, that the lead auditor should be able to rely on the network's quality control system in obtaining an understanding of the other auditor's qualifications, including the understanding of other auditors' compliance with independence and ethics requirements. In addition, some commenters suggested reducing the requirements with respect to other auditors that are registered with the PCAOB.

We are not proposing any additional revisions. As noted in the 2017 SRC, affiliation through a network does not automatically provide the lead auditor with an understanding of the other affiliates' processes and experience.[57] In addition, observations from PCAOB and SEC oversight indicate that even firms within the same network may have different policies, procedures, and processes for, and may exhibit differing levels of compliance with, independence and ethics requirements.[58] Similarly, PCAOB oversight has identified varying levels of compliance with independence and ethics requirements within registered firms.

Questions:

5. Are the proposed requirements relating to the lead auditor's responsibilities regarding other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the proposed amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

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[56] Appendix 1 of this release sets forth the proposed amendment related to the PCAOB registration status of other auditors in AS 2101.06G. The proposed amendment is not discussed in this release because the only changes made to it since the 2017 SRC were to streamline the language.

[57] 2017 SRC at 14.

[58] *See, e.g.,* the following independence-related matters involving global network firms: *Deloitte Accountants B.V.,* PCAOB Release No. 105-2016-051 (Dec. 13, 2016); *BDO Magyarország Könyvvizsgáló Kft.,* PCAOB Release No. 105-2017-024 (Apr. 12, 2017); *Deloitte LLP, Respondent*, PCAOB Release No. 105-2018-020 (Oct. 16, 2018); *Deloitte Touche Tohmatsu LLC, Futomichi Amano, and Yuji Itagaki*, SEC Accounting and Auditing Enforcement Release (AAER) No. 4020 (Feb. 13, 2019); *KPMG Audit Limited and Damion J. Henderson, CA,* PCAOB Release No. 105-2019-008 (Apr. 9, 2019); and *PricewaterhouseCoopers, S.C.*, PCAOB Release No. 105-2019-017 (Aug. 1, 2019). These enforcement cases were settled proceedings.

3. Knowledge, Skill, and Ability of[59] and Communications with Other Auditors

See paragraph .06H[60] of AS 2101 in Appendix 1

PCAOB standards have long recognized the importance of technical training and proficiency of the personnel performing the audit.[61] These matters are particularly important for senior engagement personnel because of their role in planning the audit, supervising the work of other engagement team members, and making important professional judgments.

Under current standards, in situations where the lead auditor supervises an other auditor under AS 1201,[62] the knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.[63] In situations where the lead auditor uses an other auditor's work, AS 1205 requires the lead auditor[64] to make inquiries concerning the professional reputation of the other auditor.[65]

Obtaining an understanding of the knowledge, skill, and ability of the other auditor's supervisory personnel is important for determining the extent of the lead auditor's supervision of the other auditor's work. As a practical matter, this involves procedures such as understanding the other auditors' experience in the company's industry or jurisdiction,[66] and understanding their knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules. Lack of appropriate knowledge, skill, and ability by the other auditors' supervisory personnel can have an adverse effect on the overall quality of the audit.

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59 *See* Section III.E.3 below, which discusses that, in multi-tiered audits, proposed AS 2101.06I would allow the lead auditor to seek assistance from the first other auditor in performing the procedures described in proposed AS 2101.06H.

60 The discussion below is focused on proposed AS 2101.06Ha-b. This release also includes minor revisions to proposed AS 2101.06Hc (which was in paragraph .B6c of the proposed amendments to AS 2101 in the 2017 SRC).

61 *See, e.g.,* AS 1010 and QC 20.11-.12.

62 *See* Section III.D.1 of this release, which discusses the following two approaches currently under PCAOB standards: supervising the other auditor's work under AS 1201, or using the work and reports of other auditors under AS 1205.

63 *See* AS 1015.06, AS 1201.06, and AS 2301.5a.

64 "Principal auditor" is the term used in AS 1205.

65 *See* AS 1205.10.

66 The proposed amendments add an explanatory phrase "including relevant knowledge of foreign jurisdictions" to AS 2101.16. *See* Appendix 1.

The 2016 Proposal would have required the lead auditor to understand the knowledge, skill, and ability of an other auditor who assists the lead auditor in planning or supervising the audit.[67] Commenters on the 2016 Proposal were generally supportive of the proposed requirement, and some suggested extending the procedures beyond the other auditor's supervisory personnel.

In response to these suggestions, the 2017 SRC would have required the lead auditor to inquire about the other auditor's policies and procedures related to (i) the training of *all* personnel at the firm who work on audits performed under PCAOB standards and (ii) the assignment of personnel to PCAOB audits.[68] A range of commenters on the 2017 SRC expressed concerns that firms outside the lead auditor's network could be reluctant to provide detailed proprietary information about how they assign and train their personnel. As a result, they would likely provide information too general to be useful, while still incurring the time and expense of providing this information. Some of those commenters recommended reverting to the approach described in the 2016 Proposal. One commenter recommended that the amendments, rather than require descriptions of training and assignment of personnel, require the lead auditor to obtain written representations from the other auditors about their knowledge, skill, and ability.

We acknowledge that in some situations, the type of general information that the other auditor would be able to provide the lead auditor may not satisfy the objective of obtaining an understanding of the qualifications of the other auditors performing work on the audit. Therefore, any gains derived from this general information may not justify the costs of providing and evaluating it. Instead, we are proposing to replace the requirement that the lead auditor inquire about the training and assignment of all other auditor personnel with a requirement that the lead auditor obtain a written affirmation from the other auditor that its personnel who participate on the engagement possess the knowledge, skill, and ability to perform the tasks on the audit assigned to them. This proposed revision together with the proposed requirement in AS 2101.06Ha (regarding other auditor supervisory personnel) are designed to focus the lead auditor and other auditors on the importance of assigning qualified personnel at all levels of the audit engagement, and to inform the lead auditor about the other auditor's compliance with relevant supervisory responsibilities.

Several commenters on the 2017 SRC, including some of those who supported the 2016 Proposal's approach, recommended that the rule text elaborate on procedures for gaining an understanding of an other auditor's knowledge, skill, and ability. Some suggested, for example, allowing the lead auditor to rely on its experience with the other auditor, other auditors' written representations, or a network quality control system (for affiliated firms). One commenter suggested that the standard specify that the lead auditor may use an other auditor

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67 *See* 2016 Proposal at A4-24.

68 *See* 2017 SRC at 15.

against whom there are currently no PCAOB sanctions and who is in compliance with applicable state laws and regulations, including state CPA licensure requirements. Some commenters suggested that the standard describe relevant sources of information that may be used to obtain information about the other auditor.

We are not proposing to prescribe – beyond requiring the written affirmation described above – lead auditor procedures or sources of information for gaining an understanding of the other auditor's knowledge, skill, and ability. The proposed amendments would allow the lead auditor to determine the nature and extent of its procedures in this area. The lead auditor's approach would depend, to a large extent, on the types of information available to the lead auditor and the engagement responsibilities envisioned for the other auditor. Obtaining and evaluating information regarding the other auditors' knowledge, skill, and ability is not a discrete step; it is part of a continual and iterative process.[69]

We agree with commenters that possible sources of information about the other auditor's knowledge, skill, and ability may include the lead auditor's experience with the other auditor and (for individuals at affiliated firms) information from the audit network. For example, some audit networks have established procedures for sharing certain information about the results of internal or external (e.g., PCAOB) inspections of the affiliates among select personnel of their member firms.[70] The proposed amendments, however, would not allow the lead auditor to rely solely on the general qualification requirements of a network.[71] Obtaining[72] an understanding of the other auditor's knowledge, skill, and ability will necessarily involve obtaining information specifically about the individuals in supervisory roles at the other auditor, which is critical to determining whether the other auditor is qualified to perform tasks assigned by the lead auditor. (The proposed written affirmation requirement in AS 2101.06Hb regarding the other auditor's engagement team members would not need to specifically identify each member of the engagement team.)

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69 *See, e.g.*, AS 2101.05.

70 In addition to inspection reports, other items on the PCAOB website may contain information relevant to obtaining an understanding of the other auditor's knowledge, skill, and ability. Such information includes PCAOB enforcement actions and disclosures of certain events on Form 3, *Special Report*, on which registered audit firms must report certain legal proceedings, changes in certain licenses and certifications, and other matters. *See also* PCAOB, "Form 3 Reportable Events" (PCAOB resource describing the information that audit firms must report on Form 3).

71 *See* discussion above in Section III.C.2.v regarding "Network Affiliation and PCAOB Registration Status."

72 As noted above in Section III.C.2.i, the verb used in the proposed requirement has changed from "gain" to "obtain" to more closely align with terminology used in existing PCAOB standards when required to "obtain an understanding."

Questions:

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?

4. Determining Locations or Business Units at Which Audit Procedures Should Be Performed

See paragraph .14 of AS 2101 in Appendix 1

Other auditors are often involved in audits of companies with operations in multiple locations or business units ("multi-location engagements"). For multi-location engagements, existing AS 2101.11-.13 address the determination of the locations at which audit procedures should be performed and the nature, timing, and extent of the audit procedures. Existing AS 2101.14 provides that, in situations in which AS 1205 applies, the auditor performs the procedures in paragraphs .11-.13 to determine the locations or business units where audit procedures should be performed.

Under the proposed amendments, the requirements of AS 2101.14 would be amended to specify that, in an audit involving other auditors or referred-to auditors, the lead auditor should perform the procedures set forth in AS 2101.11-.13 to determine the locations or business units at which audit procedures should be performed. This proposed amendment to AS 2101.14, together with the proposed supervisory requirements in AS 1201, are intended to ensure that the lead auditor plays the central role in determining the scope of the audit.

In the 2016 Proposal and the 2017 SRC, proposed amendments to AS 2101.14 would have included a phrase that 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." Several commenters on the 2016 Proposal and 2017 SRC found that phrase confusing. For example, for some commenters it was unclear whether discussions with both other auditors and referred-to auditors would always be required, or whether the lead auditor could use judgment in performing the procedures in AS 2101.11-.13. In the view of one commenter, the proposed provision conflicted with the iterative nature of the risk assessment process where (under existing standards) the lead auditor may identify and assess risks even before identifying locations or business units. Further, one commenter indicated that greater involvement by the lead auditor in the work of the referred-to auditor diminishes the "clear line" with respect to responsibility and several other commenters pointed out that discussions with some auditors may not always be possible.

We understand the concerns of commenters and are revising the proposed amendments to remove the above phrase, to avoid confusion. Although the phrase was intended to emphasize the importance of collaboration between auditors, upon further consideration it appears that other requirements in the auditing standards would be effective in accomplishing this objective. For example, for audits involving other auditors, AS 2110.49-.53 would require the auditor to hold brainstorming discussions about risks of material misstatements with other auditors who are key engagement team members. For audits involving referred-to auditors, proposed AS 1206 describes interactions between the lead auditor and the referred-to auditor.

D. Supervising Other Auditors

1. Overview of the Supervisory Approach

Under existing standards, AS 1205 requires the lead auditor to perform certain procedures, when using the work and reports of other auditors, that are much more limited in scope than those required by the current supervision standard, AS 1201.[73] The proposed amendments are designed to improve the lead auditor's oversight of other auditors by applying AS 1201 to *all* audits involving other auditors for whose work the lead auditor assumes responsibility, including the audits currently performed under AS 1205.[74] The approach to supervising other auditors under the proposed amendments is consistent with, and takes into account, developments at some accounting firms that have been observed through the Board's oversight activities.[75]

Currently, AS 1201 establishes requirements for supervision of the audit engagement, including supervising the work of all engagement team members. The standard allows the engagement partner to seek assistance in fulfilling his or her supervisory responsibilities from appropriate engagement team members, including team members from other firms involved in the audit. AS 1201 does not, however, describe specific supervisory procedures or assign them to a particular member, or members, of the engagement team.

The proposed amendments would not supersede any of the existing requirements of AS 1201. The engagement partner and other members of the engagement team who have supervisory roles, at the lead auditor and other auditors, are required to carry out their

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[73] "Principal auditor" is the term used in AS 1205.

[74] For situations in which the lead auditor divides responsibility for the audit with another accounting firm, *see* Appendix 2 of this release. For certain audits involving investments accounted for under the equity method of accounting whose financial statements are audited by other auditors, *see* Appendix 1 of this release for proposed changes to Appendix B of AS 1105.

[75] *See* 2016 Proposal at 14-19 and PCAOB, *Spotlight: Staff Update and Preview of 2019 Inspection Observations* (Oct. 8, 2020).

supervisory responsibilities under the provisions of AS 1201. The proposed amendments further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth in AS 1201. The proposed amendments would not preclude the lead auditor from seeking other auditors' assistance in performing any other necessary supervisory procedures that are not specified in the proposed amendments.[76]

The proposed amendments are designed to be scalable. When designing and performing the supervisory activities, the lead auditor would determine the extent of supervision of the other auditors' work in accordance with paragraph .06 of AS 1201, which describes the factors to take into account when determining the extent of supervision necessary.[77] For example, the extent of the lead auditor's supervision of the other auditors' work would depend on, among other things, the risks of material misstatement to the company's financial statements being addressed by the other auditors' work and the knowledge, skill, and ability of the other auditors.[78] The lead auditor may determine that the necessary extent of supervision of the other auditor's work under AS 1201 entails performing supervisory procedures beyond those specified in the proposed amendments.

2. Informing Other Auditors of Their Responsibilities

See paragraph .08 of AS 1201 in Appendix 1

AS 1201 currently requires that engagement team members be informed of their responsibilities, including the objectives and details of the procedures to be performed, and other relevant matters.[79] For audits performed in accordance with AS 1205, the standard does not include a specific requirement for the lead auditor to inform other auditors of their responsibilities.[80]

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76 *See* AS 1201.04.

77 *See* proposed amendment AS 1201.07 in Appendix 1 of this release.

78 *See* AS 1201.06.

79 *See* AS 1201.05a.

80 According to AS 1205.12, the lead auditor (or "principal auditor" in its terminology) should consider, among other things, reviewing the audit programs of the other auditor and issuing instructions to the other auditor.

To promote effective supervision of the other auditor's work by the lead auditor, the proposed amendments to AS 1201 would require the lead auditor to inform other auditors in writing of the following matters:

- The scope of work to be performed by the other auditor (e.g., location or business unit[81] and the general type of work to be performed, which could range from a few specified audit procedures to a standalone audit); and

- With respect to the work requested to be performed: the identified risks of material misstatement,[82] tolerable misstatement,[83] and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.[84]

Some commenters on the 2016 Proposal and the 2017 SRC interpreted the proposed amendments as requiring the lead auditor to communicate to other auditors *all* the risks of material misstatement for the location or business unit, or even *all* identified risks of material misstatement to the consolidated financial statements. Some of those commenters recommended that the lead auditor be required to communicate only the significant risks or only risks that are relevant to the other auditors' work.

We agree with commenters who stated that the lead auditor should communicate to other auditors those risks to the consolidated financial statements that are *relevant* to the other auditors' work. To clarify the requirement, we have revised the proposed amendments in AS 1201.08b to include the phrases "[w]ith respect to the work requested to be performed" and "to the consolidated financial statements that are applicable to the location or business

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81 In multi-location engagements that involve other auditors, the proposed amendments would require the lead auditor to determine locations or business units at which audit procedures should be performed. See proposed amendment to AS 2101.14.

82 *See* AS 2110.49-.53 (referenced in a footnote to proposed AS 1201.08), which requires key engagement team members (including those in differing locations) to hold discussions regarding risks of material misstatement due to error or fraud, which inform the identification and assessment of risks.

83 *See* AS 2105.08–.10 (referenced in a footnote to proposed AS 1201.08), which describe determining the amount or amounts of tolerable misstatement, including for the individual locations or business units, where applicable. As noted in the 2016 Proposal at 4, it is common for audits using other auditors to take place in different locations, including different countries.

84 *See* paragraphs .10-.11 of AS 2810, *Evaluating Audit Results* (referenced in a footnote to proposed AS 1201.08) which require auditors to accumulate misstatements identified during the audit, other than those that are clearly trivial, and provide that auditors may designate an amount below which misstatements are trivial and do not need to be accumulated. The proposed requirement in the amendments indicates that the lead auditor makes the determination of the clearly trivial threshold under AS 2810, if such a threshold is determined.

unit." The proposed amendments do not limit the lead auditor's communication to significant risks (as some commenters suggested) because doing so could lead to inadequate testing of significant accounts and disclosures where a reasonable possibility of material misstatement to the financial statements exists.

Some commenters also questioned whether the lead auditor is always best suited to assess risks of material misstatement at locations or business units audited by other auditors. Although requiring the lead auditor to communicate to the other auditor the relevant risks of material misstatement to the company's financial statements is consistent with the lead auditor's responsibilities under PCAOB standards, existing PCAOB standards also recognize that additional risks of material misstatement to the company's financial statements may be identified by other auditors, who could be more familiar than the lead auditor with a particular location or business unit where such risks may originate. All key engagement team members, including those at the other auditor firms, are currently required to discuss the susceptibility of the company's financial statements to material misstatement due to error or fraud, as part of performing the risk assessment procedures.[85] These requirements are retained by the proposed amendments.[86]

In addition, the proposed amendments include a note to paragraph AS 1201.08 stating that the lead auditor should, as necessary, hold discussions with and obtain information from the other auditor to facilitate the performance of procedures described in that paragraph.

3. Obtaining and Reviewing a Written Description of the Audit Procedures to Be Performed by the Other Auditors

See paragraphs .09 and .10 of AS 1201 in Appendix 1

Existing PCAOB standards require that the auditor develop and document an audit plan that includes a description of, among other things, the planned nature, timing, and extent of the risk assessment procedures, tests of controls, and substantive procedures.[87] In addition, pursuant to AS 1201, the auditor is required to inform engagement team members of their responsibilities, including the nature, timing, and extent of procedures they are to perform.[88] In situations governed by AS 1205, the lead auditor should consider reviewing the audit programs of the other auditor.[89]

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85 *See* AS 2110.49-.53.

86 *See* footnote reference to proposed AS 1201.08b(1) in Appendix 1.

87 *See* AS 2101.10.

88 *See* AS 1201.05a(2).

89 *See* AS 1205.12.

The proposed amendments to AS 1201 would require the lead auditor to obtain and review the other auditor's written description of audit procedures to be performed,[90] determine whether any changes to the other auditor's planned audit procedures are necessary, and if so, discuss the changes with, and communicate them in writing to, the other auditor.[91] The lead auditor would be required to inform the other auditor of the level of detail needed in the other auditor's written description of audit procedures to be performed, based on the necessary extent of the lead auditor's supervision.

These proposed amendments are intended to promote proper supervision of the other auditors' work by the lead auditor and proper coordination of work performed by the lead and other auditors. Importantly, the proposed amendments are designed to accommodate different scenarios encountered in practice. For example, the other auditor who is more familiar than the lead auditor with a location or business unit may be better positioned to design detailed audit procedures for that part of the audit (which procedures would then be subject to the lead auditor's review and approval). Conversely, an other auditor who lacks experience in addressing certain risks may not be best suited to plan the work or to design detailed audit procedures in that area. The proposed amendments provide that, as the necessary extent of supervision increases, the lead auditor, rather than the other auditor, may need to determine the nature, timing, and extent of procedures to be performed by the other auditor.[92]

The proposed amendments are substantially the same as those proposed in the 2017 SRC except for one clarifying change – in the requirement that the lead auditor obtain and review a description of the other auditor's planned audit procedures, the word "written" has been added before "description of the audit procedures to be performed."[93] As noted above, existing standards generally require the auditor to develop and document an audit plan that describes the audit procedures to be performed.[94] In the proposed amendments, the addition of the word "written" would clarify that, for audits involving other auditors, the other auditor's planned audit procedures also should be documented.

One commenter on both the 2016 Proposal and the 2017 SRC expressed the view that the proposed requirement that the lead auditor communicate in writing to the other auditor any needed changes to the other auditor's description of the audit procedures, was too

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90 *See* proposed amendment to AS 1201.09 in Appendix 1 in this release. In the 2016 Proposal and 2017 SRC, the proposed requirement appeared in paragraph .B2 of Appendix B to AS 1201.

91 *See* proposed amendment to AS 1201.10 in Appendix 1 in this release.

92 *See* proposed note to AS 1201.09. This provision was originally introduced in the 2016 Proposal and would be substantially the same as originally proposed, with a clarification that the lead auditor may need to determine the details of the procedures "[a]s the necessary extent of supervision increases" (as implied in the previously proposed rule text) (AS 1201.B2b).

93 *See* proposed amendment to AS 1201.09 in Appendix 1 in this release.

94 *See* AS 2101.10.

prescriptive and that the proposed amendments should allow lead auditors to determine how to communicate changes to other auditors. Observations from PCAOB oversight have shown challenges with communication and coordination between lead auditors and other auditors that compromised the quality of other auditors' audit work. The proposed amendments in this SRC are designed to clarify the responsibilities of the auditors, which could reduce the likelihood of misunderstandings by helping to strengthen the coordination and communication between the lead auditor and other auditors in this area. Therefore, we are not proposing any substantive revisions to the proposed requirements.

4. Obtaining and Reviewing the Other Auditor's Written Affirmation Regarding Work Performed

See paragraph .11 of AS 1201 in Appendix 1

The proposed amendments in both the 2016 Proposal and 2017 SRC would not have retained the statement currently in AS 1205.03 that "the other auditor remains responsible for the performance of his own work and for his own report." The proposed amendments would have required the lead auditor to obtain and review a document describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion.[95] Some commenters asked that we clarify how the proposed requirement would work in relation to the PCAOB standard on documentation, AS 1215. In some commenters' view, the proposed document (described in the 2017 SRC as a "summary memorandum") could duplicate information that the lead auditor is already required to obtain, review, and retain in accordance with AS 1215, such as key aspects of the other auditor's work, which are included in the engagement completion document.[96]

Having considered the comments received, we are proposing to revise the amendments to avoid unnecessary duplication of audit documentation. Instead of requiring the lead auditor to obtain a "summary memorandum," the proposed amendments would require the lead auditor to obtain and review a written affirmation[97] as to whether the other auditor has performed the work in accordance with instructions provided, as described in proposed paragraphs AS 1201.08-.10, including the use of applicable PCAOB standards. If the other auditor has not performed work in such a manner, the lead auditor would obtain and review a description of the nature of, and explanation of the reasons for, instances where the work was

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[95] The document that was proposed to be required was referred to as a "written report" in the 2016 Proposal (in proposed AS 1201.B2d), and as a "summary memorandum" in the 2017 SRC (in proposed AS 1201.B2d). *See* 2016 Proposal at A4-35 and 2017 SRC at 18.

[96] *See* AS 1215.19. *See also* AS 1215.12 and .13, which discuss the engagement completion document.

[97] The proposed amendments have been revised to use the term "affirmation" for certain communications *within* the engagement team (e.g., AS 2101.06Db, AS 2101.06F, and AS 2101.06Hb.), to better differentiate them from certain communications *outside* the engagement team, which are described in the proposed amendments as "representations" (e.g., AS 1206).

not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed.

This new proposed requirement is designed to both inform the lead auditor of audit areas that may require additional attention, and emphasize the other auditor's responsibility for properly planning and performing its work. It is also consistent with the practice by some accounting firms that an other auditor affirms in writing its compliance with the lead auditor's instructions (e.g., in an "interoffice memorandum" issued at the completion of the other auditor's work). As revised, the proposed amendment would complement, without duplicating, the requirement in AS 1215.19 for the lead auditor to obtain, review, and retain certain documents relating to the other auditor's work.

5. Directing the Other Auditors to Provide Specific Documentation

See paragraph .12 of AS 1201 in Appendix 1

Supervision under existing PCAOB standards necessarily involves review of audit documentation.[98] For example, under AS 1201, the engagement partner and other engagement team members performing supervisory activities should review the work of engagement team members to evaluate whether the work was performed and documented. (AS 1201 does not prescribe specific documents to be reviewed.) In addition, for audits involving other auditors, PCAOB standards describe certain documentation of the other auditor's work that the lead auditor must obtain, review, and retain prior to the report release date.[99]

The proposed amendments would supplement the existing standards by requiring the lead auditor to direct the other auditor to provide for the lead auditor's review specified documentation with respect to the work the other auditor is requested to perform. This requirement is designed so that the lead auditor obtains information about the other auditor's work that is necessary for the lead auditor to carry out its supervisory responsibilities. Under the 2017 SRC, the lead auditor would have been required to inform the other auditor of the necessary level of detail of the information the lead auditor requests.

Some commenters on the 2017 SRC suggested that the lead auditor should not be required to obtain and review other auditors' documentation beyond what is described in AS 1215.19. At the same time, commenters generally agreed that in some circumstances reviewing additional documentation (i.e., beyond the items listed in AS 1215.19) may be necessary, such as in areas with heightened risk of material misstatement. The commenters also recommended that the amendments allow the lead auditor discretion in determining the

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98 *See, e.g.,* AS 1201.05c.

99 *See, e.g.,* AS 1215.19 and AS 1205.12.

extent of any additional review of other auditors' documentation. Some commenters suggested that the scope of any additional review should be based on certain factors, including risk.

The proposed amendments have been revised from those in the 2017 SRC version to specifically state that the documentation requested by the lead auditor from the other auditor would depend on the necessary extent of supervision of the other auditor's work by the lead auditor (which is based on a number of factors, including risk). Thus, under the proposed amendments, review of additional documentation (i.e., beyond the items listed in AS 1215.19) could be necessary, for example, for work performed by less experienced other auditors, procedures in areas with heightened risks of material misstatement, or procedures to resolve significant issues arising during the audit. In directing the other auditor to provide specified documentation, the lead auditor could, for example, specify individual documents, types of documents, or documentation for audit areas that it intends to review.[100]

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?

E. Multi-Tiered Audits

1. Supervisory Procedures – Directing the First Other Auditor

See paragraphs .14-.15 of AS 1201 and paragraphs .06Ac and .06E of AS 2101 in Appendix 1

For various reasons, some engagement teams could involve multiple tiers of other auditors. Such "multi-tiered" audits are not expressly addressed in the existing standards. The proposed amendments in this release would clarify that in multi-tiered audits the lead auditor may seek assistance from an other auditor (a "first other auditor") in fulfilling certain planning and supervisory responsibilities of the lead auditor with respect to one or more second other auditors. (Seeking assistance with planning responsibilities is discussed in Section III.E.3 below.)

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[100] Other clarifying edits are proposed in AS 1201.13 in Appendix 1 and include adding specific references to the "lead auditor" responsibilities, deleting the term "summary memorandum" for reasons discussed above, replacing "written communications" with "lead auditor's instructions," including paragraph references to such instructions, and adding the phrases, "including the use of applicable PCAOB standards" regarding the work performed by the other auditor and "with respect to one or more locations or business units in response to the associated risks."

A multi-tiered audit of a U.S.-based multinational corporation that consolidates the results of its European operations in the U.K. could include the following structure:

- A U.S. firm as lead auditor;
- A U.K. firm as first other auditor, auditing the European operations; and
- A German firm as a second other auditor, auditing a business unit in Germany that is consolidated into, and is a significant portion of, the European operations.

In this example, under the proposed amendments, the lead auditor could seek assistance from the U.K. firm in supervising the work of the second other auditor in Germany.[101] In a more complex structure, the lead auditor could seek assistance from a first other auditor in supervising the work of multiple second other auditors.

In the 2016 Proposal, the lead auditor would be allowed to direct a first other auditor to perform certain required supervisory procedures with respect to a second other auditor on behalf of the lead auditor, if appropriate, pursuant to factors set out in AS 1201.06.

Commenters on the 2016 Proposal and the 2017 SRC generally supported addressing multi-tiered audits in the proposed amendments. However, some commenters were concerned that amendments in the 2016 Proposal would preclude the lead auditor from seeking a first other auditor's assistance in communicating the scope of work, tolerable misstatement, and risks of material misstatement to a second other auditor. In the commenters' view, a first other auditor often is better positioned to make those communications because it may understand operations and controls at a company location better than the lead auditor.

We agreed that the proposed amendments should allow the most appropriate auditor (i.e., lead auditor or first other auditor) to communicate with and direct the work of the second other auditor. As a result, we revised the amendments in the 2017 SRC to allow the lead auditor to direct an other auditor to perform certain supervisory procedures with respect to a second other auditor on behalf of the lead auditor, if appropriate.[102] Commenters supported the

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[101] Proposed amendments in the 2017 SRC included an example of a similar company structure, but – because of a wide range of company structures that exist in practice – the example has been removed from the proposed amendments, to avoid the misperception that the amendments are applicable solely to a particular structure.

[102] The supervisory procedures are described in proposed AS 1201.08-.13. The lead auditor's determination of whether it would be appropriate for the first other auditor to perform supervisory procedures with respect to the second other auditor would be based on the factors for determining the extent of supervision in AS 1201.06.

change, and the proposed amendments[103] in this release are substantially the same as those proposed in the 2017 SRC.[104]

2. Supervisory Procedures – Evaluating the First Other Auditor's Supervision of the Second Other Auditor's Work

In conjunction with directing the first other auditor to perform supervisory procedures described in AS 1201.14 (discussed in Section III.E.1 above), the 2017 SRC would have required that the lead auditor obtain, review, and retain certain documentation relating to the second other auditor's work (such as planning documentation, a summary memorandum, and the items described in AS 1215.19). Some commenters on the 2017 SRC noted that the proposed requirement would have resulted in the lead auditor obtaining, reviewing, and retaining some or all of the same documentation relating to the second other auditor's work that the first other auditor obtains, reviews, and retains. The commenters therefore recommended that the lead auditor be allowed to determine the extent of its review of the second other auditor's work.

To avoid unnecessary duplication of the first other auditor's review by the lead auditor, a proposed requirement in the 2017 SRC to review the second other auditor's planning documentation has been replaced in this release with a proposed requirement to review documentation identifying the second other auditor's scope of work. Further, instead of requiring the lead auditor to review a "summary memorandum" (as proposed in the 2017 SRC), the proposed amendments would require that the lead auditor take into account the first other auditor's review of the second other auditor's work in determining the extent of its own review, if any, of the second other auditor's work.

In addition, the proposed amendments[105] clarify that, for purposes of the lead auditor's compliance with AS 1215.19 with respect to work performed by a second other auditor, the lead auditor may request that the first other auditor both (i) obtain, review, and retain the audit documentation described in AS 1215.19 related to the second other auditor's work and (ii) incorporate the information in that documentation in the first other auditor's documentation that it provides to the lead auditor pursuant to AS 1215.19.[106] In other words,

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[103] *See* proposed AS 1201.14 in Appendix 1 of this release. Other proposed provisions of AS 1201.14 are discussed below in Section III.E.2.

[104] In a multi-tiered audit, the engagement partner remains responsible for the engagement and its performance, including the supervision of engagement team members. *See* AS 1015.06 and AS 1201.04.

[105] *See* proposed note to AS 1201.14 in Appendix 1 of this release.

[106] The proposed amendments would not change the existing requirement of AS 1215.19. In situations where no other auditor is assisting the lead auditor with supervising an other auditor's work, the documentation described in AS 1215.19 related to the other auditor's work must be obtained, reviewed, and retained by the lead auditor.

the amendments would not require the first other auditor to provide to the lead auditor multiple sets of the same type of documentation – e.g., the first other auditor could submit to the lead auditor one schedule that incorporates misstatements identified during the audit by the first other auditor and the second other auditors.

Thus, under the proposed amendments, the lead auditor would apply the provisions of AS 1201.06, including taking into account the knowledge, skill, and ability of the first other auditor, when determining the necessary extent of its review (if any) of the second other auditor's work. This approach would be consistent with the commenters' suggestions and with the supervision approach under existing PCAOB standards. For example, the lead auditor could determine it needs to be less involved in supervising the second other auditor (including reviewing the second other auditor's work) if the first other auditor has adequate experience in areas audited by the second other auditor, maintains documentation sufficient to understand the supervisory procedures it performs with respect to the second other auditor, and if no unexpected issues arise during the audit.

3. Audit Planning – Serving as Lead Auditor and Seeking Assistance from a First Other Auditor Relating to a Second Other Auditor's Qualifications

As discussed in more detail in Section III.C.1 above, the proposed amendments include a third consideration for determining whether the participation of an engagement partner's firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements.[107] This third consideration pertains to the extent of the engagement partner's firm's supervision of other auditors' work for portions of the company's financial statements for which the other auditors perform audit procedures. With regard to multi-tiered audits, we are proposing that this consideration apply only to the engagement partner's firm's direct supervision of other auditors, and not to any supervisory assistance that the firm might receive from other auditors in a multi-tiered audit.

With regard to performing certain other planning procedures some commenters suggested allowing the lead auditor to seek assistance from the first other auditor. More specifically, the lead auditor could seek assistance from the first other auditor in performing the proposed planning procedures relating to the second other auditor's qualifications, including its (i) compliance with independence and ethics requirements, and (ii) knowledge, skill, and ability, (which are discussed above in Sections III.C.2 and III.C.3). The commenters noted that seeking assistance from the first other auditor in performing these procedures would be appropriate because the first other auditor interacts more closely than the lead auditor does with the second other auditor.

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107 *See* proposed AS 2101.06Ac.

We agree with the commenters and are proposing to revise the provisions in the amendments to allow a first other auditor to assist the lead auditor in performing the procedures described in paragraph AS 2101.06D (independence and ethics)[108] and AS 2101.06H (knowledge, skill, and ability, and certain other items).[109]

Under the proposed amendments, if a first other auditor assists the lead auditor in performing the procedures described in AS 2101.06D with respect to one or more second other auditors, the lead auditor should instruct the first other auditor to inform the lead auditor of the results of procedures performed, including bringing to the lead auditor's attention any information indicating that a second other auditor is not in compliance with the independence and ethics requirements. The proposed amendments emphasize that the lead auditor remains responsible for determining compliance with the independence and ethics requirements.[110]

Allowing, under the proposed requirements,[111] a first other auditor to assist the lead auditor to perform the proposed procedures described in AS 2101.06H with respect to one or more second other auditors would be consistent with the requirement that a first other auditor should take into account the second other auditor's qualifications to determine the necessary extent of supervision of the second other auditor's work.[112] The lead auditor's evaluation of the first other auditor's supervision of the second other auditor's work would necessarily cover the procedures that the first other auditor performs regarding the second other auditor's qualifications.

4. Further Tiers of Other Auditors

In addition to the first and second other auditors, some engagements may involve further tiers of other auditors. For example, in the scenario discussed in Section III.E.1 above, the other auditor in Germany could assist the auditors in the U.S. and U.K. with supervising the work of an accounting firm in Belgium ("a third other auditor") that audits the company's local subsidiary.[113] For one commenter, it was unclear whether in such situations the 2016 Proposal would apply at every level, requiring some other auditors to act as "lead auditors" for the next tier below.

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108 *See* proposed AS 2101.06E in Appendix 1 of this release.

109 *See* proposed AS 2101.06I in Appendix 1 of this release.

110 *See* proposed AS 2101.06E in Appendix 1 of this release.

111 *See* proposed AS 2101.06I in Appendix 1 of this release.

112 *See* AS 1201.06d.

113 In proposed footnote 19 to AS 1201.14, an "e.g." is added to the sentence, which describes multi-tiered audits, to avoid suggesting that no tiers could exist beyond the second other auditor(s).

PCAOB standards are designed to work in situations involving multiple tiers of other auditors. While the proposed amendments are focused on certain responsibilities of the lead auditor, other requirements of PCAOB standards apply, and would continue to apply under the proposal, to all auditors involved in the audit. For example, in determining the necessary extent of supervision of the third other auditor's work, the second other auditor would be required to take into account items listed in AS 1201.06, including the nature of the work assigned to the third other auditor, the risks of material misstatement, and the third other auditor's knowledge, skill, and ability.

Questions:

8. In multi-tiered audits, are the proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures, and evaluates such supervision, with respect to a second other auditor on behalf of the lead auditor, clear and appropriate? If not, how should the proposed requirements be revised?

9. In multi-tiered audits are the proposed requirements in audit planning regarding:

a. The sufficiency determination relative to the extent of the engagement partner's firm's supervision of the other auditors' work, clear and appropriate; and

b. Allowing the lead auditor to seek assistance from the first other auditor in performing the proposed planning procedures relating to the second other auditor's qualifications (i.e. independence and ethics, and knowledge, skill, and ability), clear and appropriate?

If the answer to questions 9.a or 9.b is that the proposed requirements are not clear and appropriate, how should they be revised?

F. Dividing Responsibility for the Audit with Another Accounting Firm

See proposed AS 1206 in Appendix 2

1. Retaining the Divided-Responsibility Approach under PCAOB Standards

The proposed new standard, AS 1206, specifically addresses the lead auditor's division of responsibility with another accounting firm (i.e., referred-to auditor[114]). Proposed AS 1206 would apply when the lead auditor divides responsibility for an audit of the financial statements and, if applicable, internal control over financial reporting. Currently, divided responsibility engagements are relatively uncommon.[115]

If there is more than one referred-to auditor, the proposed requirements in AS 1206.03-.09 would apply to the lead auditor regarding each referred-to auditor separately. If the lead auditor assumes responsibility for the work of another accounting firm, the lead auditor would be required to supervise the other firm's work in accordance with AS 1201.[116] The proposed new standard would retain, with certain modifications, relevant requirements for the divided-responsibility scenario that are currently in AS 1205. Proposed AS 1206 (similar to AS 1205) would not require the lead auditor to supervise the referred-to auditor's work. Rather, each auditor would be required to supervise its respective engagement team members in accordance with AS 1201.

Under proposed AS 1206, both the lead auditor and referred-to auditor would remain responsible for their respective audits. For example, both the lead auditor and referred-to auditor would be required to comply with PCAOB standards when planning and performing their audits, including making materiality determinations, and issuing audit reports.[117] Similar to the current approach in AS 1205 in the divided-responsibility scenario, the proposed amendments would require that the engagement partner determine the sufficiency of his or her firm's participation in the audit to serve as the lead auditor.[118]

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[114] AS 1205 does not use the term "referred-to auditor." The proposed definition of "referred-to auditor" is discussed above in this release, in Section III.B.3.

[115] According to PCAOB staff analysis of Form AP filings with the PCAOB, lead auditors currently divide responsibility with another auditor in about 40 issuer audits per year. Form AP filings between January 1 and December 31 showed lead auditors divided responsibility with another auditor in 41 issuer audits in 2020, 37 issuer audits in 2019, and 42 issuer audits in 2018.

[116] *See* proposed amendments to AS 1206 in Appendix 2 of this release.

[117] *See, e.g.*, AS 2101.11-.14 and AS 2105.10.

[118] This requirement appears in proposed AS 2101.06A–C in Appendix 1 of this release.

In the 2016 Proposal, the proposed amendments retained the divided-responsibility approach, which has long been permitted in PCAOB standards,[119] but we asked commenters whether the approach should be eliminated. Most commenters on this matter in the 2016 Proposal supported retaining the divided-responsibility approach because they observed no compelling practice issues that would suggest a need to eliminate it. In the 2017 SRC, the approach was retained.

Although most commenters to the 2016 Proposal supported retaining the divided-responsibility approach, some commenters on both the 2016 Proposal and the 2017 SRC expressed concern about retaining the approach.[120] They stated that the lead auditor is ultimately responsible for the overall audit opinion and should not refer to other auditors.[121] One commenter contended that the effectiveness of audit committee oversight could be reduced if the audit committee has no relationship with the referred-to auditor. In the same commenter's view, the risk of leakage of market sensitive information may increase if the referred-to auditor is involved in a corporate transaction (e.g., by consenting to the use of its report in a registration statement).[122]

Having considered the comments received, we are proposing to retain the divided-responsibility alternative, with certain conditions set forth in the proposed standard. Without the ability for auditors to divide responsibility, some companies may encounter situations in which no accounting firm is in a position to opine on the company's financial statements. For example, if it is impracticable for the lead auditor to supervise the other accounting firm (or audit the entire consolidated financial statements), the lead auditor might withdraw from the

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[119] The SEC has historically accepted audit reports indicating a division of responsibility between a lead auditor and referred-to auditor that express their opinion on the respective financial statements.

[120] One commenter, for example, expressed concern that a lead auditor might divide responsibility with another firm in order to avoid liability for its work on the audit. It should be noted, however, that under the proposed amendments a lead auditor that divides responsibility with another firm continues to have certain responsibilities with regard to the referred-to auditor under proposed AS 1206. *See, e.g.,* proposed AS 1206.06b (permitting a lead auditor to divide responsibility only if, among other things, it determines, based on inquiries and other information, that the referred-to auditor knows the relevant requirements of the applicable financial reporting framework, PCAOB standards, and SEC financial reporting requirements).

[121] Similar comments were made by certain members of the Board's Standing Advisory Group (SAG) at the May and December 2016 SAG meetings and the May 2017 SAG meeting. At the May 2016 and 2017 SAG meetings, the observer from the Auditing Standards Board ("ASB") acknowledged that AICPA standards allow for divided responsibility. *See* Transcript excerpts on the PCAOB's website (https://pcaobus.org/Rulemaking/Pages/Docket042.aspx).

[122] The commenter described these potential outcomes as "unintended consequences" of the amendments.

engagement or disclaim its opinion because the lead auditor is unable to obtain sufficient appropriate evidence regarding the portion of the company audited by the other firm.

In response to the comment regarding a potential reduction in the effectiveness of audit committee oversight and the risk of leakage of market sensitive information, we note that existing PCAOB standards already require that the audit committee of the consolidated company be informed about the lead auditor's overall strategy with respect to the use of other accounting firms.[123] The information that the lead auditor is required to provide includes, for example, the names, locations, and planned responsibilities of other firms or other persons not employed by the lead auditor that perform audit procedures.[124] Providing this information to the audit committee could facilitate a discussion of how the work of the referred-to auditors would affect the audit.[125]

Referred-to auditors would likely not have a direct line of communication with the audit committee of the company audited by the lead auditor – especially in situations in which the business unit audited by the referred-to auditor is accounted for under the equity method of accounting (i.e., the method used for the majority of the approximately 40 divided-responsibility audits that currently occur each year, according to PCAOB staff analysis[126]). However, because referred-to auditors are required to perform the audit in accordance with PCAOB standards, they would be required to communicate under AS 1301 with the audit committee or equivalent of the business unit they are auditing.[127] This includes (i) communicating with the business unit's audit committee or equivalent regarding certain matters related to the conduct of an audit, (ii) obtaining certain information from the audit committee relevant to the audit; and (iii) establishing an understanding of the terms of the audit with the audit committee and recording that understanding in an engagement letter. This proposal would not alter these requirements.

2. Reporting on Conversion Adjustments

In some divided-responsibility scenarios, the company's consolidated financial statements (audited by the lead auditor) and the business unit's financial statements (audited by the referred-to auditor) could be prepared under different financial reporting frameworks. For example, the consolidated financial statements could be prepared under the accounting

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123 *See* AS 1301.10.

124 *Id*.

125 *See Auditing Standard No. 16 – Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Sec. 380*, PCAOB Release No. 2012-004 (Aug. 15, 2012), at A4-13 through A4-15.

126 *See* note 115 above.

127 Proposed footnote 7 to AS 1206.03 in Appendix 2 indicates that the term "business units" includes subsidiaries, divisions, branches, components, or investments.

principles generally accepted in the U.S., and a business unit's financial statements under the International Financial Reporting Standards.

In practice, the accounting adjustments to convert the business unit's financial statements into the financial reporting framework used for the company's consolidated financial statements ("conversion adjustments") could be audited by the lead auditor or by the referred-to auditor. Appendix B of proposed AS 1206 would provide examples of the introductory paragraphs in the lead auditor's report when the conversion adjustments are audited by the lead auditor (Example 3) and the referred-to auditor (Example 4).

Several commenters on the 2017 SRC suggested revisions to proposed examples. In the view of one commenter, in situations where the lead auditor audited the conversion adjustments, it would be inconsistent to consider the adjustments in the percentages audited by the referred-to auditor. We disagree, because the magnitude of the portion of the company's financial statements audited by the referred-to auditor doesn't change depending on which auditor audited the conversion adjustments. Further, the lead auditor's report would clearly state which auditor audited the adjustments.

Some other commenters asked that the examples be modified so that the lead auditor's report indicates which auditor was responsible for auditing the company's controls over the adjustments in conjunction with the audit of internal control over financial reporting. We are not planning to include this revision in the examples. The disclosure in the lead auditor's report would depend on a number of factors, including the location of the controls over the conversion adjustments[128] and whether the lead auditor or the referred-to auditor audited the controls.[129] The examples presented in proposed AS 1206 would be non-exclusive, and lead auditors could customize their reports to the circumstances of their audits.

Having considered the comments received, we are not proposing changes to the examples proposed in the 2017 SRC, except for revisions to the auditor's report language to reflect the Board's adoption of amendments to AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which were approved by the SEC after the issuance of the 2017 SRC.[130]

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[128] For example, some of the controls could be located at the company's headquarters and some at the business unit.

[129] *See, e.g.,* AS 2201.B16, discussing certain situations in which the lead auditor may limit the audit in the same manner in which the SEC allows management to limit its assessment of internal control over financial reporting.

[130] *See* SEC Release No. 34-81916 (Oct. 23, 2017).

Question:

10. Are the modifications in proposed AS 1206, including Appendix B, to reflect the auditor's report language in AS 3101, appropriate and clear?

G. Other Matters

1. Investee Financial Statements Audited by an Investee's Auditor

See paragraphs .B1-.B2 of AS 1105 in Appendix 1

In some audits, auditors other than the lead auditor perform audit procedures on the financial statements of the company's investees, for example, for certain investments accounted for by the company under the equity method. Under AS 1205.14, the company's auditor (i.e., investor's auditor) who uses the report of an investee's auditor for the purpose of reporting on the investor's equity in underlying net assets and its share of earnings or losses and other transactions of the investee is in the position of a lead auditor[131] using the work and reports of other auditors under AS 1205.

Under the proposed amendments in the 2016 Proposal and the 2017 SRC, the investor's auditor in such equity method investment situations would have been in the position of a lead auditor, and thus required to supervise the work of the investee's auditor in accordance with AS 1201. Some commenters on the 2017 SRC questioned the appropriateness of that approach because it would not adequately address scenarios encountered in practice. In particular – unlike with the supervision of other auditors by the lead auditor – the investor's auditor may not be able to establish an arrangement with the investee's auditor or investee management under which the investor's auditor would direct activities of the investee's auditor and review its audit documentation, or obtain information from investee management.

Having considered the comments received, we are no longer proposing to require that the investor's auditor supervise the investee's auditor's work under AS 1201, for example, in equity method investment situations. Instead, in such situations, the investor's auditor would look to the requirements of Appendix B of the evidence standard (AS 1105), which describe the auditor's responsibilities for obtaining sufficient appropriate evidence in situations in which the valuation of an investment is based on the investee's financial results.[132] Thus, under the proposed amendments (as is currently the case under AS 1205), the investor's auditor would be able, where appropriate, to use the work and report of the investee's auditor.

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131 "Principal auditor" is used in AS 1205.

132 *See* Appendix B of AS 1105, which was adopted after the issuance of the 2017 SRC. *See also Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2018-005 (Dec. 20, 2018).

The proposed amendments also add certain relevant provisions currently included in AS 1205,[133] to further guide auditors in equity method investment circumstances. First, the proposed amendments would refer to the independence of the investee's auditor as an item for the investor's auditor to consider. Under existing AS 1105.B1, financial statements of the investee that have been audited by an investee's auditor whose report is satisfactory to the investor's auditor may constitute sufficient appropriate audit evidence. The proposed amendments would add "making inquiries as to the independence of the investee's auditor (under the applicable standards)" (i.e., whether the investee's auditor is independent of the investee) to the list of procedures in AS 1105.B1 that the investor's auditor may consider performing in determining whether the investee's auditor's report is satisfactory. AS 2101.06b requires the auditor to determine compliance with independence and ethics requirements. This includes determining whether PCAOB and SEC independence requirements are applicable.[134]

Second, the proposed amendments would refer to the professional reputation or independence of the investee's auditor as an item for the investor's auditor to consider. Under existing AS 1105.B2, if in the auditor's judgment additional evidence is needed concerning the investment, the auditor should perform procedures to gather evidence. The proposed amendments would add the investor's auditor's "concerns about the professional reputation or independence of the investee's auditor" to the list of items that may cause the investor's auditor to conclude that additional evidence is needed.

Because of a wide range of potential scenarios in practice involving equity method investees, the proposed amendments would not specify which auditor should perform procedures to obtain additional evidence. Under the facts and circumstances of a particular audit, the investor's auditor may determine, e.g., to use its own staff to perform such procedures or seek assistance from the investee's auditor and supervise the investee's auditor's work under AS 1201.

The proposed amendments also preserve the ability of the investor's auditor (afforded in the current requirements) to divide responsibility for the audit with the investee's auditor, where appropriate. In such situations, the proposed new standard AS 1206 would apply.

Questions:

11. Are the proposed amendments to AS 1105.B1 to guide auditors in equity method investment circumstances clear and appropriate? If not, how should the proposed requirements be revised?

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133 *See generally* AS 1205.10.

134 *See* SEC, Division of Corporation Finance, *Financial Reporting Manual,* Topic 4, Section 4110.5, Independent Accountants' Involvement (SEC staff guidance outlining the application of certain PCAOB requirements in various filings with the SEC).

2. Audit Documentation

See paragraph .18 of AS 1215 in Appendix 1

Under existing standards in AS 1215.18, the office of the firm issuing the auditor's report is responsible for ensuring that all the requirements for preparing and retaining the audit documentation for each engagement described in paragraphs .04-.13 of the standard are met. The requirements regarding the retention of and subsequent changes to audit documentation are in paragraphs .14-.17 of the standard.

In an audit that involves other auditors, AS 1215 currently requires that audit documentation supporting the work performed by such auditors be retained by or be accessible to the office issuing the auditor's report. To remind other auditors that they must follow the standard's requirements regarding retention of and subsequent changes to audit documentation, we are proposing an amendment to paragraph .18. The proposed amendment would state that other auditors must comply with the requirements in paragraphs .04-.17 of AS 1215, including with respect to the audit documentation that the other auditor provides or makes accessible to the office issuing the auditor's report.[135]

IV. SUPPLEMENTAL INFORMATION FOR THE ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its standard setting. The 2016 Proposal included an economic analysis that described the baseline for evaluating economic impacts, the economic need, the potential economic impacts of the proposed amendments (including potential benefits, costs, and unintended consequences), and the alternative approaches considered.[136] Commenters who reviewed the economic analysis in the 2016 Proposal did not, for the most part, provide comments primarily directed to the analysis. Comments were received, however, on aspects of the proposed amendments, including the scalability of certain requirements and their potential impact on smaller firms. The Board discussed economic considerations related to these issues in the 2017 SRC.[137]

This section does not present a full economic analysis; rather it provides newly available information for public review and comment that supplements the information included in the 2016 Proposal and 2017 SRC. Specifically, this section discusses:

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[135] The proposed amendments also include conforming amendments to the terminology in the paragraph to align it with the other proposed amendments in this standard. For example, a footnote was added (footnote 3A) to indicate that "[t]he term "other auditors," as used in this standard, has the same meaning as defined in Appendix A of AS 2101."

[136] *See* 2016 Proposal at 24-49.

[137] *See* 2017 SRC at 39-42.

- The extent of the use of other auditors by lead auditors using newly available data in AuditorSearch, which is the PCAOB's public Form AP database;[138]
- New academic research on the use of other auditors and its impact on audit quality;
- Recent observations on auditing practices related to the use of other auditors; and
- Comments received on the 2017 SRC that relate to the economic need for standard setting.

A. Extent of the Use of Other Auditors

As discussed in the 2016 Proposal, many companies have significant operations in jurisdictions outside the country or region of the lead auditor.[139] Audits of such multinational businesses often require the participation of accounting firms other than the lead auditor and can often involve multiple other firms.[140] The use of other auditors is also more prevalent in audits of larger companies audited by larger accounting firms.[141] In addition, work performed by other auditors can comprise a significant share of a given audit.[142]

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138 *See* https://pcaobus.org/resources/auditorsearch.

139 *See* 2016 Proposal at 6 (stating that, among over 4,300 publicly listed companies reporting segment assets or sales in geographic areas outside the country or region of the lead auditor, such assets and sales comprised approximately 38 percent and 45 percent of total assets and sales, respectively).

140 *See* 2016 Proposal at 6 note 4 (noting that the number of accounting firms involved in an audit in some cases is greater than 20, according to PCAOB staff analysis of inspections data).

141 *See* 2016 Proposal at 7. Based on staff analysis of inspections data, the 2016 Proposal noted that about 80 percent of Fortune 500 issuer audits performed by U.S. global network firms ("GNFs") involved other auditors. GNFs are the member firms of the six global accounting firm networks that include the largest number of PCAOB-registered non-U.S. firms (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Cooperative, and PricewaterhouseCoopers International Ltd.). The discussion in this release uses "U.S. GNF" to refer to a GNF member firm based in the United States, and "non-U.S. GNF" to refer to a GNF member firm based outside the United States. Non-Affiliate Firms ("NAFs") are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs.

142 The 2016 Proposal noted that, in audits selected by the PCAOB for inspection that involved other auditors, the other auditors audit on average between one-third and one-half of the total assets and total revenues of the company being audited. This information reflects engagement-level data for inspection years 2013 and 2014. Audits inspected by the PCAOB are often selected based on risk rather than randomly, and therefore these numbers may not represent the use of other auditors across a broader population of companies. *See* 2016 Proposal at 6-7 and note 5.

Observations in the 2016 Proposal regarding the use of other auditors are confirmed by more specific information that the PCAOB has subsequently received and made available to the public on its website. After June 30, 2017, registered public accounting firms began to report certain information about the participation of other audit firms in audits on PCAOB's Form AP.[143] Figures 1, 2, and 3 present staff analysis of Form APs filed between January 1, 2020 and December 31, 2020.[144]

[143] *See Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, PCAOB Release No. 2015-008 (Dec. 15, 2015). Form AP provides information on other accounting firms, but not individual accountants at those firms. Hence, the term "other auditors" in the analysis presented in this section refers only to accounting firms.

[144] The analysis of Form AP data presented in Figures 1, 2, and 3 is limited to issuers other than investment company vehicles and employee benefit plans.

FIGURE 1

Extent of use of other auditors (2020)

	Percentage of audits that use other auditors	Maximum number of other auditors used in an audit
All issuer audits	30%	65
By audit firm type		
U.S. GNF	41%	31
Non-U.S. GNF	58%	65
U.S. NAF	9%	6
Non-U.S. NAF	12%	19
By issuer domicile		
U.S. issuers	27%	31
Non-U.S. issuers	46%	65
By issuer size		
Fortune 500 issuers	69%	31
Large accelerated filers	57%	65
Accelerated filers	28%	16
Non-accelerated filers	13%	20

Sources: 2020 Form AP data obtained from PCAOB's AuditorSearch database; issuer groups determined using data from Audit Analytics and Standard & Poor's.

Note: The term "other auditors" as used in this table refers only to other accounting firms and not individual accountants at those firms.

The statistics presented in Figure 1 describe the percentage of issuer audits that use other auditors and the maximum number of other auditors used in an individual audit. The results indicate that other auditors are involved in many audits of issuers.

Overall, other auditors are involved in about 30 percent of all issuer audit engagements. The use of other auditors is especially common in audits performed by firms that are members of global networks; about 41 percent of U.S. GNF engagements and about 58 percent of non-

U.S. GNF engagements involved the use of other auditors. In comparison, only about 9 percent of U.S. NAF and 12 percent of non-U.S. NAF audit engagements involved other auditors.

When analyzed from the perspective of the domicile of the issuer, other auditors are involved in about 27 percent of audit engagements of issuers domiciled in the U.S., and about 46 percent of audit engagements of issuers domiciled outside the U.S. Alternately, when analyzed by issuer size, other auditors are involved in about 69 percent of Fortune 500 issuer audits and about 57 percent of large accelerated filer audits.[145] In contrast, only about 28 percent of accelerated filer audits and about 13 percent of non-accelerated filer audits involved the use of other auditors.

Some issuer audits involve many other auditors, particularly when the issuer is large. For example, the audit of one Fortune 500 issuer involved 31 other auditors and the audit of one large accelerated filer involved 65 other auditors. By contrast, the maximum number of other auditors used on an audit of an accelerated filer and a non-accelerated filer was somewhat lower, at 16 and 20 other auditors, respectively. The maximum number of other auditors used is highest for issuer audits conducted by GNFs. For example, one non-U.S. GNF audit involved 65 other auditors and one U.S. GNF audit used 31 other auditors. Non-affiliated firms can also use multiple other auditors when conducting issuer audits; on one audit a non-U.S. NAF used 19 other auditors and one U.S. NAF audit involved 6 other auditors.

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[145] For an explanation of accelerated filer criteria, *see* https://www.sec.gov/corpfin/secg-accelerated-filer-and-large-accelerated-filer-definitions.

FIGURE 2

Audits involving multiple other auditors (2020)

	Percentage of audits involving other auditors that involve:			
	2 or more other auditors	5 or more other auditors	10 or more other auditors	20 or more other auditors
All issuer audits	62%	27%	10%	2%
By audit firm type				
U.S. GNF	67%	30%	10%	1%
Non-U.S. GNF	71%	31%	15%	4%
U.S. NAF	19%	2%	0%	0%
Non-U.S. NAF	37%	7%	7%	0%
By issuer domicile				
U.S. issuers	62%	27%	9%	2%
Non-U.S. issuers	64%	29%	14%	4%

Sources: 2020 Form AP data obtained from PCAOB's AuditorSearch database; issuer groups determined using data from Audit Analytics.

Note: The term "other auditors" as used in this table refers only to other accounting firms and not individual accountants at those firms.

The statistics shown in Figure 2 describe how often more than one other auditor is used when an audit involves the use of other auditors. The results indicate that when other auditors are used, it is common to use multiple other auditors.[146] For example, among all issuer audits involving the use of other auditors, 62 percent involved two or more other auditors, 27 percent involved five or more other auditors, 10 percent involved ten or more other auditors, and 2 percent involved twenty or more other auditors. When examined by the domicile of the issuer, the results are similar.

When examined by audit firm type, the data shows that GNFs tend to use more other auditors than NAFs do. For example, in issuer audits conducted by U.S. GNFs that involved other auditors, about 67 percent involved two or more other auditors, about 30 percent involved five or more other auditors, about 10 percent involved ten or more other auditors, and about 1 percent involved twenty or more other auditors. Similarly, in audit engagements of

[146] Form AP data also indicates that when multiple other auditors are used, it is common for the other auditors to be located in multiple countries outside the lead auditor's country.

issuers conducted by non-U.S. GNFs that involved other auditors, about 71 percent involved two or more other auditors, about 31 percent involved five or more other auditors, about 15 percent involved ten or more other auditors, and about 4 percent involved twenty or more other auditors. By contrast, in audit engagements of issuers conducted by U.S. NAFs that involved other auditors, only about 19 percent involved two or more other auditors, and about 2 percent involved five or more other auditors. In audit engagements of issuers conducted by non-U.S. NAFs that involved other auditors, about 37 percent involved two or more other auditors, and about 7 percent involved five or more other auditors.

FIGURE 3

Other auditors' share of total audit hours (2020)

	Percentage of audits involving other auditors where other auditors performed:	
	10% or more of total audit hours	30% or more of total audit hours
All issuer audits	51%	18%
By audit firm type		
U.S. GNF	50%	11%
Non-U.S. GNF	59%	35%
U.S. NAF	40%	19%
Non-U.S. NAF	70%	41%
By issuer domicile		
U.S. issuers	47%	11%
Non-U.S. issuers	61%	34%

Sources: 2020 Form AP data obtained from PCAOB's AuditorSearch database; issuer groups determined using data from Audit Analytics.

Note: The term "other auditors" as used in this table refers only to other accounting firms and not individual accountants at those firms.

The statistics presented in Figure 3 describe the share of audit work performed by other auditors. The other auditors' share of total auditor hours provides a simple measure of the significance of the other auditors' work, but may not reflect the level of risk associated with that work. The results show that work performed by other auditors can, however, account for a significant share of the audit. To illustrate this finding, consider the following data regarding the frequency with which other auditors' hours exceeded a relatively lower (10 percent of total audit hours) and relatively higher (30 percent) threshold of other auditor involvement.

Looking first at the relatively lower threshold of involvement, in audits of issuers that involved other auditors, other auditors performed more than 10 percent of total audit hours in 51 percent of all issuer audits, 50 percent of U.S. GNF audits, 59 percent of non-U.S. GNF audits, 40 percent of U.S. NAF audits, and 70 percent of non-U.S. NAF audits. When examined by the domicile of the issuer, other auditors performed more than 10 percent of the total audit hours in 47 percent of audits of issuers domiciled in the U.S., and 61 percent of audits of issuers domiciled outside the U.S.

Turning to the relatively higher threshold of involvement, in audits of issuers that involved other auditors, other auditors performed more than 30 percent of the total audit hours in 18 percent of all issuer audits, 11 percent of U.S. GNF audits, 35 percent of non-U.S. GNF audits, 19 percent of U.S. NAF audits, and 41 percent of non-U.S. NAF audits. Other auditors performed more than 30 percent of the total audit hours in 11 percent of audits of issuers domiciled in the U.S., and 34 percent of audits of issuers domiciled outside the U.S.

B. Academic Research on the Use of Other Auditors

As discussed in the preceding section, audits involving other auditors often use other auditors located in different countries, and may use multiple other auditors, particularly in audits of multinational companies. Academic research on the challenges of distributed work (but not exclusively on auditing) finds that coordination and communication problems may arise when: (i) work is conducted by teams distributed across cities, countries, or continents; (ii) there are differences in language, culture, or regulation; or (iii) teamwork is required that involves a number of interdependent activities.[147]

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[147] *See* 2016 Proposal at 29; *see also* Denise Hanes Downey and Jean C. Bedard, *Coordination and Communication Challenges in Global Group Audits,* 38 Auditing: A Journal of Practice & Theory 123 (2019) (finding that communication and coordination challenges could be more common when interdependent audit teams perform work in complex environments, including those associated with the client's size and regulatory status, the client's global structure (e.g., the number of components), whether or not the component team is required to also perform a statutory audit, and when there are language or cultural barriers between the teams); Denise Hanes Downey and Kimberly D. Westermann, *Challenging Global Group Audits: The Perspective of U.S. Group Audit Leads,* 38 Contemporary Accounting Research 1395 (2020) (finding that group auditors routinely find fault with component auditors and perceive their work and/or documentation to be insufficient, inappropriate, and/or communicated too late to comply with auditing standards and reporting deadlines, and highlighting the significance of a global firm's network structure to global group audits) (Professor Hanes Downey is a former economic research fellow at the PCAOB); Lynford Graham, Jean C. Bedard, and Saurav Dutta, *Managing Group Audit Risk in a Multicomponent Audit Setting*, 22 International Journal of Auditing 40 (2018) (describing a methodology for determining a minimum number of components (or locations) to audit to provide a desired level of audit assurance when risk characteristics vary across geographically dispersed components).

Although few empirical studies have explicitly examined the relationship between the use of other auditors and audit quality, several papers have been published since the 2016 Proposal and 2017 SRC that shed light on this issue.[148] This new and growing body of research suggests that there is a relationship between the use of other auditors and audit quality, and that the facts and circumstances of the audit may be influential in determining whether this is a positive or negative relationship.[149]

C. Auditing Practices Related to the Use of Other Auditors

1. PCAOB Staff Analysis of Audit Methodologies

Since the 2016 Proposal, PCAOB staff have continued to review the methodologies, tools, and guidance of firms related to the use of other auditors. In general, the staff have observed that the methodologies of larger firms typically continue to emphasize the responsibility of the lead auditor for overseeing the work of other auditors using a risk-based

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[148] *See* Dan Sunderland and Gregory M. Trompeter, *Multinational Group Audits: Problems Faced in Practice and Opportunities for Research*, 36 Auditing: A Journal of Practice & Theory 159-183 (2017), for a summary of research related to the use of other auditors and discussion of future research opportunities.

[149] *See*, *e.g.*, William M. Docimo, Joshua L. Gunn, Chank Li, and Paul N. Michas, *Do Foreign Component Auditors Harm Financial Reporting Quality? A Subsidiary-Level Analysis of Foreign Component Auditor Use*, forthcoming in Contemporary Accounting Research (2021) (finding that financial reporting quality at foreign subsidiaries of U.S. multinational corporations is higher when the principal auditor engages a component auditor to audit the foreign subsidiary on its behalf); Jenna J. Burke, Rani Hoitash, and Udi Hoitash, *The Use and Characteristics of Foreign Component Auditors in U.S. Multinational Audits: Insights from Form AP Disclosures*, 37(4) Contemporary Accounting Research 2398-2437 (2020) (finding that the amount of work conducted by component auditors (rather than the mere use of component auditors) is associated with a higher likelihood of misstatement, a higher likelihood of non-timely reporting, and higher audit fees, concluding that "only work performed by less competent component auditors and those facing geographic and cultural/language barriers, including significant geographic and cultural distance, weak rule of law, and low English language proficiency, are associated with adverse audit outcomes"); Joshua L. Gunn and Paul N. Michas, *Auditor Multinational Expertise and Audit Quality*, 93 Accounting Review 203 (2018) (finding that audit quality is stronger when the principal auditor has expertise in conducting global group audits, particular expertise in the country where a client has a significant subsidiary, or both types of expertise on an engagement). *See also* the following unpublished working papers available on SSRN that address issues related to the impact of other auditors on audit quality and financial reporting quality: Denise Downey and Jean C. Bedard, *Do Use of Foreign Auditor Personnel and Lead Engagement Partner Incentives Affect Audit Quality for U.S. Multinational Companies?* (June 2019); Katherine Gunny, Juan Mao, and Jing Zhang, *Increased Audit Risk and Component Auditor Use: Evidence From the Revelation of Internal Control Material Weaknesses* (May 2020); and Elizabeth Carson, Roger Simnett, Ulrike Thürheimer, Ann Vanstraelen, and Greg Trompeter, *Involvement of Component Auditors in Multinational Group Audits: Determinants and Audit Outcomes* (June 2019).

approach. Some larger firms have made changes to their audit methodologies to encourage a greater level of supervision by the lead auditor, such as more frequent and comprehensive communications with other auditors and review of other auditors' work papers in areas of significant risk. Larger firms have continued to issue practice alerts, templates, and other guidance to emphasize that the lead auditor should be sufficiently involved in the work of other auditors. Smaller firms have methodologies that generally do not require the lead auditor to perform or consider supervisory procedures beyond the requirements of AS 1205.

2. PCAOB Inspection Observations

As discussed in the 2016 Proposal, PCAOB inspection staff have reviewed the work of auditors who use other auditors, including, for example, the scope of the work assigned to other auditors, the instructions provided to other auditors, and the degree of supervision and review of other auditors' work.[150] PCAOB inspection staff have also reviewed the work of other auditors, for example, through inspections abroad and reviews of work performed by non-U.S. auditors at the request of a U.S.-based lead auditor.[151] In some cases, PCAOB staff have reviewed the work performed by both the lead auditor and other auditors on the same audit.[152] This section supplements the discussion in the 2016 Proposal by describing more recent inspection observations regarding audits involving other auditors.

Over the last decade, PCAOB inspection staff have observed Part I.A deficiencies[153] in roughly 25 to 45 percent of referred work engagements[154] selected for review. As shown in Figure 4, following a peak deficiency rate in 2012 and 2013 of approximately 40 percent, deficiency rates declined and have remained relatively consistent since then at approximately 30 percent. While we cannot directly attribute the decline in deficiency rates since 2013 to specific actions by firms, PCAOB inspection staff have observed that some firms have enhanced their methodology or tools for multi-location audits and required greater levels of supervision, including review, of the work of other auditors.[155]

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150 *See* 2016 Proposal at 16.

151 *Id.*

152 *Id.*

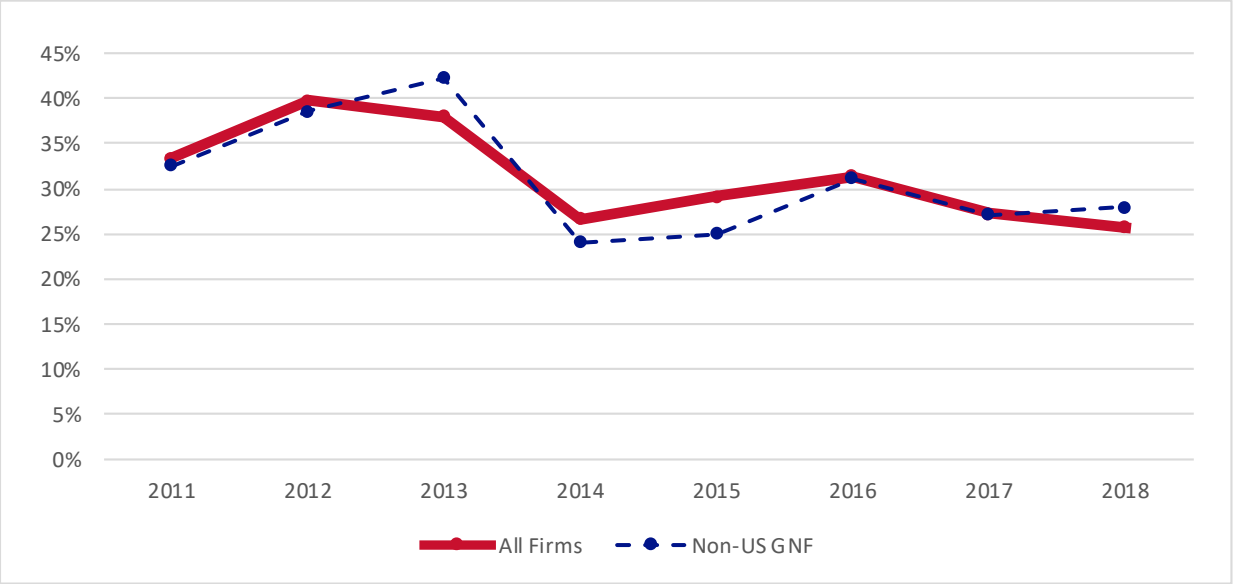
153 A Part I.A deficiency is identified through inspection and included in a PCAOB inspection report when "the Board believes that the firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR." *See* PCAOB, *PCAOB Inspection Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted?*, available at: https://pcaobus.org/oversight/inspections/inspection-procedures.

154 Referred work is work performed by other auditors.

155 *See* PCAOB, *Staff Inspection Brief: Information about 2017 Inspections*, Vol. 2017/3 (Aug. 2017) (section entitled "Multinational Audits"), available at: https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/inspections/documents/inspection-brief-2017-3-issuer-scope.pdf.

FIGURE 4

Percentage of referred work engagements with a Part I.A deficiency



The 2016 Proposal described various audit deficiencies related to the use of other auditors, including deficiencies where the other auditor failed to comply with the lead auditor's instructions or failed to communicate significant accounting and auditing issues to the lead auditor.[156] The 2016 Proposal also described deficiencies identified in other auditors' compliance with other PCAOB standards governing a variety of audit procedures.[157] In addition, the 2016 Proposal described inspection findings related to the work of lead auditors including where the lead auditor did not appropriately determine the sufficiency of its participation to serve as the lead auditor or adequately assess the qualifications of the other auditor's personnel.[158] Since the 2016 Proposal, PCAOB inspection staff have continued to observe, albeit on a less frequent basis, similar deficiencies.

In 2019, the PCAOB established a target team to perform inspection procedures across inspected firms. The work of the target team focused on current audit risks and emerging topics, including identifying good practices. The team focused its work in 2019 on multi-location audits that involved the use of other auditors. For the six U.S. GNFs, inspectors reviewed topics related to the use of other auditors, including planning and risk assessment, determining the appropriateness of serving as lead auditor, communications between the lead auditor and other auditors, and auditor independence. Based on this targeted review, inspectors observed improved audit quality when there was regular, consistent communication between the lead

156 *See* 2016 Proposal at 16-18.

157 *Id.* at 17.

158 *Id.* at 17-18.

auditor and other auditors. The target team also observed a number of good practices, including: (i) performing engagement quality reviews of work performed by other auditors; (ii) holding planning meetings with other auditors, reviewing audit work papers remotely or during site visits, and meeting with local management during site visits; and (iii) assigning a partner experienced in International Financial Reporting Standards as an additional reviewer on work referred to a U.S. firm.[159]

3. Observations from PCAOB and SEC Enforcement Actions

The 2016 Proposal described PCAOB and SEC enforcement actions related to the work of other auditors[160] and lead auditors.[161] This section supplements that discussion by providing information from more recent enforcement actions.

i. Other Auditors

Several more recent enforcement actions illustrate instances in which other auditors failed to comply with PCAOB auditing standards. For example, in one enforcement case, the Board found that an other auditor failed to obtain sufficient competent audit evidence regarding certain accounts and failed to exercise due professional care.[162] In another case, an other auditor failed to respond adequately to a known significant risk, failed to obtain sufficient appropriate audit evidence, and misrepresented the work performed in communications with the lead auditor. The other auditor also failed to exercise due professional care.[163]

ii. Lead Auditors

Several recent enforcement actions indicated that the lead auditor failed, under existing PCAOB standards, to appropriately determine the sufficiency of its participation in an audit to warrant serving as lead auditor. For example, in a recent PCAOB case, the lead auditor failed to perform an adequate analysis regarding whether it could serve as the lead auditor and use the work of the other auditor.[164] In another PCAOB case, a firm failed to consider whether it could

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159 *See* PCAOB, *Spotlight: Staff Update and Preview of 2019 Inspection Observations* (Oct. 8, 2020), available at: https://pcaobus.org/Inspections/Documents/Staff-Preview-2019-Inspection-Observations-Spotlight.pdf.

160 *See* 2016 Proposal at 16-17.

161 The term "lead auditor" has the same meaning as "principal auditor" in this section.

162 *See Wander Rodrigues Teles*, PCAOB Release No. 105-2017-007 (Mar. 20, 2017). The enforcement cases discussed in this section were settled proceedings.

163 *See Ricardo Agustín García Chagoyán, José Ignacio Valle Aparicio, Rubén Eduardo Guerrero Cervera*, PCAOB Release No. 105-2018-021 (Oct. 30, 2018).

164 *See Morgan & Company LLP,* PCAOB Release No. 105-2021-002 (Mar. 30, 2021).

serve as lead auditor when significant parts of the audit were performed by other auditors, and failed to assess, or adequately assess, the qualifications of the other auditors' personnel who participated in the audit.[165] In two SEC cases the lead auditors failed to comply with the sufficiency-of-participation requirements described in AS 1205 related to serving as lead auditor. In one case the firm failed to perform any analysis,[166] while in the other case, the firm failed to perform an adequate analysis.[167]

In several other recent enforcement cases, the lead auditor failed to adequately oversee the work of other auditors as required by PCAOB standards. For example, in a recent PCAOB case, the lead auditor failed to appropriately coordinate its activities with the other auditor.[168] In two SEC enforcement cases, the lead auditor failed to ascertain whether the other auditors, each of whom played a substantial role in the audit,[169] were registered with the PCAOB.[170] In addition, in one of those cases, the lead auditor failed to instruct the other auditor to perform an audit in accordance with PCAOB standards.[171] In a third SEC case, the lead auditor failed to properly supervise other auditors who were serving as engagement team members, as evidenced by the engagement partner's failure to inquire why the specified audit procedures were not followed.[172]

D. Discussion of Comments Related to the Economic Need for Standard Setting

In describing the need for standard setting, the 2016 Proposal discussed information and incentive problems that may arise from information asymmetry between investors and the lead auditor.[173] Specifically, in audits involving other auditors, a market failure may be caused, at least in part, by an information asymmetry between investors and the lead auditor regarding

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165 *See Gregory & Associates, LLC, and Alan D. Gregory, CPA*, PCAOB Release No. 105-2019-018 (Aug. 21, 2019).

166 *See BDO Canada LLP* , SEC AAER No. 3926 (Mar. 13, 2018).

167 *See KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

168 *See Morgan & Company LLP,* PCAOB Release No. 105-2021-002 (Mar. 30, 2021).

169 *See* PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the phrase "play a substantial role in the preparation or furnishing of an audit report."

170 *See BDO Canada LLP*, SEC AAER No. 3926 (Mar. 13, 2018); *KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

171 *See BDO Canada LLP*, SEC AAER No. 3926 (Mar. 13, 2018).

172 *See Anderson Bradshaw PLLC, Russell Anderson, CPA, Sandra Chen, CPA, and William Denney, CPA*, SEC AAER No. 3856 (Jan. 26, 2017).

173 *See* 2016 Proposal at 30-33.

the lead auditor's effort in supervising other auditors. Investors, for example, may be uncertain about the procedures performed by the lead auditor to oversee the work of other auditors, leading to uncertainty about audit quality and the risks associated with the use of other auditors. Also, as discussed in the 2016 Proposal, cost considerations may provide a disincentive for the lead auditor to (i) gather information about the competence of, and work performed by, the other auditor, or (ii) monitor and review (i.e., adequately supervise) the other auditor's work.

In light of comments received on the 2017 SRC, and in anticipation of a potential future adopting release in which a full economic analysis of the final amendments would be included, this section expands upon the need for rulemaking described in the 2016 Proposal. In particular, this section provides an economic rationale for focusing the additional requirements primarily on the lead auditor rather than on other auditors, and enables a more detailed description of the benefits of the proposed amendments.

Specifically, in an audit involving other auditors, an information asymmetry may exist not only between investors and the lead auditor, but also between lead auditors and other auditors since communication and coordination costs may be high. For example, as described in the 2016 Proposal, under current standards lead auditors may not have sufficient access to information regarding the work performed by other auditors.[174] Other auditors also may not be sufficiently incentivized to perform sufficient and appropriate audit procedures.

By addressing more clearly the responsibilities of the lead auditor (e.g., for planning the audit and supervising other auditors), the proposed amendments position the lead auditor to align the incentives and auditing behaviors of other auditors with investors' interests in reducing the risks of material misstatement in the financial statements. In particular, the amendments should incentivize lead auditors to anticipate potential problems that may arise in their relationships with other auditors and take action to address such matters. Additionally, by adding specificity and reducing ambiguity regarding the lead auditor's responsibilities, the amendments address risks arising from potential systematic, welfare-decreasing auditor and investor errors in judgment.[175]

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[174] *See* 2016 Proposal at 19-21.

[175] Welfare decreasing actions reduce the well-being of society at large. *See, e.g.,* David W. Pearce, *The MIT Dictionary of Modern Economics*, 4th Edition (1992) at 400 (social welfare, social welfare function). Academic research on vague or ambiguous standards indicates that the uncertainty arising from the lack of specificity can cause auditors and investors to respond in inconsistent and unexpected ways. *See, e.g.*, Jochen Bigus, *Vague Auditing Standards and Ambiguity Aversion*, 31(3) Auditing: A Journal of Practice & Theory 23 (2012) (suggesting that under certain conditions, auditors may respond to ambiguous standards by over- or under-auditing, resulting in an expectations gap that makes the audit function less informative to investors). For other studies on the impact of vague auditing standards on auditors, auditor liability, audit quality, and investors (users), *see, e.g.*, Mark W. Nelson and William R.

Questions:

12. Comment is requested on the new information provided in this section. Are there other data sources the Board should consider in establishing the baseline-for evaluating economic impacts? Are there additional academic research papers or external reports of which the Board should be aware? Are there additional economic problems associated with the use of other auditors? Would the revised proposed amendments result in economic impacts or unintended consequences beyond those described in the 2016 Proposal? Are there any other matters not addressed in this release that the PCAOB should consider in its economic analysis?

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups (JOBS) Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies ("EGCs"), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"), unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."[176] As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

Both the 2016 Proposal and the 2017 SRC sought comment, including any available empirical data, on how the proposed revisions would affect EGCs and on whether the revised

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Kinney, Jr., *The Effect of Ambiguity on Loss Contingency Reporting Judgments*, 72(2) Accounting Review 257 (1997); Rachel Schwartz, *Auditors' Liability, Vague Due Care, and Auditing Standards*, 11(2) Review of Quantitative Finance and Accounting 183 (1998); Marleen Willekens and Dan A. Simunic, *Precision in Auditing Standards: Effects on Auditor and Direct Liability and the Supply and Demand for Audit Services*, 37(3) Accounting and Business Research 217 (2007); Dan A. Simunic, Minlei Ye, and Ping Zhang, *Audit Quality, Auditing Standards, and Legal Regimes: Implications for International Auditing Standards*, 14(2) Journal of International Accounting Research 221 (2015).

The PCAOB previously discussed the impact of cognitive factors influencing auditor and investor judgment and decision-making in a 2018 rulemaking. *See* PCAOB Release No. 2018-005 at 31 (discussing the impact of several cognitive factors influencing auditor and investor judgment and decision-making, including the effects of bounded rationality, the use of heuristic shortcuts, and resulting decision errors and biases).

[176] *See* Pub. L. No. 112-106 (Apr. 5, 2012); Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act.

proposal would protect investors and promote efficiency, competition, and capital formation.[177] Commenters generally supported applying the proposed requirements to audits of EGCs, citing benefits to the users of EGC financial statements. These commenters asserted that consistent requirements should apply for similar situations encountered in any audit of a company, whether that company is an EGC or not.

To inform consideration of the application of auditing standards to audits of EGCs, the staff prepares a white paper annually that provides general information about characteristics of EGCs.[178] As of the November 15, 2019 measurement date, the PCAOB staff identified 1,761 companies that had identified themselves as EGCs in at least one SEC filing since 2012 and had filed audited financial statements with the SEC in the 18 months preceding the measurement date.[179]

Analysis of Form AP filings in 2020 indicates that audits of EGCs are less likely to involve other auditors compared to the broader population of issuer audits. For example, as shown in Figure 5, only 16 percent of audits of EGCs involve other auditors compared to 30 percent of issuer audits overall.[180] Thus, because the use of other auditors is less prevalent in audits of EGCs than in audits of non-EGCs, audits of EGCs generally are less likely than those of non-EGCs to be affected by the proposed amendments.

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177 *See* 2016 Proposal at 49-51 and 2017 SRC at 43.

178 For the most recent EGC report, *see Characteristics of Emerging Growth Companies and Their Audit Firms as of November 15, 2019* (published on Nov. 9, 2020), available at: https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-characteristics-emerging-growth-companies-november-15-2019.pdf.

179 Approximately 96 percent of EGCs were audited by accounting firms that also audit issuers that are not EGCs, and 42 percent of EGC filers were audited by firms that are required to be inspected on an annual basis by the PCAOB because they issued audit reports for more than 100 issuers in the year preceding the measurement date. *See id.* at 13 and 18, respectively.

180 The analysis of Form AP data presented in Figure 5 is limited to issuers other than investment company vehicles and employee benefit plans.

FIGURE 5

Comparison of the use of other auditors in audits of EGCs and issuers overall (2020)

	Audits of EGCs	Audits of issuers overall*
Percentage issuer audits that use other auditors	16%	30%
Percentage of audits involving other auditors where:		
2 or more other auditors were involved	32%	62%
5 or more other auditors were involved	2%	27%
Percentage of audits involving other auditors where:		
Other auditors performed 10% or more of total audit hours	39%	51%
Other auditors performed 30% or more of total audit hours	15%	18%

* *See* Figures 1-3 for initial presentation of statistics for audits of issuers overall.
Source: 2020 Form AP data obtained from PCAOB's AuditorSearch database.

EGC audits that do involve other auditors are likely to involve fewer other auditors than those of issuers overall. For example, as shown in Figure 5, in audits involving other auditors, EGC audits involve two or more other auditors in about 32 percent of audits compared to about 62 percent of audits of issuers overall. The difference is even greater when considering the use of several other auditors, where only about 2 percent of EGC audits involving other auditors involve five or more other auditors in contrast to about 27 percent of issuer audits overall.

A similar difference is apparent in a comparison of audit hours. Measured by the share of audit hours performed by other auditors, the role of other auditors on EGC audits is less substantial compared to their role on audits of issuers overall. For example, as shown in Figure 5, other auditors perform 10 percent or more of the audit hours in about 39 percent of audits of EGCs compared to about 51 percent of audits of issuers overall. Other auditors perform 30 percent or more of the audit hours in about 15 percent of audits of EGCs and about 18 percent of audits of issuers overall. These statistics suggest that, compared to issuers overall, EGCs are likely to experience more modest impacts from the proposed amendments, because audits of EGCs are less likely to involve the use of other auditors and, even when involving other auditors, typically use fewer other auditors and fewer audit hours from other auditors than audits of issuers overall.

Although the work of other auditors is less frequently used in audits of EGCs, the analysis of economic impacts of the proposed amendments is generally applicable to EGC

audits. In particular, the benefits to audit quality achieved through improved planning and supervision of audits involving other auditors may be especially significant for EGCs.

Although the degree of information asymmetry between investors and company management for a particular issuer is unobservable, researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs.[181] To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance the credibility of management disclosures.[182] The proposed amendments for audits involving other auditors, which are intended to enhance audit quality, could contribute to an increase in the credibility of financial reporting by EGCs.

When confronted with information asymmetry, investors may require a larger risk premium, and thus increase the cost of capital to companies. Reducing information asymmetry, therefore, can lower the cost of capital to companies, including EGCs, by decreasing the risk premium required by investors.[183]

In addition, the Board does not believe that the proposed amendments would be more difficult for auditors to apply to EGC audits than to non-EGC audits. To the extent that audits of EGCs involve other auditors, the requirements are designed to be generally scalable to those audits and the costs of performing the proposed procedures are unlikely to be disproportionate to the benefits of the proposed procedures. Conversely, if any of the proposed amendments were determined not to apply to the audits of EGCs, the resulting two sets of audit requirements would mean that auditors who audit both EGCs and non-EGCs would need to address the differing audit requirements in their methodologies, or policies and procedures, which would create the potential for confusion and likely detract from audit quality.

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[181] *See*, *e.g.*, David Aboody and Baruch Lev, *Information Asymmetry, R&D, and Insider Gains*, 55 Journal of Finance 2747 (2000); Michael J. Brennan and Avanidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 Journal of Financial Economics 361 (1995); Varadarajan V. Chari, Ravi Jagannathan, and Aharon R. Ofer, *Seasonalities in Security Returns: The Case of Earnings Announcements*, 21 Journal of Financial Economics 101 (1988); Raymond Chiang and P. C. Venkatesh, *Insider Holdings and Perceptions of Information Asymmetry: A Note*, 43 Journal of Finance 1041 (1988).

[182] *See, e.g.*, Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 Accounting Horizons 185, 189 (2004) ("[Academic studies] provide archival evidence that external assurance from auditors increases disclosure credibility. ... These archival studies suggest that bankers believe audits enhance the credibility of financial statements ....").

[183] For a discussion of how increasing reliable public information about a company can reduce risk premium, *see* David Easley and Maureen O'Hara, *Information and the Cost of Capital,* 59 The Journal of Finance 1553 (2004).

Accordingly, and for the reasons explained above, the Board anticipates that, if it adopts the proposed amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the amendments to audits of EGCs.

Request for Comment:

The Board requests further comment, including any available empirical data, on how the proposed amendments discussed in this release would specifically affect audits of EGCs and on whether the proposed amendments would protect investors and promote efficiency, competition, and capital formation.

VI. APPLICATION TO AUDITS OF BROKERS AND DEALERS

As discussed in the 2016 Proposal and 2017 SRC, the proposed amendments would apply to audits of brokers and dealers, as defined in Sections 110(3)-(4) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). The 2016 Proposal and 2017 SRC both solicited comments on such applicability. No commenters opposed, and several commenters expressly supported applying, the proposed amendments to audits of brokers and dealers.

The 2016 Proposal noted that the proposed amendments are not expected to have a widespread impact on the audits of brokers and dealers that are not subsidiaries of issuers, because there are likely few instances in which such audits involve the use of other auditors.[184] In those instances in which other auditors are used, however, the proposed requirements may provide a benefit to the customers of the broker or dealer whose auditor does use other auditors. Because of the scalability of the risk-based requirements, the Board is of the view that the costs of performing the proposed procedures are unlikely to be disproportionate to the benefits of the proposed procedures.

The Board continues to consider the applicability of the proposed amendments to audits of brokers and dealers and welcomes further comment on whether the revisions discussed in this release present specific issues with respect to these audits.

VII. EFFECTIVE DATE

The Board seeks comment on the amount of time auditors would need to prepare for the implementation of the proposed amendments and new auditing standard before they would become effective and applicable to audits, if adopted by the Board and approved by the SEC. Specifically, the Board is considering whether compliance with the proposed amendments and new auditing standard should be required for audits of fiscal years beginning in the year

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184 *See* 2016 Proposal at Section VI.

after approval by the SEC (or for audits of fiscal years beginning two years after the year of SEC approval if that approval occurs in the fourth quarter).

VIII. OPPORTUNITY FOR PUBLIC COMMENT

The Board is seeking comments on the revisions to the proposed amendments and proposed standard that the Board is considering for adoption, and on all the other matters discussed in this release. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the revised proposed amendments and standard.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules. Any such final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of Sarbanes-Oxley, proposed rules of the Board do not take effect unless approved by the SEC. For purposes of Section 107, standards are rules of the Board under Sarbanes-Oxley.

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On the 28th day of September, in the year 2021, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

September 28, 2021

APPENDIX 1

Revisions to the 2017 Proposed Amendments Relating to the Performance of Audits Involving Other Auditors

This appendix presents revisions to amendments included in the 2017 SRC for the following PCAOB standards. Language that would be deleted is ~~struck through~~. Language that would be added is underlined.

- AS 2101, *Audit Planning*
- AS 1201, *Supervision of the Audit Engagement*
- AS 1015, *Due Professional Care in the Performance of Work*
- AS 1105, *Audit Evidence*
- AS 1215, *Audit Documentation*

Note: As originally proposed in the 2016 proposing release and 2017 supplemental request for comment, the amendments to AS 2101 and AS 1201 would have been in a new Appendix B to each standard. This 2021 supplemental request for comment would reorganize those proposed amendments to appear in the body of each standard. To minimize unhelpful redlining, the original paragraph numbers from the appendices are in brackets (e.g., "[.B1]"). The transposed order of sub-paragraphs a and b of paragraph .B2 (now .06A below) of Appendix B to AS 2101 is also denoted by brackets. These moves and bracketed references are designed to make the redlining more substantive, and to minimize the apparent deletion and addition of whole paragraphs that result from the reorganization of rule text.

Note: After the 2017 supplemental request for comment, AS 2101 and AS 1201 were amended by PCAOB Release No. 2018-006, *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* (Dec. 20, 2018), and AS 1105 was amended by PCAOB Release No. 2018-005, *Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards* (Dec. 20, 2018).

- Release No. 2018-006 added footnote 3A to AS 2101.06, and the current rulemaking proposes to add a parenthetical definition of the acronym in that footnote, as marked below. The 2018 release also added footnote 2 to AS 1201.03, which the current rulemaking would not amend.
- Release No. 2018-005 added Appendix B, *Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results*, to AS 1105. The current rulemaking proposes certain amendments to that appendix, which are marked below.

AS 2101, *Audit Planning*

Introduction

.01 This standard establishes requirements regarding planning an audit.

Objective

.02 The objective of the auditor is to plan the audit so that the audit is conducted effectively.

Responsibility of the Engagement Partner for Planning

.03 The **engagement partner**[1] is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate **engagement team** members (which may include engagement team members outside the engagement partner's firm) in fulfilling this responsibility. Engagement team members who assist the engagement partner with audit planning also should comply with the relevant requirements in this standard.

[1] Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

Planning an Audit

.04 The auditor should properly plan the audit. This standard describes the auditor's responsibilities for properly planning the audit.[2] For audits that involve **other auditor**s or **referred-to auditor**s, this standard describes additional responsibilities for the engagement partner and the **lead auditor**.

~~.04A For audits that involve **other auditors** or **referred-to auditors**, Appendix B describes additional requirements for the **lead auditor** regarding planning an audit.~~

[2] The term~~,~~ "auditor," as used in this standard, encompasses both the engagement partner and the engagement team members who assist the engagement partner in planning the audit. AS 1201, *Supervision of the Audit Engagement*, establishes requirements regarding supervision of the audit engagement, including a lead auditor's supervision of the work of other auditors. AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for a lead auditor regarding dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting, with another accounting firm (i.e., a referred-to auditor).

.05 Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes, in particular, planned risk assessment procedures and planned responses to the risks of material misstatement. Planning is not a discrete phase of

an audit but, rather, a continual and iterative process that might begin shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit.

Preliminary Engagement Activities

.06 The auditor should perform the following activities at the beginning of the audit:

a. Perform procedures regarding the continuance of the client relationship and the specific audit engagement,[3]

b. Determine compliance with independence[3A] and ethics requirements,[4] and

Note: The determination of compliance with independence and ethics requirements is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.

c. Establish an understanding of the terms of the audit engagement with the audit committee in accordance with AS 1301, *Communications with Audit Committees*.

[3] Paragraphs .14-.16 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. AS 1110, *Relationship of Auditing Standards to Quality Control Standards*, explains how the quality control standards relate to the conduct of audits.

[3A] Under PCAOB Rule 3520, *Auditor Independence*, a registered public accounting firm or associated person's independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Securities and Exchange Commission ("SEC") under the federal securities laws.

~~[.B1] For engagements[4]~~ In an audit that involves other auditors ~~or referred-to auditors,~~ *see* paragraphs .06D-F of this ~~appendix describes~~ standard, which describe performing additional procedures ~~to be performed by the lead auditor with respect to planning the audit.~~

~~Note: AS 1201 establishes requirements~~ regarding ~~supervision of the audit engagement, including the lead auditor's supervision of the work of~~ other ~~auditors. When the responsibility for the audit is divided with another accounting firm (*i.e.*, a referred-to auditor), AS 1206 applies.[25]~~

~~[25] AS 1206 establishes requirements for the lead auditor regarding dividing responsibility for the audit of the company's financial statements~~ auditors' compliance with independence and ~~, if applicable, internal control over financial reporting with another~~

~~accounting firm~~ ethics requirements. In an audit that ~~performs an audit of the financial statements and, if applicable, internal control over financial reporting of one or more of the company's business units and issues an auditor's report in accordance with the standards of the PCAOB~~involves referred-to auditors, *see* AS 1206.05-.07.

Preliminary Engagement Activities – Additional Considerations for Audits Involving Other Auditors or Referred-to Auditors

Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors

~~[.B2]~~.06A In an audit that involves other auditors or referred-to auditors, the engagement partner should determine whether the participation of his or her firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements. In making this determination, the engagement partner should take into account the following, in combination:

~~[b.]~~a. The importance of the locations or business units[4A] 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~~considering quantitative and qualitative factors~~.~~;

~~[a.]~~b. The risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm performs audit procedures, in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors; and

c. The extent of the engagement partner's firm's supervision of the other auditors' work[4B] for portions of the company's financial statements for which the other auditors perform audit procedures. In a multi-tiered audit (*see* AS 1201.14), this subparagraph c applies only to the firm's supervision of a first other auditor and any other auditor that is supervised directly by the firm.

In addition, in an audit that involves referred-to auditors (*see* AS 1206), the participation of the engagement partner's firm ~~to serve as lead auditor~~ ordinarily is not sufficient for it to serve as lead auditor if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

~~[.B3]~~[4A] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

[4B] *See* AS 1201.06, which describes determining the necessary extent of supervision.

.06B In an audit that involves other auditors performing work regarding locations or business units, the involvement of the lead auditor (through a combination of planning and performing audit procedures and supervision of other auditors) should be commensurate with the risks of material misstatement[4C] associated with those locations or business units.

[4C] *See, e.g.,* AS 1201.06, paragraph .11 of this standard; *see generally* AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

.06C In an integrated audit of a company's financial statements and its internal control over financial reporting that involves other auditors or referred-to auditors, the lead auditor of the financial statements must participate sufficiently in the audit of internal control over financial reporting to provide a basis for serving as the lead auditor of internal control over financial reporting. Only the lead auditor of the financial statements can be the lead auditor of internal control over financial reporting.[4D]

[4D] *See* paragraph .C8 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Other Auditors' Compliance with Independence and Ethics Requirements

~~[.B4]~~.06D In an audit that involves other auditors,~~[26][4E]~~ the lead auditor should ~~determine~~, with respect to each other ~~auditor's compliance with~~auditor, perform the following procedures in conjunction with determining compliance with SEC independence requirements and PCAOB independence and ethics requirements ~~by~~pursuant to paragraph .06b of this standard:

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

b. Obtain~~ing~~ from ~~each~~the other auditor and review:

(1) A written affirmation as to whether the other auditor has policies and procedures that provide reasonable assurance that the other auditor maintains compliance with SEC independence requirements and PCAOB independence and ethics requirements, and if it does not, a written description of how the other auditor determines its compliance with the requirements;

(~~1~~2) 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 pursuant to the requirements of paragraph (b)(1) of PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*; and

(~~2~~3) A written ~~representation that it is, or is not,~~affirmation as to whether the other auditor is in compliance with SEC independence requirements and PCAOB independence and ethics requirements with respect to the audit client, and, if it is not in compliance, a written description of the nature of ~~any~~ the instances of non-compliance.

~~Note: The lead auditor's determination of each~~c. For the matters described in items a and b:

(1) Inform the other ~~auditor's~~auditor of changes in circumstances, of which the lead auditor becomes aware, that (i) affect determining compliance with ~~the~~ SEC independence requirements and PCAOB independence and ethics requirements ~~is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.~~, and (ii) are relevant to the other auditor's affirmations and descriptions; and

~~Note: If the lead auditor becomes aware of information during the course of the audit~~(2) Request that ~~contradicts an~~ the other ~~auditor's description of~~auditor (i) update its ~~relationships that may reasonably be thought~~affirmations and descriptions to ~~bear on independence or a representation made by an~~ reflect changes in circumstances of which the other auditor ~~regarding its~~becomes aware (including changes communicated by the lead auditor) that affect determining compliance with ~~the~~ SEC independence requirements and PCAOB independence and ethics requirements, and (ii) provide the updated affirmations and descriptions to the lead auditor ~~should perform additional procedures to determine the effect~~upon becoming aware of such ~~information on the independence~~changes.

Note: For the matters described in paragraph .06D, information (including affirmations and descriptions) may be obtained from the other auditor covering the other auditor's firm and engagement team members who are partners, principals, shareholders, or employees of the ~~other auditor~~firm.

~~26~~ *See*~~4E~~ For audits involving referred-to auditors, *see* AS 1206 ~~for requirements for the lead auditor relating to the referred-to auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements~~.

.06E In multi-tiered audits (*see* AS 1201.14), a first other auditor may assist the lead auditor in performing the procedures described in paragraph .06D with respect to one or more second other auditors. If so, the lead auditor should instruct the first other auditor to inform the lead auditor of the results of procedures performed, including bringing to the lead auditor's

attention any information indicating that a second other auditor is not in compliance with SEC independence requirements or PCAOB independence and ethics requirements. The lead auditor remains responsible for determining compliance with those requirements pursuant to paragraph .06b of this standard.

.06F If the lead auditor becomes aware of information that contradicts an affirmation or description provided by an other auditor pursuant to paragraph .06D, the lead auditor should investigate the circumstances and consider the reliability of the affirmation or description. If, after such investigation, or based on the other auditor's affirmation, the lead auditor obtains information indicating that the other auditor is not in compliance with SEC independence requirements or PCAOB independence and ethics requirements, the lead auditor should consider the implications for determining compliance with those requirements pursuant to paragraph .06b of this standard.[4F]

[4F] The lead auditor should also consider the implications for determining compliance with PCAOB Rule 3526.

PCAOB Registration Status of Other Auditors

~~[.B5]~~.06G In an audit that involves an other auditor that ~~would play~~plays a substantial role in the preparation or furnishing of the lead auditor's report ~~on the company's financial statements and, if applicable, internal control over financial reporting~~, the lead auditor may use ~~an~~the work of the other auditor only if the other auditor is registered ~~pursuant to the rules of~~with the PCAOB.[~~27~~4G]

[~~27~~4G] *See* PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the phrase "play a substantial role in the preparation or furnishing of an audit report." *See also* AS 1206 for requirements for the lead auditor relating to the registration status of ~~the~~a referred-to auditor.

~~*Qualifications*~~*Knowledge, Skill, and Ability of and Communications with Other Auditors*

~~[.B6] At the beginning of~~.06H In an audit that involves other auditors, the lead auditor should~~:~~

~~a. Inquire about~~, with respect to each other ~~auditors' policies and procedures relating to the:~~auditor:

~~(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~~a. Obtain an understanding of the knowledge, skill, and ability of the other ~~auditors~~auditor's engagement team members who assist the lead auditor with planning or supervision,~~284~~[284H] 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; ~~and~~

b. Obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks; and

c. Determine that the lead auditor is able to communicate with the other auditor~~s~~ and gain access to the other auditor~~s~~'s audit documentation.~~294~~[294I]

~~Note: The requirements of this paragraph are not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.~~

~~284~~[284H] *See* paragraph .06 of AS 1015~~.06~~, *Due Professional Care in the Performance of Work*, according to which "~~[a]uditors~~[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability~~",~~ ...," and AS 2301.~~05a,~~05(a), which describes making appropriate assignments of significant engagement responsibilities~~. *See also* AS 1201.B3, which describes assisting the lead auditor with supervision of a multi-tiered engagement team~~.

~~294~~[294I] *See, e.g.*, AS 1201.05, .09, .11, and ~~Appendix B of AS 1201~~.12, which establish requirements for the auditor's review of work performed by engagement team members. *See also* paragraph .18 of AS 1215~~.18~~, *Audit Documentation*, according to which audit documentation supporting the work performed by other auditors must be retained by or be accessible to the office of the firm issuing the auditor's report.

.06I In multi-tiered audits (*see* AS 1201.14), a first other auditor may assist the lead auditor in performing the procedures described in paragraph .06H with respect to one or more second other auditors.

Planning Activities

.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor's previous experience with the company, and changes

in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, the auditor should evaluate whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures:

- Knowledge of the company's internal control over financial reporting obtained during other engagements performed by the auditor;
- Matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes;
- Matters relating to the company's business, including its organization, operating characteristics, and capital structure;
- The extent of recent changes, if any, in the company, its operations, or its internal control over financial reporting;
- The auditor's preliminary judgments about materiality,[5] risk, and, in integrated audits, other factors relating to the determination of material weaknesses;
- Control deficiencies previously communicated to the audit committee[6] or management;
- Legal or regulatory matters of which the company is aware;
- The type and extent of available evidence related to the effectiveness of the company's internal control over financial reporting;
- Preliminary judgments about the effectiveness of internal control over financial reporting;
- Public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the company's internal control over financial reporting;
- Knowledge about risks related to the company evaluated as part of the auditor's client acceptance and retention evaluation; and
- The relative complexity of the company's operations.

  Note: Many smaller companies have less complex operations. Additionally, some larger, complex companies may have less complex units or processes. Factors that might indicate less complex operations include: fewer business lines; less complex

business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control.

[5] AS 2105, *Consideration of Materiality in Planning and Performing an Audit.*

[6] If no audit committee exists, all references to the audit committee in this standard apply to the entire board of directors of the company. *See* 15 U.S.C §§ 78c(a)(58) and 7201(~~a)(~~3).

Audit Strategy

.08 The auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan.

.09 In establishing the overall audit strategy, the auditor should take into account:

a. The reporting objectives of the engagement and the nature of the communications required by PCAOB standards,[7]

b. The factors that are significant in directing the activities of the engagement team,[8]

c. The results of preliminary engagement activities[9] and the auditor's evaluation of the important matters in accordance with paragraph .07 of this standard, and

d. The nature, timing, and extent of resources necessary to perform the engagement.[10]

[7] *See*, *e.g.*, AS 1301. Also, various laws or regulations require other matters to be communicated. (*See, e.g.*, Rule 2-07 of Regulation S-X, 17 CFR 210.2-07; and Rule 10A-3 under the Securities Exchange Act of 1934, 17 CFR 240.10A-3.) The requirements of this standard do not modify communications required by those other laws or regulations.

[8] *See*, *e.g.*, ~~paragraph .06 of~~ AS 1015~~, *Due Professional Care in*~~.06, which describes assigning auditors to tasks and supervising them commensurate with their level of knowledge, skill, and ability, and AS 1201.06, which describes the ~~*Performance*~~extent of ~~*Work*, and paragraph .06 of AS 1201, *Supervision of the Audit Engagement*~~.supervisory activities necessary for proper supervision of engagement team members. *See also* ~~Appendix B of~~ AS 1201.08-.15, which ~~describes~~ further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other ~~auditors' work~~auditors, in conjunction with the required supervisory activities set forth in AS 1201.

[9] Paragraphs .06-.06I of this standard.

[10] *See*, *e.g.*, AS 1015.06, paragraph .16 of this standard, and ~~paragraph .05a. of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*~~AS 2301.05a.

Audit Plan

.10 The auditor should develop and document an audit plan that includes a description of:

a. The planned nature, timing, and extent of the risk assessment procedures;[11]

b. The planned nature, timing, and extent of tests of controls and substantive procedures;[12] and

c. Other planned audit procedures required to be performed so that the engagement complies with PCAOB standards.

[11] AS 2110, *Identifying and Assessing Risks of Material Misstatement.*

[12] AS 2301 and AS 2201~~, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*~~.

Multi-location Engagements

.11 In an audit of the financial statements of a company with operations in multiple locations or business units,~~[13]~~ the auditor should determine the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate evidence to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. This includes determining the locations or business units at which to perform audit procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual locations or business units. The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit.

~~[13] The term "business units" includes subsidiaries, divisions, branches, components, or investments.~~

[13] [Footnote deleted.]

.12 Factors that are relevant to the assessment of the risks of material misstatement associated with a particular location or business unit and the determination of the necessary audit procedures include:

a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions that are outside the normal course of business for the company or that otherwise appear to be

unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;[14]

b. The materiality of the location or business unit;[15]

c. The specific risks associated with the location or business unit that present a reasonable possibility[16] of material misstatement to the company's consolidated financial statements;

d. Whether the risks of material misstatement associated with the location or business unit apply to other locations or business units such that, in combination, they present a reasonable possibility of material misstatement to the company's consolidated financial statements;

e. The degree of centralization of records or information processing;

f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and

g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.

Note: When performing an audit of internal control over financial reporting, refer to Appendix B, Special Topics, of AS 2201[17] for considerations when a company has multiple locations or business units.

[14] Paragraph .66 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*.

[15] AS 2105.10 describes the consideration of materiality in planning and performing audit procedures at an individual location or business unit.

[16] There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.

[17] AS 2201.B10–.B16.

.13 In determining the locations or business units at which to perform audit procedures, the auditor may take into account relevant activities performed by internal audit, as described in AS 2605, *Consideration of the Internal Audit Function*, or others, as described in AS 2201. AS 2605 and AS 2201 establish requirements regarding using the work of internal audit and others, respectively.

Multi-location Engagements – Additional Considerations for Audits Involving Other Auditors or Referred-to Auditors

.14 In an audit that involves other auditors or referred-to auditors, the lead auditor should perform the procedures in paragraphs .11-.13 of this standard to determine the locations or business units at which audit procedures should be performed. ~~In making this determination, the lead auditor should hold discussions with and obtain information from the other auditors[18] 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.~~

~~Note: AS 1201 sets forth specific procedures for the lead auditor to perform in determining the audit procedures to be performed by other auditors. AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, sets forth the lead auditor's responsibilities for dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting with a referred-to auditor.~~

~~[18] AS 2110.49-.53 describe conducting a discussion among engagement team members regarding risks of material misstatement.~~

[18] [Footnote deleted.]

Changes During the Course of the Audit

.15 The auditor should modify the overall audit strategy and the audit plan as necessary if circumstances change significantly during the course of the audit, including changes due to a revised assessment of the risks of material misstatement or the discovery of a previously unidentified risk of material misstatement.

Persons with Specialized Skill or Knowledge

.16 The auditor should determine whether specialized skill or knowledge, including relevant knowledge of foreign jurisdictions, is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

.17 If a person with specialized skill or knowledge employed or engaged by the auditor participates in the audit, the auditor should have sufficient knowledge of the subject matter to be addressed by such a person to enable the auditor to:

a. Communicate the objectives of that person's work;

b. Determine whether that person's procedures meet the auditor's objectives; and

c. Evaluate the results of that person's procedures as they relate to the nature, timing, and extent of other planned audit procedures and the effects on the auditor's report.

Additional Considerations in Initial Audits

.18 The auditor should undertake the following activities before starting an initial audit:

a. Perform procedures regarding the acceptance of the client relationship and the specific audit engagement; and

b. Communicate with the predecessor auditor in situations in which there has been a change of auditors in accordance with AS 2610, *Initial Audits—Communications Between Predecessor and Successor Auditors*.

.19 The purpose and objective of planning the audit are the same for an initial audit or a recurring audit engagement. However, for an initial audit, the auditor should determine the additional planning activities necessary to establish an appropriate audit strategy and audit plan, including determining the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the opening balances.[19]

[19] *See also* paragraph .03 of AS 2820, *Evaluating Consistency of Financial Statements*.

Appendix A – Definitions

.A1 For purposes of this standard, the terms listed below are defined as follows:

.A2 Engagement partner – The member of the engagement team with primary responsibility for the audit.

.A3 Engagement team –

a. Engagement team includes:

(1) Partners, principals, and shareholders of, and accountants[~~20~~] and other professional staff employed or engaged by, the lead auditor or other accounting firms~~,~~ who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to ~~AS 2101~~this standard or AS 1201, *Supervision of the Audit Engagement*; and

(2) Specialists ~~whose work is used on the audit and~~ who (i) are employed by the lead auditor or ~~another accounting firm~~ an other auditor participating in the audit and (ii) assist their firm in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

b. Engagement team does not include:

(1) The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);

(2) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; or

(3) Engaged specialists.[~~21~~2]

[~~20~~1] *See* paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*~~.~~, which defines the term "accountant."

[~~21~~] ~~*See* AS 1210.~~

[2] AS 1210, *Using the Work of an Auditor-Engaged Specialist*, establishes requirements that apply to the use of specialists engaged by the auditor's firm. Appendix A of AS 1105, *Audit Evidence*, sets forth the auditor's responsibilities for using the work of a specialist employed or engaged by the company.

.A4 Lead auditor –

a. The registered public accounting firm[~~22~~3] issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and

b. The engagement partner and other engagement team members who~~:~~ both:

(1) ~~a~~ Are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report ~~and~~ (or individuals who work under that firm's direction and control and function as the firm's employees); and

(2) ~~a~~ Assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.[~~23~~4]

Note: The registered public accounting firm issuing the auditor's report is also referred to in this standard as "the engagement partner's firm."

Note: Individuals such as secondees[5] who work under the direction and control of the registered public accounting firm issuing the auditor's report would function as the firm's employees.

~~22~~3 *See* paragraph (r)(i) in PCAOB Rule 1001, ~~*Definitions of Terms Employed in Rules,*~~ which defines the term "registered public accounting firm."

~~23~~ ~~*See* AS 2301.05a~~4 *See* paragraph .05a of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, which describes making appropriate assignments of significant engagement responsibilities. *See also* paragraph .06 of AS 1015~~.06~~, *Due Professional Care in the Performance of Work*, according to which "[~~a]uditors~~e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability ….."

5 For this purpose, the term "secondee" refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices of the registered public accounting firm issuing the auditor's report, for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer).

.A5 Other auditor –

a. A member of the engagement team who is not ~~a~~:

(1) A partner, principal, shareholder, or employee of the lead auditor~~;~~ or

(2) An individual who works under the direction and control of the registered public accounting firm issuing the auditor's report and functions as that firm's employee; and

b. A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.

.A6 Referred-to auditor – A public accounting firm, other than the lead auditor, that performs an audit of the financial statements and, if applicable, internal control over financial reporting, of one or more of the company's business units~~24~~6 and issues an auditor's report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead auditor's report on the company's financial statements and, if applicable, internal control over financial reporting.7

~~24~~6 The term "business units" includes subsidiaries, divisions, branches, components, or investments.

7 *See* AS 1206, which sets forth the lead auditor's responsibilities regarding dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting, with a referred-to auditor.

AS 1201, *Supervision of the Audit Engagement*

Introduction

.01 This standard establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team[1] members.

[1] ~~Terms~~The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A~~, *Definitions*, are set in **boldface type** the first time they appear~~ of AS 2101, *Audit Planning*.

Objective

.02 The objective of the auditor is to supervise the audit engagement, including supervising the work of engagement team members so that the work is performed as directed and supports the conclusions reached.

Responsibility of the Engagement Partner for Supervision

.03 The **engagement partner**[1A] is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members (including engagement team members outside the engagement partner's firm). The engagement partner also is responsible for compliance with PCAOB standards, including standards regarding: using the work of specialists,[2] internal auditors,[4] and others who are involved in testing controls;[5] and dividing responsibility with another accounting firm.[5A] Paragraphs .05–.06 of this standard describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members.[6]

~~Note: Appendix B describes~~Paragraphs .07-.15 of this standard further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth ~~below.~~in this standard.[6A]

[1A] The term "engagement partner" is defined in Appendix A, *Definitions*, and is set in **boldface type** the first time it appears.

[2] Appendix C describes further procedures to be performed with respect to the supervision of the work of auditor-employed specialists in conjunction with the required supervisory activities set forth below. AS 1210, *Using the Work of an Auditor-Engaged Specialist*; and Appendix A of AS 1105, *Audit Evidence*, establish requirements for an auditor using the work of an auditor-engaged specialist and a company's specialist, respectively, in performing an audit of financial statements.

[3] [Footnote deleted.]

[4] AS 2605, *Consideration of the Internal Audit Function*.

[5] Paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

[5A] *See* AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

[6] *See also* paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*.

[6A] The terms "lead auditor" and "other auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101.

.04 The engagement partner may seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in this standard with respect to the supervisory responsibilities assigned to them.

Supervision of Engagement Team Members

.05 The engagement partner and, as applicable, other engagement team members performing supervisory activities, should:

a. Inform engagement team members of their responsibilities,[7] including:

(1) The objectives of the procedures that they are to perform;

(2) The nature, timing, and extent of procedures they are to perform; and

(3) Matters that could affect the procedures to be performed or the evaluation of the results of those procedures, including relevant aspects of the company, its environment, and its internal control over financial reporting,[8] and possible accounting and auditing issues;

b. Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards;[9]

Note: In applying due professional care in accordance with AS 1015, each engagement team member has a responsibility to bring to the attention of appropriate persons, disagreements or concerns the engagement team member might have with respect

to accounting and auditing issues that he or she believes are of significance to the financial statements or the auditor's report regardless of how those disagreements or concerns may have arisen.

c. Review the work of engagement team members to evaluate whether:

(1) The work was performed and documented;

(2) The objectives of the procedures were achieved; and

(3) The results of the work support the conclusions reached.[10]

[7] AS 1015.06 and paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establish requirements regarding the appropriate assignment of engagement team members.

[8] AS 2110, *Identifying and Assessing Risks of Material Misstatement*, describes the auditor's responsibilities for obtaining an understanding of the company, its environment, and its internal control over financial reporting.

[9] *See, e.g.*, ~~paragraph .15 of~~ AS 2101.15~~, *Audit Planning*~~, AS 2110.74, and paragraphs .20–.23 and .35–.36 of AS 2810, *Evaluating Audit Results*.

[10] AS 2810 describes the auditor's responsibilities for evaluating the results of the audit, and AS 1215, *Audit Documentation*, establishes requirements regarding audit documentation.

.06 To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, the engagement partner and other engagement team members performing supervisory activities should take into account:

a. The nature of the company, including its size and complexity;[11]

b. The nature of the assigned work for each engagement team member, including:

(1) The procedures to be performed, and

(2) The controls or accounts and disclosures to be tested;

c. The risks of material misstatement; and

d. The knowledge, skill, and ability of each engagement team member.[12]

Note: In accordance with the requirements of AS 2301.05 the extent of supervision of engagement team members should be commensurate with the risks of material misstatement.[13]

[11] AS 2110.10.

[12] *See also* AS 2301.05a and AS 1015.06.

[13] AS 2301.05b indicates that the extent of supervision of engagement team members is part of the auditor's overall responses to the risks of material misstatement.

Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of Work Performed by Other Auditors[14]

[14] AS 1206 sets forth the lead auditor's responsibilities when dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting with a referred-to auditor.

~~[.B1]~~.07 For engagements that involve other auditors, ~~this appendix describes~~paragraphs .08-.15 further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other ~~auditors' work~~auditors, in conjunction with the required supervisory activities set forth in this standard. The requirements ~~of this appendix~~in paragraphs .08-.15 supplement the requirements in paragraph .05 of this standard. In performing the procedures described in ~~this appendix~~paragraphs .08-.15, the lead auditor should determine the extent of supervision of the other auditors' work in accordance with paragraph .06 of this standard.

~~[.B2] In supervising the work of other auditors, the~~ .08 The lead auditor should~~:~~[18]

~~a. Inform~~ inform the other auditor in writing of the following ~~in writing~~matters:

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

~~(2) Tolerable misstatement,~~[19] ~~the~~ b. With respect to the work requested to be performed:

(1) The identified risks of material misstatement~~,~~[20] to the consolidated financial statements that are applicable to the location or business unit;[15]

(2) Tolerable misstatement;[16] and~~,~~

(3) The amount (if determined~~, the amount~~) below which misstatements are clearly trivial and do not need to be ~~accumulated~~[21] ~~relevant to the work requested to be performed.~~accumulated.[17]

~~[.B1 Note]~~ Note: The lead auditor should, as necessary, hold discussions with and obtain information from the other ~~auditors, as necessary for~~ auditor to facilitate the performance of procedures described in ~~this appendix~~paragraph .08.

[15] *See* requirements in AS 2110.49-.53 with respect to discussions among key engagement team members (including those in differing locations) regarding risks of material misstatement including the potential for material misstatement due to fraud.

[16] *See* paragraphs .08-.10 of AS 2105, *Consideration of Materiality in Planning and Performing an Audit*.

[17] *See* AS 2810.10-.11.

~~b.~~.09 ~~Obtain~~The lead auditor should obtain and review the other auditor's written description of the audit procedures to be performed pursuant to the scope of work described in paragraph .08a. ~~B2a(1), determine whether any changes to the procedures are necessary, discuss such changes with the other auditor, and communicate them in writing to the other auditor;~~

~~Note:~~ The lead auditor should inform the other auditor of the necessary level of detail of the ~~other auditor's~~ description ~~of audit procedures to be performed~~ (e.g., ~~description of certain~~ planned audit procedures for certain accounts and disclosures), which detail should be determined based on the necessary extent of supervision of the other auditor's work by the lead auditor.

Note: ~~Based on~~As the necessary extent of supervision ~~of the other auditor's work by the lead auditor, it may be necessary for~~increases, the lead auditor (rather than the other auditor) may need to determine the nature, timing, and extent of procedures to be performed by the other auditor.

.10 The lead auditor should determine whether any changes to the other auditor's planned audit procedures (*see* paragraph .09) are necessary, and if so, should discuss the changes with, and communicate them in writing to, the other auditor.

.11 The lead auditor should obtain and review a written affirmation as to whether the other auditor has performed the work in accordance with the instructions described in paragraphs .08-.10, including the use of applicable PCAOB standards; and if it has not, a description of the nature of, and explanation of the reasons for, the instances where the work was not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed.

~~c.~~.12 The lead auditor should direct~~Direct~~ the other auditor to provide ~~for review~~ specified documentation ~~with respect to the~~concerning work requested to be performed~~;~~[22]

~~d. Obtain from the other auditor a summary memorandum describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion; and~~

~~Note: The lead auditor should inform the other auditor of the necessary level of detail of the other auditor's information described in paragraphs .B2c and .B2d (*e.g.*, information for certain accounts and disclosures), which detail should be determined,~~ based on the necessary extent of its supervision of the other auditor's work ~~by the lead auditor.~~. This documentation should include, at a minimum, the documentation described in AS 1215.19. The lead auditor should review the documentation provided by the other auditor.

~~c.~~.13 The lead auditor should determine~~Determine~~, based on a review of the documentation ~~and summary memorandum~~ provided by the other auditor (pursuant to paragraphs .~~B2c~~09, .11, and .~~B2d of this appendix~~12), discussions with the other auditor, and other information obtained by the lead auditor during the audit:

~~(1)~~a. Whether the other auditor ~~complied~~performed the work in accordance with the ~~written communications~~lead auditor's instructions received pursuant to paragraphs .~~B2a~~08 and .~~B2b~~10, including the use of applicable PCAOB standards; and

~~(2)~~b. Whether additional audit evidence should be obtained ~~with respect to the work performed~~ by the lead auditor or other auditors, for example, to address a previously unidentified risk of material misstatement or ~~in a situation in which~~when sufficient appropriate audit evidence has not been obtained ~~about a relevant assertion.[23]~~

~~[18] Paragraph .B3 of this appendix describes how the requirements of this paragraph can be applied in multi-tiered engagement teams.~~

~~[19] *See* paragraphs .08–.10 of AS 2105, *Consideration of Materiality in Planning and Performing an Audit*.~~

~~[20] *See* requirements in AS 2110.49–.51~~ with respect to ~~discussions among engagement team members in differing~~one or more locations ~~regarding~~or business units in response to the associated risks ~~of material misstatement.~~.[18]

~~[21] *See* AS 2810.10–.11.~~

~~[22] The specified documentation includes, but is not limited to, the documentation described in AS 1215.19.~~

~~[23]~~[18] *See* AS 2810.35-.36.

Multi-tiered Audits

~~[.B3]~~.14 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 sub-unit audited by a second other auditor. As another example, an other auditor might assist~~audits,[19] the lead auditor ~~in supervising a second other auditor.[24] In these situations, the lead auditor may direct the~~ may seek assistance from a first other auditor ~~to perform~~in performing the procedures in ~~paragraph .B2~~paragraphs .08-.13 with respect to ~~the~~one or more second other ~~auditor on behalf of the lead auditor~~auditors, 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. ~~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~~If the first other auditor assists the lead auditor by performing procedures in paragraph .08, the lead auditor should obtain, review, and retain documentation that identifies the scope of work to be performed by the second other auditor.

~~[24] The requirements of this paragraph also apply to audits in which there are multiple second other auditors.~~

Note: In multi-tiered audits, for purposes of complying with AS 1215.19 with respect to the work performed by a second other auditor, the lead auditor may request that the first other auditor both (i) obtain, review, and retain the audit documentation described in AS 1215.19 related to the second other auditor's work and (ii) incorporate the information in that documentation in the first other auditor's documentation that it provides to the lead auditor pursuant to AS 1215.19.

[19] Multi-tiered audits are those in which the engagement team is organized in a multi-tiered structure, e.g., whereby an other auditor assists the lead auditor in supervising a second other auditor or multiple second other auditors.

.15 If the first other auditor is assisting the lead auditor in supervising the second other auditor, the lead auditor should take into account the first other auditor's review of the second other auditor's work in determining the extent of its own review, if any, of the second other auditor's work.[20]

[20] *See* paragraph .14, regarding the lead auditor's evaluation of the first other auditor's supervision, including review.

Appendix A – Definitions

.A1 For purposes of this standard~~, the terms listed below are defined as follows~~:

~~.A2 Engagement~~ a. The term "engagement partner~~ The~~" means the member of the engagement team with primary responsibility for the audit.

b. The terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor" have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

~~.A3 Engagement team –~~

~~a. Engagement team includes:~~

~~(1) Partners, principals, and shareholders of, and accountants[14] and other professional staff employed or engaged by, the lead auditor or other accounting firms, who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201; and~~

~~(2) Specialists whose work is used on the audit and who are employed by the lead auditor or another accounting firm participating in the audit.~~

~~b. Engagement team does not include:~~

~~(1) The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);~~

~~(2) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206; or~~

~~(3) Engaged specialists.[15]~~

~~[14] *See* paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*.~~

~~[15] *See* AS 1210.~~

~~.A4 Lead auditor –~~

~~a. The registered public accounting firm[16] issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and~~

~~b. The engagement partner and other engagement team members who: (1) are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report and (2) assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.[17]~~

~~Note: The registered public accounting firm issuing the auditor's report is also referred to in this standard as "the engagement partner's firm."~~

~~[16] *See* paragraph (r)(i) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "registered public accounting firm."~~

~~[17] *See* AS 2301.05a, which describes making appropriate assignments of significant engagement responsibilities. *See also* AS 1015.06, according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability."~~

~~.A5 Other auditor –~~

~~a. A member of the engagement team who is not a partner, principal, shareholder, or employee of the lead auditor; and~~

~~b. A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.~~

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AS 1015, *Due Professional Care in the Performance of Work*

.01 Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report.

Note: For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care.[1]

[1] The lead auditor's responsibilities for planning the audit and supervising the other auditors' work are set forth in AS 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*. The terms "lead auditor" and "other auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101.

.02 The statement in the preceding paragraph requires the independent auditor to plan and perform his or her work with due professional care. Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting.

~~Note: For audits that involve other auditors,[1] the other auditors are responsible for performing their work with due professional care.~~

~~[1] The term "other auditors," as used in this standard, has the same meaning as in Appendix A of AS 1201.~~

***

.06 Engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining. The engagement partner should know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client. The engagement partner is responsible for the assignment of tasks to, and supervision of, the members of the engagement team.[4]

[4] *See* AS 1201~~, Supervision of the Audit Engagement~~.

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AS 1105, *Audit Evidence*

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Appendix B—Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results

.B1 For valuations based on an investee's financial results, the auditor should obtain sufficient appropriate evidence in support of the investee's financial results. The auditor should read available financial statements of the investee and the accompanying audit report, if any. Financial statements of the investee that have been audited by an auditor ("investee's auditor") whose report is satisfactory, for this purpose,[1] to the investor's auditor may constitute sufficient appropriate evidence.

[1] In determining whether the report of ~~another~~the investee's auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation ~~and~~, standing, and independence of the ~~other~~investee's auditor (under the applicable standards), visiting the ~~other~~investee's auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the ~~other~~investee's auditor.

.B2 If in the auditor's judgment additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in

accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results.

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AS 1215, *Audit Documentation*

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Retention of and Subsequent Changes to Audit Documentation

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.18 The office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs .04-.13 of this standard is prepared and retained. Audit documentation supporting the work performed by other offices of the firm and other auditors[3A] must be retained by or be accessible to the office issuing the auditor's report.[4] An other auditor must comply with the requirements of paragraphs .04-.17 of this standard, including with respect to the audit documentation that the other auditor provides or makes accessible to the office issuing the auditor's report.

[3A] The term "other auditors," as used in this standard, has the same meaning as defined in Appendix A of AS ~~1201~~2101, *Audit Planning*.

[4] Section 106(b) of the Sarbanes-Oxley Act of 2002 imposes certain requirements concerning production of the work papers of a foreign public accounting firm and other related documents in certain circumstances. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

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APPENDIX 2

Revisions to the 2017 Proposed Standard for Audits Involving Referred-to Auditors

This appendix presents revisions to AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm,* as proposed in the 2017 SRC. Language that would be deleted is ~~struck through~~. Language that would be added is underlined.

Proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*

Introduction

.01 This standard establishes requirements for the lead auditor[1] regarding dividing responsibility for the audit of the company's financial statements[2] and, if applicable, internal control over financial reporting[3] with a referred-to auditor.[~~3~~4]

Note: AS 2101, *Audit Planning*, establishes requirements regarding serving as the lead auditor.[~~4~~5]

Note: This standard applies when the lead auditor divides responsibility for the audit with one or more referred-to auditors. When there is more than one referred-to auditor, the lead auditor must apply the requirements of paragraphs .03 ~~through .~~ .09 of this standard in relation to each of the referred-to auditors

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[1] ~~Terms~~The term "lead auditor," as used in this standard, has the same meaning as defined in Appendix A~~, *Definitions,* are set in **boldface type** the first time they appear~~ of AS 2101, *Audit Planning*.

[2] The term "company's financial statements," as used in this standard, describes the financial statements of a company that include—through consolidation or combination—the financial statements of the company's business units.

[3] For integrated audits, *see also* paragraphs .C8 through .C11 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which provide direction with respect to opinions based, in part, on the report of a referred-to auditor in an audit of internal control over financial reporting.

[~~3~~4] ~~For integrated audits, see also paragraphs .C8 through .C11 of AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.~~ The term "referred-to auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

[~~4~~5] *See* paragraphs ~~.B2 and .B3~~06A-C of AS 2101.

individually.

Note: When another accounting firm participates in the audit and the lead auditor does not divide responsibility for the audit with the other firm, AS 1201, *Supervision of the Audit Engagement*, establishes requirements regarding the supervision of the work of the engagement team members~~, including those not employed by the lead auditor~~.[~~5~~6]

Objectives

.02 The objectives of the lead auditor are to: (1) communicate with the referred-to auditor and determine that audit procedures are properly performed with respect to the consolidation or combination of accounts in the company's financial statements and, where applicable, management's assessment of the effectiveness of the company's internal control over financial reporting and (2) make the necessary disclosures in the lead auditor's report.

Performing Procedures with Respect to the Audit of the Referred-to Auditor

.03 The lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, to test and evaluate the consolidation or combination of the financial statements of the business units[~~6~~7] audited by the referred-to auditor into the company's financial statements.[~~7~~8] Matters affecting such consolidation or combination include, for example, intercompany transactions.

.04 The lead auditor should communicate to the referred-to auditor, in writing, the lead auditor's plan to divide responsibility for the audit with the referred-to auditor pursuant to this standard and other applicable PCAOB standards.

.05 The lead auditor should obtain a written representation from the referred-to auditor that the referred-to auditor is:

a. Independent under the requirements of the PCAOB and the ~~U.S.~~ Securities and Exchange Commission ("SEC"); and

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[~~5~~6] The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

[~~6~~7] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

[~~7~~8] *See* paragraphs .30 and .31 of AS 2810, *Evaluating Audit Results*. *See also* AS 2101.18 and paragraphs .09 and .16(c) of AS 2410, *Related Parties*, for additional responsibilities with respect to interactions with the referred-to auditor.

b. Duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor.

.06 The lead auditor may divide responsibility for the audit with another accounting firm only if:

a. The referred-to auditor has represented that it has performed ~~an~~the audit and issued ~~an~~the auditor's report in accordance with the standards of the PCAOB;[~~8~~9]

b. The lead auditor determines, based on inquiries made ~~to~~of the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor ~~knows~~is familiar with the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC;

c. The referred-to auditor that would play a substantial role in the preparation or furnishing of the lead auditor's report ~~on the company's financial statements and, if applicable, internal control over financial reporting, is registered pursuant to the rules of~~, is registered with the PCAOB;[~~9~~10] and

d. In situations when the financial statements of the company's business unit audited by the referred-to auditor ~~we~~are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the company's financial statements, (1) either the lead auditor or the referred-to auditor has audited the conversion adjustments and (2) the lead auditor indicates in its report which auditor (the lead auditor or the referred-to auditor)

[~~8~~9] AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances* ~~(pending SEC approval),~~, apply to auditors' reports issued ~~in connection with~~for audits of historical financial statements that are intended to present financial position, results of operations, and cash flows in conformity with the applicable financial reporting framework. AS 2201~~, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,*~~ applies to auditors' reports issued ~~in connection with~~for audits of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements. In situations where the referred-to auditor is not registered with the PCAOB, the requirements that the auditor's report state that the auditor is registered with the PCAOB do not apply to a referred-to auditor's report. (*See* AS 3101.06 and .09g, and AS 2201.85A and .85Dd.) Disclosure in the auditor's report that a firm is not registered with the PCAOB (or omission that the firm is registered) does not relieve that firm of its obligation to register when required.

[~~9~~10] *See* PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules,* which defines the phrase "play a substantial role in the preparation or furnishing of an audit report."

has taken responsibility for auditing the conversion adjustments.

.07 In situations in which the lead auditor is unable to divide responsibility with another accounting firm (e.g., due to concerns about the qualifications of the referred-to auditor or concerns about whether the referred-to auditor's audit was in accordance with PCAOB standards), the lead auditor should:

a. Plan and perform procedures with respect to the relevant business unit that are necessary for the lead auditor to ~~issue~~express an opinion on the company's financial statements and, if applicable, internal control over financial reporting;

b. Appropriately qualify or disclaim an opinion on the company's financial statements and, if applicable, internal control over financial reporting; or

Note: The lead auditor should state the reasons for ~~modifying the report~~departing from an unqualified opinion, and, when expressing a qualified opinion, disclose the magnitude of the portion of the company's financial statements to which the lead auditor's qualification extends.~~10~~[11]

c. Withdraw from the engagement.

Making Reference in the Lead Auditor's Report

.08 When the lead auditor divides responsibility for the audit with the referred-to auditor, the lead auditor's report must make reference to the audit and auditor's report of the referred-to auditor. The lead auditor's report should:

a. Indicate clearly, in the ~~introductory, scope, and opinion paragraphs~~Opinion on the Financial Statements and Basis for Opinion sections, the division of responsibility between that portion of the company's financial statements, and if applicable, internal control over financial reporting, covered by the lead auditor's

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~~10~~[11] ~~If the lead auditor is unable to obtain sufficient appropriate audit evidence to have a reasonable basis to conclude whether the financial statements are free of material misstatement, AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances* (pending SEC approval), indicates that the auditor should express a qualified opinion or a disclaimer of opinion. For integrated audits, AS 2201.74 states, "[t]he auditor may form an opinion on the effectiveness of internal control over financial reporting only when there have been no restrictions on the scope of the auditor's work. A scope limitation requires the auditor to disclaim an opinion or withdraw from the engagement (*see* paragraphs .C3 through .C7)."~~ *See* AS 3105, which discusses the circumstances that may require the auditor to depart from the auditor's unqualified report. For integrated audits, *see also* Appendix C, *Special Reporting Situations*, of AS 2201.

own audit and that covered by the audit of the referred-to auditor;

b. Identify the referred-to auditor by name and refer to the auditor's report of the referred-to auditor when describing the scope of the audit and when expressing an opinion;~~11~~12 and

c. Disclose the magnitude of the portion of the company's financial statements, and if applicable, internal control over financial reporting, audited by the referred-to auditor. This may be done by stating the dollar amounts or percentages of total assets, total revenues, and other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.

Note: Appendix B includes examples of reporting by the lead auditor.

Note: The lead auditor's decision regarding making reference to the audit and report of the referred-to auditor in the lead auditor's report on the audit of internal control over financial reporting might differ from the corresponding decision as it relates to the audit of the financial statements.~~12~~13

.09 If the report of the referred-to auditor ~~is~~includes an opinion other than ~~a standard report,~~an unqualified opinion or includes explanatory language,[14] the lead auditor should make reference in the lead auditor's report to the departure from the ~~standard report~~unqualified opinion and its disposition ~~in the lead auditor's report~~, or to the explanatory language, or to both, unless the matter is clearly trivial to the company's financial statements.

~~11~~12 Rule 2-05 of Regulation S-X, 17 C.F.R. 210.2-05, includes requirements regarding filing the referred-to auditor's report with the SEC.

~~12~~13 *See, e.g.*, AS 2201.C10.

[14] *See, e.g.*, AS 3105, which discusses the circumstances that may require the auditor to depart from an unqualified opinion on the financial statements; AS 3101, which discusses explanatory language in the auditor's report; and AS 2201, which discusses report modifications, including expressing an adverse opinion on the audit of internal control over financial reporting. *See also* footnote 9 above, which addresses certain situations where the referred-to auditor is not registered with the PCAOB.

AppendixPPENDIX A – Definitions

.A1 For purposes of this standard, the terms listed below are defined as follows: "engagement team," "lead auditor," "other auditor," and "referred-to auditor" have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

.A2 Lead auditor –

a. The registered public accounting firm[13] issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and

b. The engagement partner and other engagement team members who: (1) are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report and (2) assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.[14]

.A3 Referred-to auditor – A public accounting firm, other than the lead auditor, that performs an audit of the financial statements and, if applicable, internal control over financial reporting of one or more of the company's business units[15] and issues an auditor's report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead auditor's report on the company's financial statements and, if applicable, internal control over financial reporting.

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[13] *See* paragraph (r)(i) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term registered public accounting firm.

[14] *See* AS 2301.05a, which describes making appropriate assignments of significant engagement responsibilities. *See also* AS 1015.06, according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability."

[15] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

AppendixPPENDIX B – Examples of Reporting by the Lead Auditor Indicating the Division of Responsibility When Making Reference to the Audit and Report of the Referred-to Auditor

.B1 The following are examples of reporting by the lead auditor indicating the division of responsibility when making reference to the audit and report of the referred-to auditor:

Example 1: The Lead Auditor Chooses[1] to Issue a Combined Report on the Financial Statements and Internal Control over Financial Reporting, Both of Which Refer to the Reports of the Referred-to Auditor

Report of Independent Registered Public Accounting Firm[16]

[*Introductory paragraphs*]

To the shareholders and the board of directors of X Company

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries (the "Company") as of December 31, 20X3 and 20X2 and 20X1, and the related consolidated statements of operations, stockholders' equity and [*titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows*] for each of the three years in the three-year period ended December 31, 20X3.20X2, and the related notes [*and schedules*] (collectively referred to as the "consolidated financial statements"). We also have audited Xthe Company's internal control over financial reporting as of December 31, 20X32, based on [*Identify control criteria, for example, "criteria established in Internal Control—Integrated Framework: 2013XX issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."*]. X Company's management is responsible

In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for these financial statements, for maintainingeach of the three years in the period ended December 31, 20X2, in conformity with accounting

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[1] Under paragraph .86 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting.

[16] *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, PCAOB Release No. 2017-001 (June 1, 2017) (pending SEC approval) finalized a number of changes to the auditor's report.

principles generally accepted in the United States of America. Also in our opinion, based on our audits and the report of Firm ABC, the Company maintained, in all material respects, effective internal control over financial reporting~~, and for its assessment of the effectiveness of internal~~ as of December 31, 20X2, based on [*Identify* control ~~over financial reporting included in the accompanying [title of management's report]. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.~~ *criteria, for example, "criteria established in Internal Control—Integrated Framework: 20XX issued by COSO."*].

We did not audit the financial statements and internal control over financial reporting of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting XX percent and YY percent of consolidated assets as of December 31, ~~20X3 and~~ 20X2 and 20X1, respectively, and total revenues constituting ~~XX~~AA percent, ~~YY~~BB percent, and ~~ZZ~~CC percent of consolidated revenues for the years ended December 31, ~~20X3,~~ 20X2, ~~and~~ 20X1, and 20X0, respectively. Those financial statements and internal control over financial reporting were audited by Firm ABC, whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for B Company and its internal control over financial reporting, are based solely on the report of Firm ABC.[~~17~~2]

~~[*Scope paragraph*]~~

Basis for Opinion

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*]. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the ~~Public Company~~

[~~17~~2] The end of this appendix presents alternatives to this paragraph for situations in which the financial statements audited by the referred-to auditor were prepared using a financial reporting framework that differs from the framework used to prepare the financial statements audited by the lead auditor. (*See* paragraph .06d of this standard.)

~~Accounting Oversight Board (United States).~~PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence ~~supporting~~regarding the amounts and disclosures in the financial statements~~, assessing~~. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall ~~financial statement~~ presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits and the report of Firm ABC provide a reasonable basis for our opinions.

~~[~~Definition ~~*paragraph*~~]and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that~~:~~ (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

~~[*Inherent limitations paragraph*]~~

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures

may deteriorate.

~~[*Opinion paragraph*]~~

~~In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 20X3, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, based on our audits and the report of Firm ABC, X Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X3, based on [Identify control criteria, for example, "criteria established in *Internal Control—Integrated Framework: 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).*"].~~

Critical Audit Matters [if applicable]

[*Include critical audit matters*]

[*Signature*]

We have served as the Company's auditor since [*year*].

[*City and State or Country*]

[*Date*]

Example 2: The Lead Auditor Chooses to Issue Separate Reports on the Financial Statements and Internal Control over Financial Reporting, and Makes Reference to the Referred-to Auditor Only in the Report on the Financial Statements[3]

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries (the "Company") as of December 31, 20X2 and 20X1, and the related

[3] Such a scenario may exist, e.g., when the audit does not extend to controls at a company's equity method investee. (*See* AS 2201.B15.) (*See also* AS 2201.88, which describes a paragraph that should be added to the lead auditor's report on the internal control over financial reporting.)

consolidated statements of [*titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows*] for each of the three years in the period ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "consolidated financial statements"). In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 20X2, based on [*Identify control criteria, for example, "criteria established in Internal Control—Integrated Framework: 20XX issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinion*].

We did not audit the financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting XX percent and YY percent of consolidated assets as of December 31, 20X2 and 20X1, respectively, and total revenues constituting AA percent, BB percent, and CC percent of consolidated revenues for the years ended December 31, 20X2, 20X1, and 20X0, respectively. Those financial statements were audited by Firm ABC, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of Firm ABC.[4]

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those

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[4] The end of this appendix presents alternatives to this paragraph for situations in which the financial statements audited by the referred-to auditor were prepared using a financial reporting framework that differs from the framework used to prepare the financial statements audited by the lead auditor. (*See* paragraph .06d of this standard.)

standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits and the report of Firm ABC provide a reasonable basis for our opinion.

Critical Audit Matters [if applicable]

[*Include critical audit matters*]

[*Signature*]

We have served as the Company's auditor since [*year*].

[*City and State or Country*]

[*Date*]

Examples of an Alternative ~~*Paragraphs*~~Paragraph (Which Precedes the Basis for Opinion section) When the Financial Statements Audited by the Referred-to Auditor were Prepared using a Financial Reporting Framework that Differs from the Framework Used to Prepare the Financial Statements Audited by the Lead Auditor

Example ~~13~~: Conversion Adjustments Audited by the Lead Auditor

We did not audit the financial statements ~~and internal control over financial reporting~~ of B Company, a wholly-~~-~~owned subsidiary. The financial statements of B Company prepared under [~~name of~~ *financial reporting framework used by B Company*] ~~and internal control over financial reporting~~ were audited by Firm ABC, whose report has been furnished to us, and our opinion~~s~~, insofar as ~~they relate~~it relates to the amounts included for B Company under [~~name of~~ *financial reporting framework used by B Company*~~] and its internal control over financial reporting, are~~], is based solely on the report of Firm ABC. The financial statements of B Company under accounting principles generally accepted in the United States of America reflect total assets constituting XX percent and YY percent of consolidated assets as of December 31, ~~20X3 and~~ 20X2 and 20X1, respectively, and total revenues constituting ~~XX~~AA percent, ~~YY~~BB percent, and ~~ZZ~~CC percent of consolidated revenues for the years ended December 31, ~~20X3,~~ 20X2, ~~and~~ 20X1, and 20X0, respectively. We have audited the adjustments to the financial statements of B Company to conform those financial statements to accounting

principles generally accepted in the United States of America.

Example ~~2~~4: Conversion Adjustments Audited by the Referred-to Auditor

We did not audit the financial statements ~~and internal control over financial reporting~~ of B Company, a wholly-~~-~~owned subsidiary. The financial statements of B Company prepared under [~~name of~~ *financial reporting framework used by B Company*~~],~~] and the adjustments to conform those financial statements to accounting principles generally accepted in the United States of America~~, and internal control over financial reporting of B Company~~ were audited by Firm ABC, whose report has been furnished to us, and our opinion~~s~~, insofar as ~~they relate~~it relates to the amounts included for B Company under accounting principles generally accepted in the United States of America ~~and its internal control over financial reporting, are~~, is based solely on the report of Firm ABC. The financial statements of B Company under accounting principles generally accepted in the United States of America reflect total assets constituting XX percent and YY percent of consolidated assets as of December 31, ~~20X3 and~~ 20X2 and 20X1, respectively, and total revenues constituting ~~XX~~AA percent, ~~YY~~BB percent, and ~~ZZ~~CC percent of consolidated revenues for the years ended December 31, ~~20X3,~~ 20X2, ~~and~~ 20X1, and 20X0, respectively.

APPENDIX 3

Cumulative Potential Amendments to Existing PCAOB Standards Relating to the Performance of Audits Involving Other Auditors

This appendix presents the cumulative potential amendments (those in the 2016 Proposal, those in the 2017 SRC, and revised by this release) for the following PCAOB standards. Language that would be deleted is ~~struck through~~. Language that would be added is underlined.

- AS 2101, *Audit Planning*
- AS 1201, *Supervision of the Audit Engagement*
- AS 1015, *Due Professional Care in the Performance of Work*
- AS 1105, *Audit Evidence*
- AS 1215, *Audit Documentation*
- AS 1220, *Engagement Quality Review*
- AS 1301, *Communications with Audit Committees*

AS 2101, *Audit Planning*

Introduction

.01 This standard establishes requirements regarding planning an audit.

Objective

.02 The objective of the auditor is to plan the audit so that the audit is conducted effectively.

Responsibility of the Engagement Partner for Planning

.03 The **engagement partner**[1] is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate **engagement team** members (which may include engagement team members outside the engagement partner's firm) in fulfilling this responsibility. Engagement team members who assist the engagement partner with audit planning also should comply with the relevant requirements in this standard.

[1] Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

Planning an Audit

.04 The auditor should properly plan the audit. This standard describes the auditor's responsibilities for properly planning the audit.[2] For audits that involve **other auditor**s or **referred-to auditor**s, this standard describes additional responsibilities for the engagement partner and the **lead auditor**.

[2] The term~~,~~ "auditor," as used in this standard, encompasses both the engagement partner and the engagement team members who assist the engagement partner in planning the audit. AS 1201, *Supervision of the Audit Engagement*, establishes requirements regarding supervision of the audit engagement, including a lead auditor's supervision of the work of other auditors. AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for a lead auditor regarding dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting, with another accounting firm (i.e., a referred-to auditor).

.05 Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes, in particular, planned risk assessment procedures and planned responses to the risks of material misstatement. Planning is not a discrete phase of an audit but, rather, a continual and iterative process that might begin shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit.

Preliminary Engagement Activities

.06 The auditor should perform the following activities at the beginning of the audit:

a. Perform procedures regarding the continuance of the client relationship and the specific audit engagement,[3]

b. Determine compliance with independence[3A] and ethics requirements,[4] and

> Note: The determination of compliance with independence and ethics requirements is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.

c. Establish an understanding of the terms of the audit engagement with the audit committee in accordance with AS 1301, *Communications with Audit Committees*.

[3] Paragraphs .14-.16 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. AS 1110, *Relationship of Auditing Standards to Quality Control Standards*, explains how the quality control standards relate to the conduct of audits.

[3A] Under PCAOB Rule 3520, *Auditor Independence*, a registered public accounting firm or associated person's independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Securities and Exchange Commission ("SEC") under the federal securities laws.

[4] In an audit that involves other auditors, *see* paragraphs .06D-F of this standard, which describe performing additional procedures regarding other auditors' compliance with independence and ethics requirements. In an audit that involves referred-to auditors, *see* AS 1206.05-.07.

Preliminary Engagement Activities – Additional Considerations for Audits Involving Other Auditors or Referred-to Auditors

Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors

.06A In an audit that involves other auditors or referred-to auditors, the engagement partner should determine whether the participation of his or her firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements. In making this determination, the engagement partner should take into account the following, in combination:

a. The importance of the locations or business units[4A] for which the engagement partner's firm performs audit procedures in relation to the financial statements of the company as a whole, considering quantitative and qualitative factors;

b. The risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm performs audit procedures, in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors; and

c. The extent of the engagement partner's firm's supervision of the other auditors' work[4B] for portions of the company's financial statements for which the other auditors perform audit procedures. In a multi-tiered audit (*see* AS 1201.14), this subparagraph c applies only to the firm's supervision of a first other auditor and any other auditor that is supervised directly by the firm.

In addition, in an audit that involves referred-to auditors (*see* AS 1206), the participation of the engagement partner's firm ordinarily is not sufficient for it to serve as lead auditor if the

referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

[4A] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

[4B] *See* AS 1201.06, which describes determining the necessary extent of supervision.

.06B In an audit that involves other auditors performing work regarding locations or business units, the involvement of the lead auditor (through a combination of planning and performing audit procedures and supervision of other auditors) should be commensurate with the risks of material misstatement[4C] associated with those locations or business units.

[4C] *See, e.g.*, AS 1201.06, paragraph .11 of this standard; *see generally* AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

.06C In an integrated audit of a company's financial statements and its internal control over financial reporting that involves other auditors or referred-to auditors, the lead auditor of the financial statements must participate sufficiently in the audit of internal control over financial reporting to provide a basis for serving as the lead auditor of internal control over financial reporting. Only the lead auditor of the financial statements can be the lead auditor of internal control over financial reporting.[4D]

[4D] *See* paragraph .C8 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Other Auditors' Compliance with Independence and Ethics Requirements

.06D In an audit that involves other auditors,[4E] the lead auditor should, with respect to each other auditor, perform the following procedures in conjunction with determining compliance with SEC independence requirements and PCAOB independence and ethics requirements pursuant to paragraph .06b of this standard:

a. Obtain an understanding of the other auditor's (1) knowledge of SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements; and

b. Obtain from the other auditor and review:

(1) A written affirmation as to whether the other auditor has policies and procedures that provide reasonable assurance that the other auditor maintains compliance with SEC independence requirements and PCAOB independence and ethics requirements, and if it does not, a written

description of how the other auditor determines its compliance with the requirements;

(2) 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 pursuant to the requirements of paragraph (b)(1) of PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*; and

(3) A written affirmation as to whether the other auditor is in compliance with SEC independence requirements and PCAOB independence and ethics requirements with respect to the audit client, and, if it is not in compliance, a written description of the nature of the instances of non-compliance.

c. For the matters described in items a and b:

(1) Inform the other auditor of changes in circumstances, of which the lead auditor becomes aware, that (i) affect determining compliance with SEC independence requirements and PCAOB independence and ethics requirements, and (ii) are relevant to the other auditor's affirmations and descriptions; and

(2) Request that the other auditor (i) update its affirmations and descriptions to reflect changes in circumstances of which the other auditor becomes aware (including changes communicated by the lead auditor) that affect determining compliance with SEC independence requirements and PCAOB independence and ethics requirements, and (ii) provide the updated affirmations and descriptions to the lead auditor upon becoming aware of such changes.

Note: For the matters described in paragraph .06D, information (including affirmations and descriptions) may be obtained from the other auditor covering the other auditor's firm and engagement team members who are partners, principals, shareholders, or employees of the firm.

[4E] For audits involving referred-to auditors, *see* AS 1206.

.06E In multi-tiered audits (*see* AS 1201.14), a first other auditor may assist the lead auditor in performing the procedures described in paragraph .06D with respect to one or more second other auditors. If so, the lead auditor should instruct the first other auditor to inform the lead auditor of the results of procedures performed, including bringing to the lead auditor's attention any information indicating that a second other auditor is not in compliance with SEC

independence requirements or PCAOB independence and ethics requirements. The lead auditor remains responsible for determining compliance with those requirements pursuant to paragraph .06b of this standard.

.06F If the lead auditor becomes aware of information that contradicts an affirmation or description provided by an other auditor pursuant to paragraph .06D, the lead auditor should investigate the circumstances and consider the reliability of the affirmation or description. If, after such investigation, or based on the other auditor's affirmation, the lead auditor obtains information indicating that the other auditor is not in compliance with SEC independence requirements or PCAOB independence and ethics requirements, the lead auditor should consider the implications for determining compliance with those requirements pursuant to paragraph .06b of this standard.[4F]

[4F] The lead auditor should also consider the implications for determining compliance with PCAOB Rule 3526.

PCAOB Registration Status of Other Auditors

.06G In an audit that involves an other auditor that plays a substantial role in the preparation or furnishing of the lead auditor's report, the lead auditor may use the work of the other auditor only if the other auditor is registered with the PCAOB.[4G]

[4G] *See* PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the phrase "play a substantial role in the preparation or furnishing of an audit report." *See also* AS 1206 for requirements for the lead auditor relating to the registration status of a referred-to auditor.

Knowledge, Skill, and Ability of and Communications with Other Auditors

.06H In an audit that involves other auditors, the lead auditor should, with respect to each other auditor:

a. Obtain an understanding of the knowledge, skill, and ability of the other auditor's engagement team members who assist the lead auditor with planning or supervision,[4H] 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;

b. Obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks; and

c. Determine that the lead auditor is able to communicate with the other auditor and gain access to the other auditor's audit documentation.[4I]

[4H] *See* paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*, according to which "[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability ...," and AS 2301.05(a), which describes making appropriate assignments of significant engagement responsibilities.

[4I] *See, e.g.*, AS 1201.05, .09, .11, and .12, which establish requirements for the auditor's review of work performed by engagement team members. *See also* paragraph .18 of AS 1215, *Audit Documentation*, according to which audit documentation supporting the work performed by other auditors must be retained by or be accessible to the office of the firm issuing the auditor's report.

.06I In multi-tiered audits (*see* AS 1201.14), a first other auditor may assist the lead auditor in performing the procedures described in paragraph .06H with respect to one or more second other auditors.

Planning Activities

.07 The nature and extent of planning activities that are necessary depend on the size and complexity of the company, the auditor's previous experience with the company, and changes in circumstances that occur during the audit. When developing the audit strategy and audit plan, as discussed in paragraphs .08-.10, the auditor should evaluate whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures:

- Knowledge of the company's internal control over financial reporting obtained during other engagements performed by the auditor;
- Matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes;
- Matters relating to the company's business, including its organization, operating characteristics, and capital structure;
- The extent of recent changes, if any, in the company, its operations, or its internal control over financial reporting;

- The auditor's preliminary judgments about materiality,[5] risk, and, in integrated audits, other factors relating to the determination of material weaknesses;
- Control deficiencies previously communicated to the audit committee[6] or management;
- Legal or regulatory matters of which the company is aware;
- The type and extent of available evidence related to the effectiveness of the company's internal control over financial reporting;
- Preliminary judgments about the effectiveness of internal control over financial reporting;
- Public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the company's internal control over financial reporting;
- Knowledge about risks related to the company evaluated as part of the auditor's client acceptance and retention evaluation; and
- The relative complexity of the company's operations.

Note: Many smaller companies have less complex operations. Additionally, some larger, complex companies may have less complex units or processes. Factors that might indicate less complex operations include: fewer business lines; less complex business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control.

[5] AS 2105, *Consideration of Materiality in Planning and Performing an Audit.*

[6] If no audit committee exists, all references to the audit committee in this standard apply to the entire board of directors of the company. *See* 15 U.S.C §§ 78c(a)(58) and 7201(~~a)(~~3).

Audit Strategy

.08 The auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit and guides the development of the audit plan.

.09 In establishing the overall audit strategy, the auditor should take into account:

a. The reporting objectives of the engagement and the nature of the communications required by PCAOB standards,[7]

b. The factors that are significant in directing the activities of the engagement team,[8]

c. The results of preliminary engagement activities[9] and the auditor's evaluation of the important matters in accordance with paragraph .07 of this standard, and

d. The nature, timing, and extent of resources necessary to perform the engagement.[10]

[7] *See*, *e.g.*, AS 1301. Also, various laws or regulations require other matters to be communicated. (*See, e.g.*, Rule 2-07 of Regulation S-X, 17 CFR 210.2-07; and Rule 10A-3 under the Securities Exchange Act of 1934, 17 CFR 240.10A-3.) The requirements of this standard do not modify communications required by those other laws or regulations.

[8] *See*, *e.g.*, ~~paragraph .06 of AS 1201, *Supervision of the Audit Engagement*.~~ AS 1015.06, which describes assigning auditors to tasks and supervising them commensurate with their level of knowledge, skill, and ability, and AS 1201.06, which describes the extent of supervisory activities necessary for proper supervision of engagement team members. *See also* AS 1201.08-.15, which further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors, in conjunction with the required supervisory activities set forth in AS 1201.

[9] Paragraph~~s~~ .06~~-~~.06l of this standard.

[10] *See*, *e.g.*, ~~paragraph .06 of~~ AS 1015~~, *Due Professional Care in the Performance of Work*~~.06, paragraph .16 of this standard, and ~~paragraph .05a. of~~ AS 2301~~, *The Auditor's Responses to the Risks of Material Misstatement*.~~.05a.

Audit Plan

.10 The auditor should develop and document an audit plan that includes a description of:

a. The planned nature, timing, and extent of the risk assessment procedures;[11]

b. The planned nature, timing, and extent of tests of controls and substantive procedures;[12] and

c. Other planned audit procedures required to be performed so that the engagement complies with PCAOB standards.

[11] AS 2110, *Identifying and Assessing Risks of Material Misstatement.*

[12] AS 2301 and AS 2201~~, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*~~.

Multi-location Engagements

.11 In an audit of the financial statements of a company with operations in multiple locations or business units,~~[13]~~ the auditor should determine the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate evidence to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. This includes determining the locations or business units at which to perform audit procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual locations or business units. The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit.

~~[13] The term "business units" includes subsidiaries, divisions, branches, components, or investments.~~

[13] [Footnote deleted.]

.12 Factors that are relevant to the assessment of the risks of material misstatement associated with a particular location or business unit and the determination of the necessary audit procedures include:

a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;[14]

b. The materiality of the location or business unit;[15]

c. The specific risks associated with the location or business unit that present a reasonable possibility[16] of material misstatement to the company's consolidated financial statements;

d. Whether the risks of material misstatement associated with the location or business unit apply to other locations or business units such that, in combination, they present a reasonable possibility of material misstatement to the company's consolidated financial statements;

e. The degree of centralization of records or information processing;

f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and

g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.

Note: When performing an audit of internal control over financial reporting, refer to Appendix B, Special Topics, of AS 2201[17] for considerations when a company has multiple locations or business units.

[14] Paragraph .66 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*.

[15] AS 2105.10 describes the consideration of materiality in planning and performing audit procedures at an individual location or business unit.

[16] There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.

[17] AS 2201.B10–.B16.

.13 In determining the locations or business units at which to perform audit procedures, the auditor may take into account relevant activities performed by internal audit, as described in AS 2605, *Consideration of the Internal Audit Function*, or others, as described in AS 2201. AS 2605 and AS 2201 establish requirements regarding using the work of internal audit and others, respectively.

~~.14 AS 1205, *Part of the Audit Performed by*~~

Multi-location Engagements – Additional Considerations for Audits Involving Other ~~*Independent*~~ **Auditors**~~, describes the auditor's responsibilities regarding using the work and reports of~~ **or Referred-to Auditors**

.14 In an audit that involves other ~~independent~~ auditors ~~who audit the financial statements of one or more of the locations or business units that are included in the consolidated financial statements.[18] In those situations, the~~ or referred-to auditors, the lead auditor should perform the procedures in paragraphs .11-.13 of this standard to determine the locations or business units at which audit procedures should be performed.

~~[18] For integrated audits, *see also* AS 2201.C8–.C11.~~

[18] [Footnote deleted.]

Changes During the Course of the Audit

.15 The auditor should modify the overall audit strategy and the audit plan as necessary if circumstances change significantly during the course of the audit, including changes due to a revised assessment of the risks of material misstatement or the discovery of a previously unidentified risk of material misstatement.

Persons with Specialized Skill or Knowledge

.16 The auditor should determine whether specialized skill or knowledge, including relevant knowledge of foreign jurisdictions, is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

.17 If a person with specialized skill or knowledge employed or engaged by the auditor participates in the audit, the auditor should have sufficient knowledge of the subject matter to be addressed by such a person to enable the auditor to:

a. Communicate the objectives of that person's work;

b. Determine whether that person's procedures meet the auditor's objectives; and

c. Evaluate the results of that person's procedures as they relate to the nature, timing, and extent of other planned audit procedures and the effects on the auditor's report.

Additional Considerations in Initial Audits

.18 The auditor should undertake the following activities before starting an initial audit:

a. Perform procedures regarding the acceptance of the client relationship and the specific audit engagement; and

b. Communicate with the predecessor auditor in situations in which there has been a change of auditors in accordance with AS 2610, *Initial Audits—Communications Between Predecessor and Successor Auditors*.

.19 The purpose and objective of planning the audit are the same for an initial audit or a recurring audit engagement. However, for an initial audit, the auditor should determine the additional planning activities necessary to establish an appropriate audit strategy and audit plan, including determining the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the opening balances.[19]

[19] *See also* paragraph .03 of AS 2820, *Evaluating Consistency of Financial Statements*.

Appendix A – Definitions

.A1 For purposes of this standard, the terms listed below ~~is~~are defined as follows:

.A2 Engagement partner – The member of the engagement team with primary responsibility for the audit.

.A3 Engagement team –

a. Engagement team includes:

(1) Partners, principals, and shareholders of, and accountants[1] ~~and~~ other professional staff employed or engaged by, the lead auditor or other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to this standard or AS 1201, *Supervision of the Audit Engagement*; and

(2) Specialists who (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist their firm in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

b. Engagement team does not include:

(1) The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);

(2) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; or

(3) Engaged specialists.[2]

[1] *See* paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "accountant."

[2] AS 1210, *Using the Work of an Auditor-Engaged Specialist*, establishes requirements that apply to the use of specialists engaged by the auditor's firm. Appendix A of AS 1105, *Audit Evidence*, sets forth the auditor's responsibilities for using the work of a specialist employed or engaged by the company.

.A4 Lead auditor –

a. The registered public accounting firm[3] issuing the auditor's report on the company's financial statements and, if applicable, internal control over financial reporting; and

b. The engagement partner and other engagement team members who both:

(1) Are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report (or individuals who work under that firm's direction and control and function as the firm's employees); and

(2) Assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.[4]

Note: The registered public accounting firm issuing the auditor's report is also referred to in this standard as "the engagement partner's firm."

Note: Individuals such as secondees[5] who work under the direction and control of the registered public accounting firm issuing the auditor's report would function as the firm's employees.

[3] *See* paragraph (r)(i) in PCAOB Rule 1001, which defines the term "registered public accounting firm."

[4] *See* paragraph .05a of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, which describes making appropriate assignments of significant engagement responsibilities. *See also* paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*, according to which "[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability ...."

[5] For this purpose, the term "secondee" refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices of the registered public accounting firm issuing the auditor's report, for at least three consecutive months, performing audit procedures with respect to entities in that other country (and not performing more than de minimis audit procedures over the term of the secondment in relation to entities in the country of his or her employer).

.A5 Other auditor –

a. A member of the engagement team who is not:

(1) A partner, principal, shareholder, or employee of the lead auditor or

(2) An individual who works under the direction and control of the registered public accounting firm issuing the auditor's report and functions as that firm's employee; and

b. A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.

.A6 Referred-to auditor – A public accounting firm, other than the lead auditor, that performs an audit of the financial statements and, if applicable, internal control over financial reporting, of one or more of the company's business units[6] and issues an auditor's report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead auditor's report on the company's financial statements and, if applicable, internal control over financial reporting.[7]

[6] The term "business units" includes subsidiaries, divisions, branches, components, or investments.

[7] *See* AS 1206, which sets forth the lead auditor's responsibilities regarding dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting, with a referred-to auditor.

AS 1201, *Supervision of the Audit Engagement*

Introduction

.01 This standard establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team[1] members.

[1] The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Objective

.02 The objective of the auditor is to supervise the audit engagement, including supervising the work of engagement team members so that the work is performed as directed and supports the conclusions reached.

Responsibility of the Engagement Partner for Supervision

.03 The **engagement partner**[1A] is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members ~~and~~ (including engagement team members outside the engagement partner's firm). The engagement partner also is responsible for compliance with

PCAOB standards, including standards regarding: using the work of specialists,[2] ~~other auditors,[3]~~ internal auditors,[4] and others who are involved in testing controls~~.~~;[5] and dividing responsibility with another accounting firm.[5A] Paragraphs .05–.06 of this standard describe the nature and extent of supervisory activities necessary for proper supervision of engagement team members.[6] Paragraphs .07-.15 of this standard further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in conjunction with the required supervisory activities set forth in this standard.[6A]

~~1~~ ~~Terms~~[1A] The term "engagement partner" is defined in Appendix A, *Definitions*, and is ~~are~~ set in **boldface type** the first time it~~they~~ appears.

[2] Appendix C describes further procedures to be performed with respect to the supervision of the work of auditor-employed specialists in conjunction with the required supervisory activities set forth below. AS 1210, *Using the Work of an Auditor-Engaged Specialist*; and Appendix A of AS 1105, *Audit Evidence*, establish requirements for an auditor using the work of an auditor-engaged specialist and a company's specialist, respectively, in performing an audit of financial statements.

~~3~~ ~~AS 1205, *Part of the Audit Performed by Other Independent Auditors.*~~

[3] [Footnote deleted.]

[4] AS 2605, *Consideration of the Internal Audit Function*.

[5] Paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

[5A] *See* AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm.*

[6] *See also* paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*.

[6A] The terms "lead auditor" and "other auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101.

.04 The engagement partner may seek assistance from appropriate engagement team members (which may include engagement team members outside the engagement partner's firm) in fulfilling his or her responsibilities pursuant to this standard. Engagement team members who assist the engagement partner with supervision of the work of other engagement team members also should comply with the requirements in this standard with respect to the supervisory responsibilities assigned to them.

Supervision of Engagement Team Members

.05 The engagement partner and, as applicable, other engagement team members performing supervisory activities, should:

a. Inform engagement team members of their responsibilities,[7] including:

(1) The objectives of the procedures that they are to perform;

(2) The nature, timing, and extent of procedures they are to perform; and

(3) Matters that could affect the procedures to be performed or the evaluation of the results of those procedures, including relevant aspects of the company, its environment, and its internal control over financial reporting,[8] and possible accounting and auditing issues;

b. Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards;[9]

Note: In applying due professional care in accordance with AS 1015, each engagement team member has a responsibility to bring to the attention of appropriate persons, disagreements or concerns the engagement team member might have with respect to accounting and auditing issues that he or she believes are of significance to the financial statements or the auditor's report regardless of how those disagreements or concerns may have arisen.

c. Review the work of engagement team members to evaluate whether:

(1) The work was performed and documented;

(2) The objectives of the procedures were achieved; and

(3) The results of the work support the conclusions reached.[10]

[7] AS 1015.06 and paragraph .05 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establish requirements regarding the appropriate assignment of engagement team members.

[8] AS 2110, *Identifying and Assessing Risks of Material Misstatement*, describes the auditor's responsibilities for obtaining an understanding of the company, its environment, and its internal control over financial reporting.

[9] *See, e.g.*, ~~paragraph .15 of~~ AS 2101~~, *Audit Planning*~~.15, AS 2110.74, and paragraphs .20–.23 and .35–.36 of AS 2810, *Evaluating Audit Results*.

[10] AS 2810 describes the auditor's responsibilities for evaluating the results of the audit, and AS 1215, *Audit Documentation*, establishes requirements regarding audit documentation.

.06 To determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions, the engagement partner and other engagement team members performing supervisory activities should take into account:

a. The nature of the company, including its size and complexity;[11]

b. The nature of the assigned work for each engagement team member, including:

(1) The procedures to be performed, and

(2) The controls or accounts and disclosures to be tested;

c. The risks of material misstatement; and

d. The knowledge, skill, and ability of each engagement team member.[12]

Note: In accordance with the requirements of AS 2301.05 the extent of supervision of engagement team members should be commensurate with the risks of material misstatement.[13]

[11] AS 2110.10.

[12] *See also* AS 2301.05a and AS 1015.06.

[13] AS 2301.05b indicates that the extent of supervision of engagement team members is part of the auditor's overall responses to the risks of material misstatement.

Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of Work Performed by Other Auditors[14]

[14] AS 1206 sets forth the lead auditor's responsibilities when dividing responsibility for the audit of the company's financial statements and, if applicable, internal control over financial reporting with a referred-to auditor.

.07 For engagements that involve other auditors, paragraphs .08-.15 further describe procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors, in conjunction with the required supervisory activities set forth in this standard. The requirements in paragraphs .08-.15 supplement the requirements in paragraph .05 of this standard. In performing the procedures described in paragraphs .08-.15, the lead auditor

should determine the extent of supervision of the other auditors' work in accordance with paragraph .06 of this standard.

.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) The identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit;[15]

(2) Tolerable misstatement;[16] and

(3) The amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.[17]

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.

[15] *See* requirements in AS 2110.49-.53 with respect to discussions among key engagement team members (including those in differing locations) regarding risks of material misstatement including the potential for material misstatement due to fraud.

[16] *See* paragraphs .08-.10 of AS 2105, *Consideration of Materiality in Planning and Performing an Audit*.

[17] *See* AS 2810.10-.11.

.09 The lead auditor should obtain and review the other auditor's written description of the audit procedures to be performed pursuant to the scope of work described in paragraph .08a. The lead auditor should inform the other auditor of the necessary level of detail of the description (e.g., planned audit procedures for certain accounts and disclosures), which detail should be determined based on the necessary extent of supervision of the other auditor's work by the lead auditor.

Note: As the necessary extent of supervision increases, the lead auditor (rather than the other auditor) may need to determine the nature, timing, and extent of procedures to be performed by the other auditor.

.10 The lead auditor should determine whether any changes to the other auditor's planned audit procedures (*see* paragraph .09) are necessary, and if so, should discuss the changes with, and communicate them in writing to, the other auditor.

.11 The lead auditor should obtain and review a written affirmation as to whether the other auditor has performed the work in accordance with the instructions described in paragraphs .08-.10, including the use of applicable PCAOB standards; and if it has not, a description of the nature of, and explanation of the reasons for, the instances where the work was not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed.

.12 The lead auditor should direct the other auditor to provide specified documentation concerning work requested to be performed, based on the necessary extent of its supervision of the other auditor's work. This documentation should include, at a minimum, the documentation described in AS 1215.19. The lead auditor should review the documentation provided by the other auditor.

.13 The lead auditor should determine, based on a review of the documentation provided by the other auditor (pursuant to paragraphs .09, .11, and .12), discussions with the other auditor, and other information obtained by the lead auditor during the audit:

a. Whether the other auditor performed the work in accordance with the lead auditor's instructions received pursuant to paragraphs .08 and .10, including the use of applicable PCAOB standards; and

b. Whether additional audit evidence should be obtained by the lead auditor or other auditors, for example, to address a previously unidentified risk of material misstatement or when sufficient appropriate audit evidence has not been obtained with respect to one or more locations or business units in response to the associated risks.[18]

[18] *See* AS 2810.35-.36.

Multi-tiered Audits

.14 In multi-tiered audits,[19] the lead auditor may seek assistance from a first other auditor in performing the procedures in paragraphs .08-.13 with respect to one or more second other auditors, 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. If the first other auditor assists the lead auditor by performing procedures in paragraph .08, the lead auditor should obtain, review, and retain documentation that identifies the scope of work to be performed by the second other auditor.

Note: In multi-tiered audits, for purposes of complying with AS 1215.19 with respect to the work performed by a second other auditor, the lead auditor may request that the first other auditor both (i) obtain, review, and retain the audit documentation described in AS 1215.19 related to the second other auditor's work and (ii) incorporate the

information in that documentation in the first other auditor's documentation that it provides to the lead auditor pursuant to AS 1215.19.

[19] Multi-tiered audits are those in which the engagement team is organized in a multi-tiered structure, e.g., whereby an other auditor assists the lead auditor in supervising a second other auditor or multiple second other auditors.

.15 If the first other auditor is assisting the lead auditor in supervising the second other auditor, the lead auditor should take into account the first other auditor's review of the second other auditor's work in determining the extent of its own review, if any, of the second other auditor's work.[20]

[20] *See* paragraph .14, regarding the lead auditor's evaluation of the first other auditor's supervision, including review.

Appendix A – Definitions

.A1 For purposes of this standard~~, the~~:

a. The term ~~listed below is defined as follows:~~

~~.A2~~ "~~Engagement~~engagement partner" means ~~– The~~ the member of the engagement team with primary responsibility for the audit.

b. The terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor" have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Appendix B – [Reserved]

Appendix C – Supervision of the Work of Auditor-Employed Specialists

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AS 1015, *Due Professional Care in the Performance of Work*

.01 Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report.

Note: For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care.[1]

[1] The lead auditor's responsibilities for planning the audit and supervising the other auditors' work are set forth in AS 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*. The terms "lead auditor" and "other auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101.

***

.06 Engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining. The engagement partner should know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client. The engagement partner is responsible for the assignment of tasks to, and supervision of, the members of the engagement team.[4]

[4] *See* AS 1201~~, *Supervision of the Audit Engagement*~~.

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AS 1105, *Audit Evidence*

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Appendix B—Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results

.B1 For valuations based on an investee's financial results, the auditor should obtain sufficient appropriate evidence in support of the investee's financial results. The auditor should read available financial statements of the investee and the accompanying audit report, if any. Financial statements of the investee that have been audited by an auditor ("investee's auditor") whose report is satisfactory, for this purpose,[1] to the investor's auditor may constitute sufficient appropriate evidence.

[1] In determining whether the report of ~~another~~the investee's auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation ~~and~~, standing, and independence of the ~~other~~investee's auditor (under the applicable standards), visiting the ~~other~~investee's auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the ~~other~~investee's auditor.

.B2 If in the auditor's judgment additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and

budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results.

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AS 1215, *Audit Documentation*

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Retention of and Subsequent Changes to Audit Documentation

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.18 The office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs .04-.13 of this standard is prepared and retained. Audit documentation supporting the work performed by other ~~auditors (including auditors associated with other~~ offices of the firm~~, affiliated firms, or non-affiliated firms),~~ and other auditors[3A] must be retained by or be accessible to the office issuing the auditor's report.[4] An other auditor must comply with the requirements of paragraphs .04-.17 of this standard, including with respect to the audit documentation that the other auditor provides or makes accessible to the office issuing the auditor's report.

[3A] The term "other auditors," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

[4] Section 106(b) of the Sarbanes-Oxley Act of 2002 imposes certain requirements concerning production of the work papers of a foreign public accounting firm ~~on whose opinion or services the auditor relies.~~and other related documents in certain circumstances. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

.19 In addition, the office issuing the auditor's report must obtain, and review and retain, prior to the report release date, the following documentation related to the work performed by ~~other auditors (including auditors associated with~~ other offices of the firm~~, affiliated firms,~~ and ~~non-affiliated firms):~~other auditors:[4A]

a. An engagement completion document consistent with paragraphs .12 and .13.

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

b. A list of significant risks, the auditor's responses, and the results of the auditor's related procedures.

c. Sufficient information relating to any significant findings or issues that are inconsistent with or contradict the final conclusions, as described in paragraph .08.

d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.

e. Sufficient information to enable the office issuing the auditor's report to agree or to reconcile the financial statement amounts audited by ~~the~~ other ~~auditor~~offices of the firm and other auditors to the information underlying the consolidated financial statements.

f. A schedule of accumulated misstatements, including a description of the nature and cause of each accumulated misstatement, and an evaluation of uncorrected misstatements, including the quantitative and qualitative factors the auditor considered to be relevant to the evaluation.

g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.

h. Letters of representations from management.

i. All matters to be communicated to the audit committee.

~~If the auditor decides to make reference in his or her report to the audit of the other auditor, however, the auditor issuing the report need not perform the procedures in this paragraph and, instead, should refer to AS 1205, *Part of the Audit Performed by Other Independent Auditors*.~~

[4A] For multi-tiered audits, *see* note to paragraph .14 of AS 1201, *Supervision of the Audit Engagement*.

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AS 1220, *Engagement Quality Review*

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.10 In an audit, the engagement quality reviewer should:

a. Evaluate the significant judgments that relate to engagement planning, including –

- The consideration of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process,

- The consideration of the company's business, recent significant activities, and related financial reporting issues and risks, ~~and~~

- The judgments made about materiality and the effect of those judgments on the engagement strategy, and

- In an audit involving other auditors or referred-to auditors, the engagement partner's determination that the participation of his or her firm is sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements and, if applicable, internal control over financial reporting.[3A]

[3A] The terms "lead auditor," "other auditor," and "referred-to auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101, *Audit Planning*. AS 2101.06A-C describe requirements for the engagement partner's determination that the participation of his or her firm is sufficient for it to serve as the lead auditor.

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AS 1301, *Communications with Audit Committees*

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Obtaining Information and Communicating the Audit Strategy

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Overall Audit Strategy, Timing of the Audit, and Significant Risks

***

.10 As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

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d. The names, locations, and planned responsibilities[12] of other ~~independent public accounting firms or other persons, who are not employed by the auditor,~~auditors that perform audit procedures in the current period audit ~~;~~and of referred-to auditors;[12A] and

~~Note: The term "other independent public accounting firms" in the context of this communication includes firms that perform audit procedures in the current period audit regardless of whether they otherwise have any relationship with the auditor.~~

e. ~~The~~ In an audit that involves other auditors or referred-to auditors, the basis for the ~~auditor's~~engagement partner's determination that the ~~auditor can~~participation of his or her firm is sufficient to serve as ~~principal~~the lead auditor, if significant parts of the audit are to be performed by other auditors or referred-to auditors.[13]

[12] *See* AS 2101.08-.14, which discuss the auditor's responsibilities for determining the audit strategy, audit plan, and extent to which audit procedures should be performed at selected locations or business units ~~involving~~in multi-location engagements.

[12A] The terms "other auditor" and "referred-to auditor," as used in this standard, have the same meanings as defined in Appendix A of AS 2101.

~~[13] *See* AS 1205, *Part of the Audit Performed by Other Independent Auditors,* which discusses the professional judgments the auditor makes in deciding whether the auditor may serve as principal auditor.~~

[13] The term "lead auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101. *See* AS 2101.06A-C, which establish requirements regarding serving as the lead auditor.

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